Fordham Competition Law Institute

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CLE Course Materials & Speaker Biographies

Fordham Law School
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Mary Coleman  
**Executive Vice President, Compass Lexecon**

Mary T. Coleman is an Executive Vice President with Compass Lexecon. She previously served as the Deputy Director for Antitrust in the Bureau of Economics of the Federal Trade Commission from 2001 to 2004. Dr. Coleman holds a Ph.D. in Economics from Stanford University and a B.A. in Economics from Stonehill College. Dr. Coleman’s expertise focuses on competitive analysis of mergers and acquisitions as well as antitrust and intellectual property litigation and regulatory proceedings. Her case work has also included price fixing, predation, vertical restraints, foreclosure, tying, and exclusive dealing. Dr. Coleman has testified before regulatory agencies in the U.S., Europe and Australia. Her experience covers a wide variety of industries including petroleum and natural gas, chemicals, consumer products, retailing, shopping malls, cable and broadband television, pharmaceuticals, medical devices, healthcare providers (including hospitals and physicians), telecommunications, and computer hardware and software.

Deborah L. Feinstein  
**Partner, Arnold & Porter Kaye Scholer LLP**

Debbie Feinstein heads the Global Antitrust Group at Arnold & Porter Kaye Scholer. Previously, she was Director of the Bureau of Competition at the U.S. Federal Trade Commission. She has been consistently lauded as a leading practitioner by Chambers USA and other ranking publications. The *National Law Journal* named her one of the most influential women lawyers in America and *Global Competition Review* recognized her as global “Lawyer of the Year” and named her to its international list of the “Top 100 Women in Antitrust.” She has also been ranked by *Super Lawyers* as being among the top 50 women lawyers in Washington, D.C. She is a graduate of Harvard Law School and the University of California at Berkeley.

Eliana Garcés-Tolon  
**Principal, The Brattle Group**

Eliana Garcés-Tolón is a Principal in the Competition Practice at The Brattle Group. She was previously the Deputy Chief Economist in the Directorate General of Competition in the European Commission. In that capacity she provided analysis for regulatory initiatives in various areas pertaining to the promotion of European economic competitiveness. She is a former Member of the Cabinet of Vice President Joaquin Almunia, European Commissioner for Competition Policy, and was previously a member of the Cabinet of European Commissioner for Consumer Affairs Meglena Kuneva. She has worked as a member of the Chief Economist Team in the Directorate General of Competition in the European Commission and in private economic consulting in the United States. She holds a PhD in Economics from the University of California at Los Angeles. During 2016-2017, she was at George Mason University in the Washington, D.C., area teaching Regulation and Digital Innovation in the EU.

David I. Gelfand  
**Partner, Cleary Gottlieb Steen & Hamilton LLP**

Dave Gelfand is a partner in the Washington office of Cleary Gottlieb. His practice focuses on a broad range of antitrust matters, including merger reviews, litigation, government investigations and counseling regarding various business practices. He first joined Cleary in 1991. From 2001 to 2004, he was resident in the Brussels office, where he handled matters before the European Commission and national competition authorities. From 2013 to 2016, he served as the Deputy Assistant Attorney General for Litigation of the Antitrust Division of the U.S. Department of Justice, where he oversaw the Division’s litigation efforts. He returned to Cleary in July 2016.

D. Bruce Hoffman  
**Acting Director, Bureau of Competition, U.S. Federal Trade Commission**

Bruce Hoffman is Acting Director of the Bureau of Competition at the U.S. Federal Trade Commission. He came to the FTC from Shearman & Sterling, where he was global co-head of the firm’s antitrust practice. Previously, he served as chair of Hunton & Williams’ antitrust practice, and prior to that, as Deputy Director and Associate Director of the FTC’s Bureau of Competition. He has a law degree from the University of Florida, and a bachelor’s degree from Penn State.

Bryan Keating  
**Executive Vice President, Compass Lexecon**

Bryan Keating specializes in the economics of industrial organization and antitrust economics. He has substantial experience applying complex econometric models in merger review and litigation matters. He has previously worked on antitrust matters involving airlines and other methods of transport, healthcare, cable television, consumer products, industrial commodities, payment cards, software, and telecommunications. He has also conducted extensive research on prescription drug plans. Dr. Keating earned a Ph.D. in economics from Stanford University and a B.A. in economics and Government from Dartmouth College. Previously, he held positions at Acumen, LLC and NERA Economic Consulting.

James Keyte  
**FCLI Director and Adjunct Professor of Law, Fordham Law School**

James A. Keyte is director of the Fordham Competition Law Institute and, as an adjunct professor at Fordham Law, teaches the Comparative Antitrust Law and Enforcement course. As a partner at Skadden, he handles a wide variety of antitrust litigation, transactional and advisory matters across numerous industries. In the litigation area, he has handled a number of cases involving alleged price-fixing, monopolization, litigated mergers, other restraints of trade and class actions. In addition, he has handled or played significant roles in a number of sports-related litigations and trials. In the transactional arena, he has represented numerous clients before the Department of Justice and the Federal Trade Commission, as well as parties involved in litigated mergers. Mr. Keyte also counsels on general antitrust matters. He has advised numerous clients on compliance with basic antitrust statutes, including issues relating to competitor collaborations, unilateral conduct and distribution. He also counsels a number of clients on intellectual property matters with antitrust implications. He is the past chair of the Trade, Sports and Professional Associations Committee. He is a former senior editor of the *Antitrust Law Journal* and a current editor of *Antitrust Magazine*. He also authors a monthly antitrust column for the *New York Law Journal*. He holds a J.D. from Loyola Law School and B.A. from Harvard University.

Daniel McFadden  
**Nobel Laureate**

**Presidential Professor of Health Economics, University of Southern California, and Principal, The Brattle Group**

Professor McFadden is the Presidential Professor of Health Economics at the University of Southern California, where he has joint appointments at the USC Sol Price School of Public Policy and the Department of Economics at USC.
Dornsife College. Previously, he was the E. Morris Cox Professor Emeritus of Economics at the University of California at Berkeley, the James R. Killian Professor of Economics at MIT, the Irving Fisher Research Professor at Yale University, and the Fairchild Distinguished Scholar at the California Institute of Technology. Professor McFadden was awarded the 2000 Nobel Prize in Economics for his work developing methods and theory used in analyzing how consumers and households make choices from sets of discrete alternatives. His work is now a standard tool in analyzing consumer behavior in a wide variety of markets and it is used to determine how people choose and purchase one brand of product over others. His work is also commonly used in making public policy and regulatory decisions. Professor McFadden has received numerous other awards, including the John Bates Clark Medal given every two years to the American economist under the age of forty who has made the most outstanding contribution to the field of economic science. He is also the recipient of the Frisch Medal from the Econometric Society and the Nenmers Prize in Economics from Northwestern University. Professor McFadden’s teaching areas included economic theory, econometrics, and statistics at the graduate level. He has published seven books and more than 100 professional papers.

Joel M. Mitnick
Partner, Sidley Austin LLP
Joel Mitnick is a global co-leader of Sidley Austin’s Antitrust and Competition practice and former head of the firm’s electronic discovery program. He is also a litigation partner in the firm’s New York office. His practice focuses on antitrust matters on behalf of a wide array of financial market, life science, publishing, service industry and industrial clients. He has been selected as a leading lawyer in antitrust matters by Chambers USA: America’s Leading Lawyers for Business, Benchmark Litigation, The Best Lawyers in America, The Legal 500 US, Super Lawyers and Who’s Who Legal: Competition. He is a frequent lecturer and author on antitrust topics. He appears regularly before federal and state antitrust enforcement agencies, has lectured at enforcement programs sponsored by the Federal Trade Commission and the National Association of Attorneys General, and has served as a faculty member at an intensive ABA Antitrust Trial Skills three-day workshop. Currently, he serves as Vice Chair of the ABA Antitrust Section’s Joint Conduct Committee.

Daniel P. O’Brien
Partner, Bates White
Daniel P. O’Brien is a partner at Bates White, former Senior Economic Policy Adviser and Deputy Director of the Federal Trade Commission’s Bureau of Economics, and former Chief of the Economic Regulatory Section at the Department of Justice’s Antitrust Division. As Deputy Director for Antitrust at the FTC, he was responsible for overseeing the economic analysis in all of the agency’s antitrust investigations. He has led investigations across a wide range of industries, and his widely-published research has affected how antitrust agencies approach competition issues. His current research includes work on conditional pricing practices (share-based discounts, exclusive dealing, and tying and bundling), cross ownership by institutional investors, and the economics of privacy and disclosure, all topics motivated by his work at the antitrust agencies. Prior to joining Bates White, Dr. O’Brien taught economics at Northwestern, Michigan, Georgetown Law School, the University of Verona, Italy, and most recently the Kelley School of Business, Indiana University, where he was a Visiting Professor of Business Economics.

Joshua H. Soven
Partner, Gibson, Dunn & Crutcher LLP
Joshua H. Soven is a partner in the Washington, D.C., office of Gibson, Dunn & Crutcher LLP. His practice focuses on government antitrust investigations, antitrust litigation, and counseling on competition issues. He represents clients before the Antitrust Division of the U.S. Department of Justice and the Federal Trade Commission, and in the federal courts. He has served as lead global antitrust counsel for strategic transactions for a range of prominent companies, and he recently represented LinkedIn in its $26 billion sale to Microsoft and St. Jude Medical in its $25 billion sale to Abbott Laboratories. Previously, he served in high-level positions at both U.S. antitrust agencies—as Chief of the Litigation I Section of the Antitrust Division of the U.S. Department of Justice and as an Attorney Advisor to Federal Trade Commission Chairwoman Deborah Platt Majoras. He is an editor of the ABA’s Antitrust Law Journal and a former editor of the ABA’s Antitrust Magazine. He earned a J.D. from the University of Virginia and a B.A. from the University of Pennsylvania.

Kenneth S. Reinker
Partner, Cleary Gottlieb Steen & Hamilton LLP
Kenneth S. Reinker is a partner at Cleary Gottlieb. His practice focuses on all aspects of antitrust law, including litigation, government investigations and merger review. Ken’s practice spans all industries, including extensive experience in pharmaceuticals, medical devices, and health care; high-technology industries; mass media; and financial institutions. He has particular expertise in the application of economics to complex legal matters and in working with economic experts. After law school and prior to joining the firm, he worked as an antitrust economist on cutting-edge litigation as executive director of Legal Economics LLC. In addition to appearing before U.S. courts and regulators, he has had in-depth involvement with China’s Ministry of Commerce (MOFCOM) and other global regulators. He joined the firm in 2010 and became a partner in 2017. He earned a J.D. from Harvard Law School and B.S. in economics from Duke University.

Loren Smith
Executive Vice President, Compass Lexecon
Loren Smith specializes in the application of economic and econometric tools to antitrust and competition matters. His experience includes the analysis of horizontal and vertical mergers, vertical restraints, pay-for-delay, and exclusionary conduct. Since joining Compass Lexecon in 2013, he has assisted clients with government investigations, federal merger challenges, and private litigations in industries that include retail, healthcare, lodging, medical devices, and various consumer products and intermediate goods. Prior to joining Compass Lexecon, Smith worked at the U.S. Federal Trade Commission as a staff economist. While at the FTC, he oversaw several high profile merger and conduct investigations, supported litigations, and evaluated settlements. He also co-authored a report to Congress and provided technical assistance and training to competition agencies in South Africa, Brazil, and Hungary. Smith has taught microeconomics and econometrics at the University of Virginia and Johns Hopkins University, and his research is published in academic journals that include the Journal of Applied Econometrics, Economic Inquiry, and Journal of Economics and Management Strategy. Smith received a Ph.D. in economics from the University of Virginia in 2006.

Joshua H. Soven
Partner, Gibson, Dunn & Crutcher LLP
Joshua H. Soven is a partner in the Washington, D.C., office of Gibson, Dunn & Crutcher LLP. His practice focuses on government antitrust investigations, antitrust litigation, and counseling on competition issues. He represents clients before the Antitrust Division of the U.S. Department of Justice and the Federal Trade Commission, and in the federal courts. He has served as lead global antitrust counsel for strategic transactions for a range of prominent companies, and he recently represented LinkedIn in its $26 billion sale to Microsoft and St. Jude Medical in its $25 billion sale to Abbott Laboratories. Previously, he served in high-level positions at both U.S. antitrust agencies—as Chief of the Litigation I Section of the Antitrust Division of the U.S. Department of Justice and as an Attorney Advisor to Federal Trade Commission Chairwoman Deborah Platt Majoras. He is an editor of the ABA’s Antitrust Law Journal and a former editor of the ABA’s Antitrust Magazine. He earned a J.D. from the University of Virginia and a B.A. from the University of Pennsylvania.
Speakers (continued)

Michael G. Vita  
**Acting Director, Bureau of Economics, U.S. Federal Trade Commission**

Michael Vita is Acting Director of the Research & Management in the U.S. Federal Trade Commission’s Bureau of Economics. Currently he also is serving as the Bureau’s Acting Director. His previous positions at the FTC include Assistant Director for Antitrust (2000-15); Deputy Assistant Director for Economic Policy Analysis (1986-2000); and economic adviser to Commissioner Roscoe Starek (1993-99). He received his Ph.D in economics from the University of Wisconsin. Over the course of his FTC career, he has published articles on a variety of topics, including: *ex post* evaluations of consummated hospital mergers; “must-carry” regulations for cable television systems; “divorcement” regulations in petroleum refining and retailing; “any willing provider” regulations for health insurers; and the economic analysis of vertical restraints. His current project is a meta-analysis of consummated horizontal mergers.

David A. Weiskopf  
**Executive Vice President, Compass Lexecon**

David Weiskopf is an Executive Vice President at Compass Lexecon and a member of the faculty at Johns Hopkins University. Dr. Weiskopf specializes in industrial organization, microeconomic analysis, consumer behavior, applied econometrics and statistics, and labor economics. He has testified as an expert witness in private litigation regarding antitrust issues, economic damages, and consumer behavior. He has also published articles in *Research in Law & Economics, Antitrust* magazine, the *International Journal of the Economics of Business* on topics including merger simulation, demand estimation, and market definition. Dr. Weiskopf has presented papers at academic conferences and has co-authored economic studies that were presented at antitrust enforcement agencies throughout the world. He has led a number of engagements evaluating competitive effects in the context of merger investigations. Dr. Weiskopf has also consulted on matters involving allegations of monopolization, market foreclosure, collusion, and exclusive dealing, as well as on employment and consumer protection matters.
I. INTRODUCTION

These cases challenge restraints in the market for baseball and hockey broadcasting. The essence of plaintiffs' argument is that the leagues — Major
League Baseball (“MLB”) and the National Hockey League (“NHL”) — have conspired with regional sports networks (“RSNs”), who produce broadcasts for individual teams, as well as multichannel video programming distributors (“MVPDs”), who sell broadcasts to consumers, to maintain a system of “territorial exclusivity” that limits viewing options and inflates prices.

The details of that system are described in detail in a companion Opinion, also issued today, addressing the issue of class certification.¹ This Opinion addresses the admissibility of the damages model proffered by plaintiffs’ expert, Dr. Roger Noll (the “Daubert Opinion”). For the purpose of that task, the important background is that RSNs are currently prohibited — by league-wide agreement — from broadcasting their content to baseball and hockey fans who live outside an RSN’s home team territory. Consequently, if a fan of an out-of-market team wishes to watch that team’s games, she is forced to buy an out-of-market package (“OMP”) that contains broadcasts of all games in the league.

Plaintiffs believe that this arrangement reflects an unlawful restraint of trade, and that if the league-wide agreement preventing out-of-market RSN distribution were eliminated, fans of out-of-market teams would be able to subscribe to “a la carte channels,” which would carry broadcasts only of the

¹ See Certification Opinion.
subscriber’s preferred team — at a lower price than the OMP. For example, a Yankees fan living in Iowa now has to purchase an OMP if she wants to watch a season’s worth of Yankees’ games — whereas in the but-for world envisioned by plaintiffs (“BFW”), the same fan would have the option of purchasing an OMP or getting an a la carte subscription from the Yankees’ RSN.

According to plaintiffs, the absence of a la carte options in the actual world has insulated the OMPs from competition, allowing the leagues, the RSNs, and the MVPDs to command super-competitive subscription fees — leading to overcharge. The purpose of Dr. Noll’s model is to model the extent of that overcharge, by comparing the price of OMPs in the actual world to the projected price of OMPs in the BFW, once the territorial restraints are lifted, and the supply chain is reconfigured accordingly.

Defendants have moved pursuant to Rule 702 of the Federal Rules of Evidence (“FRE”) to exclude Dr. Noll’s expert opinions, alleging that his model suffers from numerous methodological flaws that render his opinions unreliable as a matter of law. For the foregoing reasons, defendants’ motion is GRANTED in part and DENIED in part.

II. LEGAL STANDARD

The proponent of expert evidence bears the initial burden of
establishing admissibility by a “preponderance of the evidence.” For expert testimony to be admissible under FRE 702, the witness must be “qualified as an expert by knowledge, skill, experience, training, or education[.]” The court must then “compare the area in which the witness has superior knowledge, education, experience or skill with the subject matter of the proffered testimony.”

To be admissible, the proposed expert testimony must be based “on a reliable foundation.” In assessing reliability, the trial judge should consider whether:

(1) the testimony is based upon sufficient facts or data, (2) the testimony is the product of reliable principles and methods, and (3) the witness has reliably applied the principles and methods to the facts of the case.

Although the Supreme Court has instructed district courts to focus “on [the] principles and methodology” employed by the expert and “not on the conclusions that they generate,” “nothing in either Daubert v. Merrell Dow Pharmaceuticals

2 United States v. Williams, 506 F.3d 151, 160 (2d Cir. 2007).
3 Fed. R. Evid. 702.
4 United States v. Tin Yat Chin, 371 F.3d 31, 40 (2d Cir. 2004).
6 Fed. R. Evid. 702 (emphasis added).
7 Daubert, 509 U.S. at 595.
or the Federal Rules of Evidence requires a district court to admit opinion evidence that is connected to existing data only by the *ipse dixit* of the expert.”

Indeed, “[a] court may conclude that there is simply too great an analytical gap between the data and the opinion proffered.” For this reason, “even where an expert’s methodology is reliable, if the analysis is not based upon relevant and reliable data, the expert’s opinion will be inadmissible.”

District courts are charged with acting as “‘gatekeeper[s] to exclude invalid and unreliable expert testimony,’” and are given “broad discretion” to make such determinations. However, trial courts must consider only the admissibility of expert evidence rather than its weight or credibility. “As the Supreme Court has explained, ‘[v]igorous cross-examination, presentation of contrary evidence, and careful instruction on the burden of proof are the traditional

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8 *Kumho Tire*, 526 U.S. at 157 (quotation marks and citations omitted).


and appropriate means of attacking shaky but admissible evidence.’”

Finally, it is often the case that some, but not all, of an expert’s opinions will meet the criteria of FRE 702. Indeed, it is routine for a party to retain a single expert to opine on a variety of issues that, while related, can be analyzed independently under the Daubert standard. In such cases, the court, as gatekeeper, has discretion to decide which opinions are reliable and which are not, from which it follows that a court may exclude portions of an expert report while admitting other portions.  

III. PLAINTIFFS’ EXPERT

Dr. Noll, a nationally-recognized sports economist, has submitted an expert report explaining why the prices of baseball and hockey broadcasts would decrease in the BFW. In support of this expert report, Dr. Noll designed an economic structural model to simulate how consumers and RSNs would behave if

13. Amorgianos, 303 F.3d 256 at 267 (quoting Daubert, 509 U.S. at 596).


15. Defendants do not challenge Dr. Noll’s academic or professional qualifications.
territorial restrictions were lifted. Dr. Noll claims that his model is based on a similar study conducted by Drs. Gregory Crawford and Ali Yurukoglu (the “C&Y Model”), which measured how the hypothetical unbundling of cable television packages would impact consumer welfare over the short-run. How closely Dr. Noll’s model follows the approach of the C&Y Model is the subject of major disagreement among the parties, but at least one difference between the two models is undisputed: in Dr. Noll’s model, unbundling reduces prices for the consumer; in the C&Y Model, it does not.

In broad strokes, both models are built on the interplay between consumer demand and preferences for content (the “Demand Side”) and the supply chains that distribute that content (the “Supply Side”). In attempting to predict future outcomes in a hypothetical universe, the models depend both on existing data in the actual world and assumptions about how consumers and distributors

16 See 2/23/15 Corrected Reply Declaration of Roger G. Noll (“Dr. Noll Reply Decl.”); 9/19/14 Supplemental Declaration of Roger G. Noll (“Dr. Noll Supp. Decl.”); 2/18/14 Declaration of Roger G. Noll (“Dr. Noll Decl.”). For reasons explained below, Dr. Noll twice tweaked the model he offered in his first declaration in response to criticism from defendants’ experts. Yet all of these models are considered “interim” models — the Court did not require a final model at this early class certification stage of the litigation.

will behave in the BFW.

    Defendants attack Dr. Noll’s methodological approach to constructing both the Demand Side and the Supply Side, arguing that design flaws in each constitute independent bases for rendering his model unreliable as a matter of law under FRE 702 and Daubert. In support of their motion, defendants retained several experts to vet both sides of Dr. Noll’s model, all of whom — along with Dr. Noll — were examined and cross-examined over the course of a three-day Daubert hearing. On the Demand Side, defendants’ primary concern is that Dr. Noll did not rely on sufficient data about fan preferences in estimating what their demand would be for products in the BFW. On the Supply Side, defendants’ grievance centers on Dr. Noll’s conceptual assumptions; they argue that Dr. Noll has not justified all the building blocks of his structural model. In this Opinion, I separately discuss the Demand Side and the Supply Side of Dr. Noll’s model.

18 See generally Memorandum of Law in Support of Defendants’ Joint Motion to Exclude Opinions and Testimony of Plaintiffs’ Expert, Dr. Roger Noll (“Def. Mem.”); Reply Memorandum of Law in Support of Defendants’ Joint Motion to Exclude Opinions and Testimony of Plaintiffs’ Expert, Dr. Roger Noll (“Reply Mem.”).

19 See 3/17/15 Transcript of Proceedings, Dkt. 339 (“Day 1 Tr.”); 3/18/15 Transcript of Proceedings, Dkt. 341 (“Day 2 Tr.”); 3/19/15 Transcript of Proceedings, Dkt. 343 (“Day 3 Tr.”). The hearing concluded with summations by counsel for plaintiffs and defendants addressing both the reliability, or lack thereof, of Dr. Noll’s model and how the Court’s decision on the Daubert challenge bears on class certification. See Day 3 Tr.
IV. DEMAND SIDE

A. Summary of Dr. Noll’s Opinions

The price of the league bundles and a la carte channels in the BFW is driven by consumer demand. To predict those prices, Dr. Noll’s model follows a two-step approach. First, he captures a mathematical curve of consumer demand in the actual world, with territorial restrictions, based on observed consumer and producer behavior and various corresponding assumptions, by designing mathematical equations designed to replicate the observed behavior. Second, he simulates markets in the BFW using consumer demand as determined by the estimates in the first step. The general idea, according to Dr. Noll, is to “us[e] a demand estimate [] derived from the status quo to analyze another counterfactual world that has territorial restrictions removed.” Determining how Dr. Noll arrives at these step-one estimates is critical to analyzing the reliability of the

20 As mentioned above, Dr. Noll ultimately made two adjustments to his original model in designing the Demand Side in response to criticism from the defendants’ experts. The most recent version of Dr. Noll’s model, outlined in his February 23, 2015 declaration, was the primary focus of the Daubert hearing. It is this third version I will analyze here, unless otherwise noted.

21 See, e.g., Day 1 Tr. at 64-65.

22 See id. at 66.

23 See id.

24 Id. at 67.
Demand Side.

At bottom, these estimates are predicated on the notion that consumers derive welfare, or utility, from spending time watching the live telecasts of their preferred teams, but only to a certain point — especially in light of price considerations and the corresponding utility of doing things other than watching televised sporting events.\(^\text{25}\) Therefore, the Demand Side “requires a large sample of consumer viewing data across the channels in a bundle . . . to calculate the means and standard deviations of time spent viewing each sports channel and engaging in other activities.”\(^\text{26}\) The viewing data on which Dr. Noll relies is drawn from subscriber information for the OMPs provided over the Internet and through DirecTV for the 2012 MLB season and for the OMPs provided over the Internet for the 2011-2012 NHL season.\(^\text{27}\) Dr. Noll then uses this data to estimate statistical distributions of consumers’ preferences for each team in the bundles.

1. **The Underlying Data**

Before delving into the technicalities of the statistical analysis

\(^{25}\) See Dr. Noll Decl. at 100.

\(^{26}\) Id.

\(^{27}\) See Dr. Noll Supp. Decl. at 5. Dr. Noll states that the data that the MVPD providers for the NHL OMP produced were “too fragmentary to support estimating the same model.” Id.
underpinning the Demand Side, it is important to review the underlying consumer
viewership statistics — the observed, real-world data buttressing the demand
component of the model — in greater detail, as well as some corresponding
assumptions Dr. Noll makes using that data. Because there is no observable data
about consumer behavior in the BFW, utilizing real-world information is
paramount in estimating otherwise unknown consumer preferences.28

For its MLB OMP (“MLB Extra Innings”), DirecTV records the time
and duration of a single session of viewing a channel for each subscriber.29 This
amounts to 1,178,100 viewing records for 3,236 subscribers over the course of the
season. The DirecTV data does not include the location of the subscriber or the
specific package that the subscriber purchased — there is some variation in price
among packages, in part due to discounts for purchasing them a certain amount of
time in advance of the start of the season.30 MLB’s Internet OMP (“MLB.tv”)
provides substantially more data points, totaling 64,562,268 viewing records of
521,352 unique subscribers, but those records do not record the total time spent

28 See Dr. Noll Decl. at 100.

29 See Dr. Noll Supp. Decl. at 25.

30 See id. at 26. For the purposes of modeling, Dr. Noll assumes that all
subscribers paid the price of the most popular package. See id.
viewing each game. Accordingly, Dr. Noll estimated the mean viewing time for each team by multiplying the number of that team’s games viewed by the MLB.tv subscriber by the average viewing duration for that team in the DirecTV data. As with DirecTV, MLB.tv package prices vary slightly, so Dr. Noll used the price of the most popular package for estimation purposes. For the NHL Internet OMP (“NHL GameCenter Live”), Dr. Noll’s data set included 4,166,577 records for 99,966 subscribers for the 2011-2012 season. This data includes information regarding viewing time and subscriber location for each game. Finally, for both the MLB and NHL OMPs, Dr. Noll calculates relevant market shares as the number of subscribers to the services divided by the number of U.S. households that watched that sport’s championship series, assuming the latter figure to be an upper bound of the potential market for the package.

Dr. Noll uses this viewing data and various assumptions stemming from it to build the foundation of the Demand Side. Notably, as defendants are

31 See id. at 26-27.
32 See id. at 27.
33 See id.
34 See id.
35 See id.
36 See id. at 27-28.
quick to point out, this foundation lacks any significant additional information regarding consumer demand and preferences. For instance, in modeling demand, Dr. Noll admits that he (1) never sought to obtain demographic data or other personal characteristics about OMP subscribers or baseball and hockey fans more generally, (2) never conducted or attempted to conduct any type of survey of subscribers or non-subscribers regarding viewing preferences or tastes for new products (to wit, a la carte offerings), (3) never sought to obtain specific information regarding price sensitivities of consumers, and (4) that he ignores information regarding package price variation.37 Similarly, based on the observed data for baseball, only four percent of all World Series watchers — Dr. Noll’s assumed upper bound of the market — actually subscribed to an OMP; lacking additional preference data, it follows that all Dr. Noll knows concretely about ninety-six percent of fans in the potential market is that they did not buy a package.38

2. Recovering the Demand Curve

So, how does Dr. Noll use the observed data and his assumptions to estimate demand? This is where things get complicated. According to Dr. Noll,  

37 See, e.g., Day 3 Tr. at 476-478, 512.

38 See Day 1 Tr. at 130-131.
“[t]he goal of the econometric estimation is to recover the distribution of consumer preferences for live telecasts of the games of each team [] as well as consumer preferences for viewership and price sensitivity.”\textsuperscript{39} To accomplish this task, he builds a structural model which originates with sample mathematical equations that are meant to replicate the actual data reflecting the behavior of participants in a market on both the supply and demand sides. Included in those equations are unknown mathematical variables, which can be estimated by attempting to match them to existing viewership data.\textsuperscript{40} In economic terms, these variables are referred to as “parameters.”\textsuperscript{41} The parameters the model seeks to estimate “measure the responsiveness of the consumer to price, the value they place on having access to the bundle, and the value they place on viewing time of each of the teams or RSNs that they view.”\textsuperscript{42} Put differently, the parameters gauge the relative utility a consumer derives for each out-of-market channel as compared to all other non-sports-watching activities, which can then be applied to predicting outcomes in the BFW.

\textsuperscript{39} Dr. Noll Supp. Decl. at 31-32.
\textsuperscript{40} See Day 1 Tr. at 67-68.
\textsuperscript{41} See id. at 68.
\textsuperscript{42} Id.
These parameters are ultimately determined using the Generalized Method of Moments ("GMM"), an estimation procedure commonly deployed by economists to study demand in markets with differentiated products. Without going into great mathematical detail — many pages of Dr. Noll’s declarations consist almost entirely of complex equations beyond the comprehension of the Court or the lawyers in this case — GMM works by using an iterative process in which experimental values are assigned to these parameters with the goal of getting the sample equations to produce results as close as possible to the actual, observed data. In other words, and at the risk of oversimplifying it, the GMM component of the model essentially runs through a series of sixty-six mathematical formulas over and over again, each of which predicts “moments” (measures of the statistical distribution) of data relating mainly to viewing time, until the moments predicted by a given, experimental formula nearly replicate the actual moments of viewing data collected from MLB Extra Innings, MLB.tv, and NHL GameCenter Live, described above. When the GMM process concludes, and the predicted moments

43 See id. at 68-69.

44 See id. at 69. Because a perfect match between predicted moments and observed moments is impossible, the GMM procedure stops once the match is as close as possible. The moments themselves characterize the shape of the statistical distribution of a particular variable. See id. at 70-71. They are calculated by using the means and standard deviations of viewing data, bundle market share, and price-cost margin.
closely match the observed ones, the demand parameters of the model are established.

Dr. Noll’s predicted moments come close to matching the actual moments drawn from the observed data in the existing world. Consequently, Dr. Noll concludes that “the explanatory power of the model to replicate the data from which it is estimated is high.” While there is some variation in match accuracy across individual teams, Dr. Noll insists that “what is actually important is the power of the model itself to explain all of the data,” not just the results for specific teams.

After recapturing the demand curve, Dr. Noll turns to the second step of the model — predicting prices in the BFW. To do so, Dr. Noll uses data about demand in the actual world to simulate demand in a market where out-of-market RSNs are available a la carte.

3. **Categorizing Fans and the Logit Error**

One of the realities of the BFW, assuming bundles continue to exist, is that fans will have the choice between purchasing one or more a la carte channels.

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45 Id. at 80.

46 Id.

47 See id. at 82. For a detailed discussion of the Supply Side, see infra Part IV.
or a traditional OMP. To simulate this competition on the Demand Side, Dr. Noll’s model sorts potential subscribers into one of three categories: (1) single-team fans, (2) two-team fans, and (3) multi-team fans.48

Single-team fans subscribe to a bundle for access to only one team. These are fans that “do relatively little viewing of any other team.”49 Two-team fans are those who subscribe to OMPs because they have an interest in two teams — for example, a husband and a wife who have different favorite teams.50 Multi-team fans are interested in watching anywhere between three teams and the maximum number available to them.51

Dr. Noll relies on the mathematical estimation procedures driving the GMM to help him sort fans into various categories.52 Significantly, these

48 See Day 1 Tr. at 91. His first two models did not distribute fans in this manner. The adjustment in the third model responded to critiques of defendants’ Demand Side expert, who demonstrated that Dr. Noll’s second model was unresponsive to drastic changes in viewership patterns, producing the same results regardless of those changes. See Dr. Noll Supp. Decl. at 12-13. Therefore, the fan categories of the third model attempt to account for a wider range of viewership patterns.

49 Day 1 Tr. at 80.

50 See id.

51 See id.

52 See id. at 137 (“[T]he proportions of people who are one, two, and many are determined by the estimation procedure to maximize the explanatory value of the three-way categorization.”).
categories comprise “simulated fans” whose preferences are not directly corroborated by any actual, observable data — instead, they are driven by moments of viewing time.\textsuperscript{53} To put this in perspective at the \textit{Daubert} hearing, defendants’ counsel and Dr. Noll addressed the process of classifying a hypothetical fan who watches one team ninety percent of the time but still derives significant value from the ability to view other games from time to time.\textsuperscript{54} Dr. Noll would likely classify that fan as a single-team fan.\textsuperscript{55} In essence, while a fan with a primary allegiance to a single team may in fact have a strong preference to watch other teams as well, Dr. Noll admits that those preferences are “zeroed out” in his model.\textsuperscript{56}

Dr. Noll insists that this type of viewing utility is accounted for by a mathematical component built into his model called the “logit error.” The term logit error does not connote a mistake; rather, the error is a random component of the model that seeks to capture factors bearing on the utility a fan derives from

\textsuperscript{53} See id. at 137-138.

\textsuperscript{54} See id. Imagine a die-hard Yankees fan who spends ninety percent of his baseball-watching time viewing only Yankees games, but ten percent of the time, he might want to check in on games featuring the Yankees’ division rivals – perhaps even more than ten percent of the time if the division is particularly competitive that season.

\textsuperscript{55} See id. at 138.

\textsuperscript{56} Id.
watching a specific team beyond simply the time spent viewing that team.\textsuperscript{57} According to Dr. Noll, the logit error is a “random component value” factored into the Demand Side to account for the fact that there are forms of utility from the bundle other than pure viewing time.\textsuperscript{58} So the logit error adds to the model a random distribution of utility to provide, per Dr. Noll, “a shock that isn’t measured by what is already in there.”\textsuperscript{59} But, as Dr. Noll admits, “[t]here is no additional information about [fans’] preferences other than the logit error that measures the departure of the utility from the expected value.”\textsuperscript{60}

4. Results of the Model

Dr. Noll’s model yields significantly reduced prices of bundles in the BFW. Specifically, the average monthly price of the MLB.tv package would decrease from $20.05 to $14.50.\textsuperscript{61} The average monthly price of NHL GameCenter Live would decrease from $26.28 to 18.08.\textsuperscript{62} The average monthly price of MLB

\textsuperscript{57} See id. at 140.
\textsuperscript{58} Id. at 171.
\textsuperscript{59} Id. at 175.
\textsuperscript{60} Id. at 179.
\textsuperscript{61} See Dr. Noll Reply Decl.
\textsuperscript{62} See id.
Extra Innings would drop from $33.59 to $24.59.\(^\text{63}\)

Central to evaluating the reliability of those findings are the specific results Dr. Noll’s model yields for fans’ preferences between a la carte channels and bundles in the BFW. For both the MLB and the NHL, the following pattern holds true. Of the three fan types in Dr. Noll’s model, the fans classified as “single-team fans” — the ones primarily interested in watching one and only one team — are the most likely to purchase the league package, and the least likely to purchase an a la carte channel.\(^\text{64}\) Further, the fans most likely to purchase an a la carte channel are those that are interested in the greatest number of teams.\(^\text{65}\) These multi-team fans almost universally reject the opportunity to purchase a league bundle in the BFW.\(^\text{66}\) The relevant data demonstrating this pattern is reflected for MLB.tv in the chart below.

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\(^\text{63}\) See id.

\(^\text{64}\) See Defendants’ Demonstratives and Exhibits (“Def. Demonstratives”), Tab 8, at 13.

\(^\text{65}\) See id. Of course, there is a limit to the number of a la carte channels that a fan would purchase — once the number of a la carte channels a fan is interested in purchasing exceeds the price of the bundle, or is about the same, the fan would be better off buying the bundle.

\(^\text{66}\) See id.
Chart 1: Purchasing Decisions by Fan Type in the BFW - MLB.tv

<table>
<thead>
<tr>
<th>Fan Type</th>
<th>% Purchasing Standalone</th>
<th>% Purchasing Bundle</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single-Team Fan</td>
<td>68</td>
<td>32</td>
</tr>
<tr>
<td>Two-Team Fan</td>
<td>81</td>
<td>19</td>
</tr>
<tr>
<td>Multi-Team Fan</td>
<td>99</td>
<td>1</td>
</tr>
</tbody>
</table>

B. Defendants’ Key Modeling Criticisms

Defendants insist that these results are absurd and counterintuitive, signaling that something is amiss about Dr. Noll’s model. After all, common sense would suggest that the opposite of Dr. Noll’s model should hold true — fans interested primarily in one team would buy an a la carte channel, and fans interested in several teams would buy a bundle. To that end, defendants rely on their own expert, economist Dr. Daniel McFadden, to highlight methodological flaws on the Demand Side. Dr. McFadden offers a number of criticisms of Dr. Noll’s model, ultimately characterizing it as “junk science.”

67 See id.

68 See Day 2 Tr. at 359-360. Dr. McFadden won the Nobel Prize for developing methods to study discrete choice — situations where consumers have to choose between one product or another. See id. According to Dr. McFadden, Dr. Noll “is using discrete choice models and analysis at the core of his demand analysis.” Id. at 360. Plaintiffs do not challenge Dr. McFadden’s credentials as an expert.

69 Id. at 383.
independent, perceived flaws that inform Dr. McFadden’s conclusion fit one common theme: the Demand Side relies too heavily on mathematical assumptions and random error, and too little on actual data about consumers and their preferences.\textsuperscript{70}

To illustrate this problem, Dr. McFadden closely examines the process by which Dr. Noll simulates the behavior of consumers. As noted above, only four percent of all World Series watchers — Dr. Noll’s assumed upper bound of the market — actually subscribed to an OMP.\textsuperscript{71} This means that Dr. Noll has no data for ninety-six percent of consumers in the potential market, other than that they chose not to buy the package in the actual world. To design simulated consumers (or “avatars”), Dr. Noll starts with real demand data on fans that subscribed to league packages in the actual world — but these fans constitute only a very small

\textsuperscript{70} At the beginning of his testimony at the Daubert hearing, Dr. McFadden offered three guiding principles for evaluating the reliability of the demand component of structural models. \textit{First}, when modeling demand, “you should be using data on consumer behavior rather than say, for example, mathematical assumptions.” \textit{Id.} at 362 (emphasis added). \textit{Second}, the model’s predictions should be “falsifiable,” such that the model should not yield certain kinds of results in situations where different demand inputs are used to alter the expected predictions. \textit{See id. Third}, the “model should be consistent with observed consumer behavior[,] particularly on dimensions that are important for that application.” \textit{Id.} (emphasis added).

\textsuperscript{71} The same method is applied to the NHL and viewers of its championship series, the Stanley Cup.
subset of the total BFW population. To account for the overwhelming majority of BFW consumers, about which he knows very little based on the actual world, he is forced to, in Dr. McFadden’s words, “assign[] a mathematical DNA to these avatars” using “assumptions to essentially fill out the DNA which will determine how these people make choices and behave.” Ultimately, the behavioral properties of these avatars are not based directly on “anything in the real data that [Dr. Noll] has.”

As a result, while Dr. Noll is able to match predicted viewing times in the BFW to observed viewing times in the actual world with some precision through the GMM procedure, his model’s estimates about viewer preferences are inaccurate. To prove this point, Dr. McFadden compares the actual league subscriber data to the predicted habits of Dr. Noll’s avatars. The results of that comparison are reflected in the chart below.

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72 Id. at 366.
73 Id. at 369.
74 See id. at 373.
This simple fitting test reveals major differences between viewers’ tastes as defined by the actual, observed data and those predicted by the GMM.

As another example, Dr. McFadden runs a different test to show that Dr. Noll’s model underpredicts the popularity of individual RSNs within league bundles across the board. The general pattern is that bundle subscribers “watch a lot more teams,” and a “higher share of them watch every team [or] any team” than Dr. Noll’s model predicts. In fact, for all but two teams in the NHL, Dr. Noll’s model predicts that a lower percentage of subscribers watch a given team than what was observed in the actual data for package subscribers. This discrepancy is particularly noteworthy, according to Dr. McFadden, because it represents a departure from the C&Y Model, which “imposed as part of [its] moments the

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75 Def. Demonstratives, Tab 8, at 9. Testimony regarding similar MLB data was stricken from the record because Dr. McFadden’s MLB charts were not disclosed to plaintiffs in advance of the Daubert hearing. See Day 2 Tr. at 374.

76 Day 2 Tr. at 377; see also Def. Demonstratives, Tab 8, at 12.

77 See Day 2 Tr. at 377; Def. Demonstratives, Tab 8, at 12.
condition that these actual and predicted shares had to match.”\textsuperscript{78} This is not the only instance of Dr. Noll’s model failing to replicate the C&Y Model on the Demand Side. At a more general level, Dr. McFadden testified that an important difference between Dr. Noll’s model and that of Crawford and Yurukoglu is that the latter was built on substantially more data.\textsuperscript{79} Dr. Noll conceded as much during the \textit{Daubert} hearing.\textsuperscript{80}

When asked how he would remedy this problem, Dr. McFadden testified that

\begin{quote}
[t]he standard procedure would be to try to get data . . . from the entire population . . . certainly first to go look and see if someone else has already collected it. But if you can’t find that, it would [be] common procedure [\textit{\ldots}]

to collect your own data, do your own survey, find out who is, for example, in this case who’s a fan and who is not, and perhaps also find out more about what their tastes are, whether they would consider buying or not at various suggested prices.\textsuperscript{81}
\end{quote}

\textsuperscript{78} Day 2 Tr. at 377.

\textsuperscript{79} \textit{See id.} at 367.

\textsuperscript{80} \textit{See} Day 1 Tr. at 123-128. In their study, Crawford and Yurokoglu based their model on a variety of sources of information, including surveys of random samples of consumers about media usage, consumer behavior, and demographics. \textit{See} C&Y at 653. The information they gleaned factored into their GMM estimates. \textit{See id.} at 668-671.

\textsuperscript{81} Day 2 Tr. at 367-368.
He added that collecting surveys is “almost a standard in market research where this problem of estimating demand for new product” arises — “something that firms deal with all the time, and there is now a long tradition and a long history of using survey techniques to understand what’s going on and [to] make predictions.”

According to Dr. McFadden, the dearth of data in Dr. Noll’s model culminates in nonsensical results – namely those reported in Table 1 — which are driven by the logit error. Specifically, Dr. McFadden contends that Dr. Noll’s use of logit error in his model is “inappropriate” in this circumstance because of what is known as the “red bus/blue bus problem” — a function of the logit error that forces an overprediction of how many consumers will buy standalone RSNs instead of the bundle in the BFW. The red bus/blue bus problem — a known characteristic of logit error models — draws from a hypothetical decision commuters face: whether to travel by car or by a red bus. In the first instance, one assumes that a commuter chooses between these options with equal probabilities. Then, add to the hypothetical a third option — a blue bus, in addition to a red one. In theory, the additional color choice should not affect the probability of whether a

82 Id. at 368.
83 Id. at 380.
commuter chooses to commute by car or by bus, generally. But the potential flaw of the logit error is that introducing the third option, a different type of bus, spreads the odds evenly between car, red bus, and blue bus. As a result, the odds of choosing to commute by car drop when they really should remain the same. The more colors of buses that are added, the more likely a commuter will ultimately choose a bus.  

In this case, the logit error flaw becomes apparent by substituting cars and buses for bundles and a la carte channels — the logit error decreases the probability of choosing the former as more types of the latter are added. Dr. Noll never tested whether this problem affected his model, despite the fact that, according to Dr. McFadden, “[i]t’s a limitation of the model which people are warned against” and for which “there are tests.”

Above all else, Dr. McFadden notes that this problem is exacerbated by Dr. Noll’s heavy reliance on mathematical assumptions and equations to derive properties of avatars. Dr. McFadden concludes that, “from a scientific point of view,” the red bus/blue bus problem shows that the Demand Side of Dr. Noll’s model is “very badly specified.” Dr. Noll’s results “violate[] common sense”

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84 See id.
85 See id. at 380-381.
86 Id. at 381.
87 Id. at 382.
because “he’s making a mathematical inference on how choice behavior is going to look without going into any real data on it[,] and that is itself simply unreliable.”

C. Dr. Noll’s Response

Dr. Noll claims that his model does not suffer from data deficiencies, and moreover, that the seemingly counterintuitive results of his model make economic sense in that they reflect differing price sensitivities among categories of fans. According to Dr. Noll, “the parameters [ ] estimate[d] produce the result that the multi-team [fans] are the most price sensitive.” This is because the viewing time moment in his model is a “mechanism that picks up the degree to which teams are substitutes for each other, and when you finally get to the multi-team fan, you have lots of teams that are perfect substitutes, and so you can distribute your time.” Expanding on this explanation, Dr. Noll offered a hypothetical during his rebuttal testimony:

Suppose you are a Yankees fan. You couldn’t care less what the price of the Houston Astros channel is. Right? You are going to buy the Yankees — you’re pretty price sensitive to it. All right? Now instead suppose you’re someone who just likes baseball[,] and you don’t care whether it’s the Houston Astros or the New York Yankees.

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88 Id. at 383.
89 Day 1 Tr. at 182.
90 Id. at 180.
You are more likely to look at the relative price of those two to decide which channel to subscribe to.\textsuperscript{91}

Therefore, Dr. Noll insists that his model produces the result that for multi-team fans price sensitivity outweighs preference for diversity.

During Dr. Noll’s rebuttal testimony at the \textit{Daubert} hearing I asked whether, in simply enjoying watching the game of baseball or hockey, multi-team fans would buy a package instead of one or two RSNs, which would heavily restrict the number of teams they could watch on any given day. Dr. Noll asserted that the “coefficient in the regression in the utility function” of his model — part of the logit error — accounts for that possibility.\textsuperscript{92} In support of that contention, Dr. Noll dismissed Dr. McFadden’s conclusion about the effects of the red bus/blue bus problem on the model’s logit error as “inaccurate.”\textsuperscript{93} Defending his use of the logit error, Dr. Noll stated:

\begin{quote}
The red bus/blue bus problem is not a problem of the model. The problem of the model is, in fact, in certain circumstances, the logit error is driving results or is affecting — I shouldn’t say driving — it is one of the factors producing results. The right way to say it is [the logit] introduces heterogeneity in consumer behavior. And
\end{quote}

\textsuperscript{91} Day 3 Tr. at 439.

\textsuperscript{92} \textit{Id.} at 444. Dr. Noll does not actually know the value for this parameter but assumes the lowest possible value to be conservative. \textit{See id.}

\textsuperscript{93} \textit{Id.} at 493.
Dr. Noll also attempts to rebut defendants’ more pointed criticisms regarding the data on which he relied, or failed to rely, in designing the Demand Side. Mainly, he insists that it would have been impractical for him to do a survey. This holds true as well for a conjoining analysis — a smaller type of survey that reduces the sample size. Conjoining analyses are frequently performed by companies that seek to introduce new products into the market. But Dr. Noll concludes that in this case, performing such an analysis would require too large of a sample size to be practical.

Dr. Noll also attempts to show that Dr. Ariel Pakes, one of defendants’ Supply Side experts, relied on similar quantities and types of data in constructing avatars for a 2004 study estimating the demand for automobiles. In

94 "Id. at 494.
95 See id. at 480.
96 See id.
97 See id.
98 See id.
99 See id. at 430; Steven Berry, James Levinsohn, and Ariel Pakes ("BLP"), Automobile Prices in Market Equilibrium, 63 Econometrica 841 (1995).
that paper, Dr. Pakes constructed demand for automobiles with a potential market size of over one hundred million consumers even though the average annual sales of automobiles in his actual world sample were slightly above ten million.\textsuperscript{100} Thus, Dr. Noll asserts that Dr. Pakes knew next to nothing about a huge percentage of the potential market other than that they did not purchase an automobile.\textsuperscript{101} However, as Dr. Noll acknowledged on cross-examination, Dr. Pakes’ model relied on demographic data from the census as well as random surveys conducted of over thirty-seven thousand actual purchasers regarding automobile preferences.\textsuperscript{102} Further, the ultimate results of Dr. Pakes’ model were that less than one percent of people in the potential market for automobiles became purchasers, as opposed to forty-three percent of the potential market in Dr. Noll’s study.\textsuperscript{103}

Finally, in response to Dr. McFadden’s observation that Dr. Noll’s model underpredicts the number of channels bundle subscribers view, Dr. Noll insists that the \textit{time} spent viewing a channel is more important than the number of overall channels a subscriber watches. According to Dr. Noll, “the ability of the model to predict should be evaluated on the basis of the ability to predict viewing

\begin{footnotesize}
\begin{itemize}
    \item \textsuperscript{100} See Day 3 Tr. at 430.
    \item \textsuperscript{101} See id. at 431.
    \item \textsuperscript{102} See id. at 476.
    \item \textsuperscript{103} See id. at 476-478.
\end{itemize}
\end{footnotesize}
time, not [on the basis of] whether a bunch of subscribers [] spent very little time watching that channel.”104 Thus, Dr. Noll asserts that his model’s predictions for viewing time by team do match up very closely to the observed data.105

D. Dr. Noll’s Demand Side Opinion Must Be Excluded

Calculating damages on the basis of predictions about hypothetical, counterfactual scenarios is not an easy task. Further, estimating damages in antitrust cases is especially challenging because “causes and effects in the realm of economics are not nearly as clear-cut as they are in other disciplines.”106 It is against this backdrop that plaintiffs bring an unusually complex and sweeping class action lawsuit, premised on the theory that access to out-of-market baseball and hockey telecasts would be cheaper in a counterfactual world without territorial restrictions. Unless plaintiffs can prove that there is a scientifically-reliable way to predict with some precision the prices of those telecasts in the future, they cannot recover damages for being overcharged in the past.

There is no question that this task is enormously challenging, even for the most seasoned and distinguished of experts. But it is not impossible — it has

104 Id. at 437.

105 See id. at 437-438.

been done before in similar circumstances.\textsuperscript{107} More importantly, the law is clear: expert opinions are inadmissible if they are not “based on sufficient facts or data,” or on a reliable application of scientific methods to those facts or data.\textsuperscript{108} This is true no matter how burdensome or difficult collecting relevant data or devising methods to apply to that data may be.\textsuperscript{109}

Dr. Noll’s modeling of demand in the BFW is unreliable because the Demand Side is largely untethered from the actual facts of this case.\textsuperscript{110} Defendants offer a number of independent criticisms of the Demand Side, accusing Dr. Noll of committing methodological flaws ranging from making inaccurate assumptions about estimating market size to inappropriately using logit error in determining the value fans derive from league bundles. Some of defendants’ criticisms are very technical, none of which would be independently sufficient to win a \textit{Daubert}

\footnotesize
\begin{itemize}
\item \textsuperscript{107} \textit{See} C&Y at 16-19 (explaining how demand for individual channels was estimated, using a combination of existing viewership data and demographic data).
\item \textsuperscript{108} \textit{Fed. R. Evid.} 702.
\item \textsuperscript{109} \textit{See, e.g.,} \textit{Fishman Transducers, Inc. v. Paul}, 684 F.3d 187, 195 (1st Cir. 2012) (excluding expert who failed to undertake “difficult, time-consuming and expensive efforts” to obtain “direct testimony from customers, [or] market research surveys of [product] purchasers as to their reasons for purchases,” noting that, without them, “[the expert’s] report was merely a basis for jury speculation”).
\item \textsuperscript{110} \textit{See} Fed. R. Evid. 702.
\end{itemize}
The problem for plaintiffs is that, at bottom, all of the examples defendants and Dr. McFadden point to, and all of the tests they run on Dr. Noll’s model, expose the same underlying problem, which is quite fundamental and fatal: Dr. Noll’s estimates do not rely on sufficient data about consumer tastes and preferences. Instead, time and time again, Dr. Noll substitutes actual, readily-obtainable information for mathematical assumptions in determining how hockey and baseball fans will behave in the BFW.

For these reasons, I conclude that Dr. Noll’s expert opinions on forecasting demand in the BFW must be excluded. And because a structural model is only as reliable as its component parts, Dr. Noll’s model cannot be admitted to calculate damages on plaintiffs’ theory of overcharge. As explained below, the actual data on which Dr. Noll relies to extrapolate consumer demand in the BFW is simply too sparse to survive defendants’ challenge under FRE 702 and Daubert.

In the antitrust context, economists are frequently asked to confront problems of

111 For instance, defendants complain that Dr. Noll’s model relied on average monthly prices of the most popular league bundle subscriptions instead of inputting a variety of subscription prices into the model to account for consumers’ tolerance to price variation. See Dr. McFadden Decl. ¶ 38. In isolation, this modeling shortcut does not bear too heavily on the reliability of the overall model. The cause for concern is that without surveys of consumers’ preferences for products at various suggested price points, or additional data reflecting such preferences, it is virtually impossible to gauge reliably how price sensitivities would affect demand in the BFW, or how important it would be to build the differing package prices into the model.
extraordinary complexity. In such studies, it is standard operating procedure to rely on more data than Dr. Noll did here in attempting to measure consumer demand in a counterfactual world.\textsuperscript{112}

1. The Foundation of the Recaptured Demand Curve Lacks Sufficient Data

It is easy to detect the symptoms of Dr. Noll’s over-reliance on mathematical assumptions, and under-reliance on actual data, in the initial demand curve he derives through the GMM procedure. Dr. Noll’s approach to recapturing this demand curve is casual, at best. In fact, his benchmark for estimating demand is essentially a hodgepodge of data sets — varying in their levels of completeness and detail — from MLB Extra Innings, MLB.tv, and NHL GameCenter Live, combined with an assumption about the size of the market for OMPs.\textsuperscript{113} That is it. And, as noted above, the prices Dr. Noll assigns to these OMPs are actually average monthly prices — no price variation data is taken into account, despite the fact that prices vary significantly depending on when consumers purchased the package.\textsuperscript{114}

\textsuperscript{112} See, e.g., C&Y; BLP.

\textsuperscript{113} See Dr. Noll Decl. at 27-28.

\textsuperscript{114} See Dr. McFadden Decl. ¶ 38 (noting that 47 percent of NHL GameCenter Live subscribers, 73 percent of MLB.tv subscribers, and 34 percent of MLB Extra Innings subscribers pay a different price from the one assigned by Dr.
This perfunctory approach impugns the overall reliability of the GMM estimation, on which his entire model is built. For instance, Dr. Noll offers no principled reason, and points to no actual data regarding fan preferences, for his important assumption that the total number of viewers of a sport’s championship series should constitute the upper bound of the market for that sport’s OMP. He may be right, and this one assumption on its own does not necessarily sink the model, but that is besides the point. For demand to be reliably estimated, Dr. Noll needs a data-driven basis for his underlying assumptions, including those pertaining to the important issue of market shares. If a swath of baseball fans had been surveyed in some form, Dr. Noll might have gained a helpful insight into whether setting the upper bound of the market at the total number of World Series viewers was an appropriate assumption. Such survey data could have corroborated his approach, or it could have caused him to refine it. Either way, without preference data, the reliability of an important assumption driving demand in the BFW remains in question. This type of unsupported assumption is all the more problematic when the actual data sets Dr. Noll relies on are not as robust as they could be. Some of these data sets contain subscriber location; others do not. Some contain information about exactly how much time a fan spent viewing each team;
others do not. While Dr. Noll cannot be faulted for not being provided with certain information, in constructing a reliable model, he must do his best to fill the gaps.\footnote{See \textit{Fishman Transducers, Inc.}, 684 F.3d at 195.}

\section*{2. The Preferences of Dr. Noll’s Avatars Are Heavily Impacted by the Logit Error, Not Actual Data}

Instead, Dr. Noll’s lack of reliance on actual data compounds the potentially harmful impact of his unsupported assumptions. Consider Dr. Noll’s sorting of consumers into single-team, two-team, and multi-team fans. Dr. Noll categorizes fans through a mathematical estimation procedure tied to viewing time. Acknowledging that fans may not distribute perfectly across these categories on the basis of viewing time alone, Dr. Noll relies on the logit error to provide “a shock that isn’t measured by what is already in there.”\footnote{Day 1 Tr. at 175.} By Dr. Noll’s own admission, “[t]here is no additional information about [fans’] preferences other than logit error that measures the departure of the utility from the expected value.”\footnote{\textit{Id.} at 179.} This is quite problematic, especially considering that Dr. Noll has no real world data for ninety-six percent of the consumers in the potential market for OMPs.

Worse still, the logit error he relies on to compensate for his lack of

\footnotesize
\begin{itemize}
  \item \footnote{See \textit{Fishman Transducers, Inc.}, 684 F.3d at 195.}
  \item \footnote{Day 1 Tr. at 175.}
  \item \footnote{\textit{Id.} at 179.}
\end{itemize}
preference data is susceptible to reliability issues because of the red bus/blue bus problem. While the Court is not nearly proficient enough in econometrics to evaluate the extent to which the red bus/blue bus problem might throw off Dr. Noll’s predictions, this much is clear: if Dr. Noll had leaned more heavily on actual preference data, he could have reduced his reliance on logit error and enhanced the reliability of his model. And, at minimum, he could have tested his model more thoroughly to ensure that the logit error was not muddying his results. Indeed, Dr. Noll admits that the logit error has an important impact on his model, stating during the Daubert hearing that “[t]he problem of the model is, in fact, in certain circumstances, the logit error is driving results or is affecting — I shouldn’t say driving — it is one of the factors producing results.”

3. The Results of Dr. Noll’s Model Demonstrate Its Unreliability

Actual preference data would have enabled Dr. Noll to distribute fans into his three categories, and to evaluate the importance of viewing time as compared to other measures of potential bundle utility, in a much more reliable fashion. To prove that point, the Court need look no further than the questionable, hotly-debated results of his fan sorting experiment. For ease of reference, Chart 1, 

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118 See Day 2 Tr. at 379-381.
119 Day 3 Tr. at 494.
which illustrates those results, is reprinted below.

Chart 1: Purchasing Decisions by Fan Type in the BFW - MLB.tv

<table>
<thead>
<tr>
<th>Fan Type</th>
<th>% Purchasing Standalone</th>
<th>% Purchasing Bundle</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single-Team Fan</td>
<td>68</td>
<td>32</td>
</tr>
<tr>
<td>Two-Team Fan</td>
<td>81</td>
<td>19</td>
</tr>
<tr>
<td>Multi-Team Fan</td>
<td>99</td>
<td>1</td>
</tr>
</tbody>
</table>

The parties thoroughly disagree over the meaning of these results, and the role the logit error plays in driving them. To a layperson — even one who does not watch sports — this distribution of results makes no sense: the more teams a fan is interested in watching, the more likely he would be to buy a package of the telecasts of all teams instead of the telecasts of only one team.

Dr. Noll has an explanation for this. Assuming his model’s assumptions about viewing preferences by category are correct, then the model’s results are economically sensible in that they are informed by the respective price sensitivities of the categories of fans.

But, as with so many other opinions Dr. Noll offers on the Demand Side, the real world data to support his price-sensitivity conclusion is nowhere to be found in the model. As Dr. McFadden points out, if an expert modeler lacked such information, “it would [be] common procedure [] to collect your own data, do your own survey, find out . . . who’s a fan and who is not, and perhaps also find
out more about what their tastes are, whether they would consider buying or not at various suggested prices.” 120 Only then could consumer demand start to come into focus. That is why Crawford and Yurukoglu relied on substantial real world preference information and survey data, including demographic data, in their study. 121 And, what’s more, the emphasis on collecting real world data and integrating it into the C&Y Model was hardly that model’s innovative feature, just as Dr. Pakes’ use of surveys in his study was perfectly ordinary. Indeed, Dr. McFadden stated that economists now follow “a long tradition and a long history of using survey techniques to understand what’s going on and [to] make predictions.” 122

By contrast, Dr. Noll’s Demand Side model is so far removed from actual viewer preferences and tastes that a finder of fact could only speculate as to

120 Day 2 Tr. at 367-368.
121 See C&Y at 653.
122 Day 2 Tr. at 368. Dr. Noll’s excuses for not conducting surveys or attempting to incorporate additional information are unconvincing, especially considering that his failure to do so seems to be a stark departure from the industry norm. Additionally, throughout the course of expert discovery and the various iterations of his model, Dr. Noll and plaintiffs were on notice of defendants’ concern that the Demand Side was not sufficiently tied to viewer preferences, but they stood by the sparse data in Dr. Noll’s model anyway. Dr. Noll’s declarations speak to the infeasibility of separating fans into 435 categories, but not to doing a survey of a relatively small group of people using a conjoining analysis. See Day 3 Tr. at 482.
the reasons for the model’s seemingly nonsensical results. Dr. Noll claims that multi-team fans are more price-sensitive because the “model of their demand behavior . . . kicks out that result.”\textsuperscript{123} But the very model that produces that result is unreliable because Dr. Noll never conducted any surveys or collected and incorporated any additional data regarding viewers’ tastes. Doing so could have enabled his model to predict more reliably the price sensitivities of various categories of fans.

For instance, with some extra legwork, Dr. Noll might have uncovered data that multi-team fans’ supposed price sensitivity would actually tend to drive them out of the market altogether — after all, cable subscribers can watch a local baseball game almost every night during the season without paying extra for an out-of-market option.\textsuperscript{124} Or maybe he would have uncovered and incorporated preference data into his model that reflected the opposite trend — that multi-team fans genuinely value diversity to a greater degree than the logit error provides, and

\textsuperscript{123} Day 3 Tr. at 485.

\textsuperscript{124} Indeed, one can envision a number of ways in which a price-sensitive fan — even a non-cable-subscriber — could get his baseball or hockey fix without paying for a standalone RSN or OMP. Fans can read about every play of every game online in real time and watch extensive highlights of every game on MLB.com or NHL.com. They can also watch games at a bar or at the residence of a friend who subscribes to cable. Many baseball games each season are broadcast locally over-the-air such that a cable subscription is not even necessary. All of these options may be preferable to paying for an a la carte channel.
strongly desire the option to watch any team on any given night, not just one team.\textsuperscript{125} It is also possible that real-world data supports his price-sensitivity claim.

4. Under FRE 702, Dr. Noll’s Testimony About Consumer Demand Must Be Excluded

Whether any of these possibilities are accurate is irrelevant – what matters is that Dr. Noll’s failure to obtain information about consumer tastes and preferences and failure to study baseball and hockey viewing patterns more thoroughly create “too great an analytical gap between the data and the opinion

\textsuperscript{125} It may be that a non-negligible percentage of “multi-team fans” are fans not of many teams, but of many players across different teams. To this end, it might have been useful to seek data regarding the impact of the rise of fantasy sports on OMP subscriptions, including the growing trend towards daily fantasy sports. In this context, fans are interested in observing the performance of a collection of players across a range of different teams each night, as opposed to the performance of only one or two teams. Participants in daily fantasy sports, who pay to play, consume forty percent more sports content — across all media, including television — once they begin playing. See Brent Schrotenboer, Leagues See Real Benefits in Daily Fantasy Sports, \textit{USA Today} (Jan. 1, 2015), http://www.usatoday.com/story/sports/2015/01/01/daily-fantasy-sports-gambling-fanduel-draftkings-nba-nfl-mlb-nhl/21165279/ (noting that “daily fantasy sports consumption will have a steroid effect on television revenue, because nobody watches live sports on television quite as intensely as fans with money at stake”). But the teams they support — and are interested in watching — change every night; they might only view a given game for a very short window of time, just to check in on the at-bat of a single player. Fantasy sports aside, a “multi-team fan” may wish to view games of different teams each night based on intriguing pitching match-ups or other player-specific interests. Dr. Noll’s model does not incorporate any real data regarding consumer tastes to account for any of these possibilities, which may or may not have a significant impact on estimating demand.
proffered.”126 FRE 702 requires expert testimony to be based on “sufficient facts or data.” Dr. Noll’s testimony about consumer demand is based on insufficient facts and data. His Demand Side opinions are even less reliable in that they are not the product of any significant, independent research or study, but have instead been developed for the sole purpose of bolstering plaintiffs’ position in this litigation.127 For all of these reasons, the model must be excluded. Without a reliable way to estimate demand in the BFW, plaintiffs cannot demonstrate with any precision the potential monetary damages class members incurred as a result of defendants’ alleged overcharging for OMPs.

V. SUPPLY SIDE

A. Summary of Dr. Noll’s Supply Side Analysis

Because territorial restraints would no longer exist in the BFW, RSNs

126 Joiner, 522 U.S. at 146. Because the underlying demand data is the same for the third model as it is for Dr. Noll’s first two, it is unnecessary to examine the first two models more closely, to the extent that plaintiffs believe they are still viable. All versions of Dr. Noll’s model suffer from the same fatal data sufficiency flaw on the Demand Side.

127 See Daubert v. Merrell Dow Pharms., Inc. (Daubert II), 43 F.3d 1311, 1317 (9th Cir. 1995) (noting that “in determining whether proposed expert testimony amounts to good science, we may not ignore the fact that a scientist’s normal workplace is the lab or the field, not the courtroom or the lawyer’s office”); see also Awad v. Merck & Co., 99 F. Supp. 2d 301, 304 (S.D.N.Y. 1999), aff’d sub nom. Washburn v. Merck & Co., 213 F.3d 627 (2d Cir. 2000) (noting that in determining reliability under Daubert, “a significant consideration is whether research was conducted independently or for the sole purpose of litigation”).
would be able to sell their content — in a la carte form — directly to out-of-market consumers. According to Noll, this change would spark a reconfiguration of the overall market for sports broadcasting, leading to greater consumer welfare.

1. **The Supply Side in the C&Y Model**

The C&Y Model, as described earlier, is a framework for assessing the result of “unbundling” television distribution — *i.e.*, of moving from (1) a distribution chain in which consumers are required to purchase bundled packages (of television channels) from MVPDs to (2) a distribution chain in which consumers may either purchase bundled packages *or* purchase a la carte channels. The C&Y Model examined the effects of unbundling on *all* broadcasting, not just sports broadcasting. They were interested in determining whether consumers would be better off in a world where they could pick and choose among individual networks — The History Channel, and Arts and Entertainment Network, and so on — instead of being forced to purchase a bundled cable package.

The C&Y Model documented two effects of unbundling. *First*, greater consumer choice, resulting from the existence of a la carte options, spurred competition, and tended to push prices down in the BFW. *Second*, the Supply Side bargaining that would transpire in response to unbundling introduced new costs
into the supply chain, which tended to push prices up in the BFW. The reason for this second finding — as Dr. Pakes explained — is that unbundling resulted in a “[smaller] amount of money [] go[ing] back to each [network],” which meant that to avoid “go[ing] out of business” networks were forced to negotiate higher fees from MVPDs, which in turn meant that MVPDs would charge consumers higher prices for each a la carte network. The end result was that in the BFW, consumers ended up “slightly worse off” than they were in the actual world of exclusively bundled options.

In short, the C&Y Model concluded that the unbundling of television channels had two different effects, pulling in opposite directions, on the market for television distribution. The synthesis of these two effects is to restore consumers to essentially the same position as they were in before unbundling.

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128 See C&Y at 4 (“There are two countervailing forces that largely determine our results. First, for fixed input costs, unbundling unlocks consumer surplus. . . . Allowing renegotiation, however, increases costs [and] [p]rices follow suit, making the average consumer indifferent [to unbundling].”).

129 Day 2 Tr. at 298.

130 Id.

131 See id. at 315 (where Dr. Pakes explains that the C&Y Model did not result in a “statistically significant” increase in prices). This is true, at least, with respect to prices. It is still possible (indeed, it seems quite likely) that some consumers would be better off in the BFW, even taking for granted the C&Y Model’s assumptions about bargaining, depending on their specific preferences. For example, a consumer that only wanted The History Channel — a rough
2. Dr. Noll’s Basic Deviation from the C&Y Model

The crude way to summarize Dr. Noll’s analysis — and the essence of defendants’ criticism — is that he adopted the first half of the C&Y Model while ignoring the second. Following the C&Y Model, Dr. Noll posits that the “unbundling” of sports broadcasts — i.e., the availability of a la carte RSNs — would have a downward effect on prices. But from there, Dr. Noll parts ways with the C&Y Model. Dr. Noll’s analysis does not include a Supply Side bargaining dynamic that results in MVPDs imposing mark-ups when distributing either a la carte channels or OMPs to consumers. Absent this bargaining dynamic, the second effect documented in the C&Y Model — the increased price of each particular RSN’s content — does not occur in Dr. Noll’s analysis. Accordingly, unlike in the C&Y Model, whose end result was neutral for consumers, Dr. Noll’s analysis shows an obvious benefit to consumers — choices multiply, and prices drop.

Dr. Noll has a rationale for this deviation. According to Dr. Noll, there is no need to model bargaining between RSNs and MVPDs in the BFW, because “internet delivery [of RSN feeds] is a competitive substitute for delivery analogue to the single-team fan — would no doubt prefer the unbundled world, even if the price per channel was substantially higher than it was in the bundled world.
over an MVPD.”

Assuming this premise is correct, MVPDs would have no power to mark up prices above a profit-maximizing equilibrium. If they did raise prices, consumers would migrate to Internet products. Therefore, Dr. Noll concludes that it is unnecessary to model “the agreements between [] buyer[s] and [] seller[s]” at an “intermediate” stage in the supply chain — i.e., the agreements between RSNs and MVPDs — because there is no way that such agreements will “affect [the] final price.”

With respect to the bargaining issue, there is a notable mismatch between what Dr. Noll has done and what defendants have accused him of doing. Defendants’ experts repeatedly argue that Dr. Noll’s analysis ignores bargaining in the BFW. This is misleading. Whether or not Dr. Noll’s deviation from the C&Y Model is ultimately justified, it is important to understand the nature of his deviation. By assuming that it is unnecessary to model bargaining between RSNs and MVPDs in the BFW, Dr. Noll is not suggesting that no bargaining between the RSNs and MVPDs would occur. He is suggesting that to capture the results of

132 Noll Decl. at 102.

133 Day 3 Tr. at 447.

134 For example, Dr. Pakes testified that “[t]he MVPDs don’t enter Dr. Noll’s model at all. They’re just not there,” and likewise, that Dr. Noll “doesn’t assume anything” about the MVPDs. Day 2 Tr. at 299. Accord Reply Mem. at 6-9.
bargaining between RSNs and MVPDs in the BFW, it is unnecessary to model the process of bargaining. It is appropriate to assume that any bargaining will result in profit-maximization for the RSNs — because the RSNs hold the power to control the distribution of their content.

### 3. Other Assumptions Built into Dr. Noll’s Analysis

In addition to the deviation from the C&Y Model, Dr. Noll’s analysis also rests on three methodological assumptions — all contested by defendants — that propel the conclusion that consumers will be better off in the BFW. *First*, Dr. Noll assumes that RSN distribution in the BFW will not be subject to (or subject only to de minimus) “double marginalization,” and therefore, that it is unnecessary to account for double marginalization in the projection of BFW prices. *Second*, Dr. Noll assumes that individual RSNs will pledge their content to the OMP in exchange for one-thirtieth of the overall profit from OMP subscriptions (in baseball) — *i.e.*, Dr. Noll assumes that the RSNs will share in OMP profits equally, such that no individual RSN, regardless of its market power, will be able to negotiate for a higher share of the OMP profits vis-à-vis other RSNs. *Third*, Dr. Noll assumes that the prices of a la carte channels will be set independently from the price of the OMP, and vice versa. In other words, he assumes that the league and the teams will price their broadcasts competitively — at arm’s length — not as
a joint venture.

**B. Dr. Noll’s Supply Side Analysis Meets the Daubert Test**

1. The Lack of Bargaining Between RSNs and MVPDs Is Justified

Defendants attack the exclusion of a bargaining dynamic from Dr. Noll’s analysis on three grounds. *First*, defendants argue that bargaining was the “central innovation” of the C&Y Model,\(^{135}\) which means that when Dr. Noll decided to eschew bargaining, he “deviate[d]” from the only “peer-reviewed or otherwise reliable methodology” that his analysis conceivably relied on.\(^{136}\) *Second*, defendants argue that Dr. Noll’s rationale for why it is unnecessary to model bargaining between RSNs and MVPDs — that “[i]nternet delivery is a competitive substitute for delivery over an MVPD”\(^{137}\) — is implausible. *Third*, defendants argue that Dr. Noll has not justified the assumption running through his entire analysis — that RSNs would continue to exist in the BFW.

a. Deviation from the C&Y Model Is Not *Ipso Facto* Problematic

Defendants’ first argument is, in essence, an appeal to authority —

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\(^{135}\) C&Y at 2. *Accord* Def. Mem. at 15 (arguing that Dr. Noll “eschewed” the core of the C&Y Model).

\(^{136}\) Def. Mem. at 13.

\(^{137}\) Noll Decl. at 102.
because C&Y included a bargaining model, Dr. Noll should have as well. But plaintiffs have pointed to numerous reputable papers that use structural models but do not include a bargaining dynamic. This makes it hard to sustain the claim that by jettisoning bargaining, Dr. Noll’s analysis lost its foundation in “peer-reviewed or otherwise reliable methodolog[ies].” Ultimately, the implicit premise of defendants’ position is that bargaining is always essential to the integrity of a structural model. Plaintiffs have offered more than sufficient evidence to question that premise. It would be more accurate to say that bargaining is often — but not always — essential to the integrity of a structural model, depending on the specific features of an industry.

Here, the parties disagree about whether sports broadcasting is such an industry. The details of that disagreement are not material to defendants’ Daubert challenge. Plaintiffs argue that “modeling bargaining is not called for where

138 See Memorandum of Law in Opposition to Defendants’ Joint Motion to Exclude Opinions and Testimony of Plaintiffs’ Expert Dr. Roger G. Noll (“Opp. Mem.”), at 11 n.7 (noting that “since C&Y was published,” there has been “a significant number of papers by well-known economists in top-tier journals that employ structural models without bargaining” — and listing examples). It is also worth noting that Dr. Crawford and Dr. Yurukoglu, the creators of the C&Y Model, worked with Dr. Noll in crafting his analysis. See 10/22/14 Letter from Plaintiffs to the Court, at 2 (Dkt. No. 273).

139 Def. Mem. at 13.
products are relatively similar.” And as a conceptual matter, defendants agree. As Dr. Pakes explained during the hearing,

if there’s only one good that the producer is producing and there’s only one good that the [distributor] is marketing, then it makes sense . . . to devise a contract where we maximize the joint profits from the endeavor and split it somehow between the two.\textsuperscript{141}

When products are similar, it can be assumed that actors at different levels of a vertical supply-chain (such as RSNs and MVPDs) will negotiate fee-splitting arrangements that replicate acting in concert, which means from the perspective of consumers — and for the purpose of assessing consumer prices — no bargaining model is required. The real issue, then, is not whether it is sometimes permissible to jettison bargaining from a structural model, but rather, whether plaintiffs were right to do so in this case. And that is a question that deserves “[v]igorous cross-examination” at trial.\textsuperscript{142}

\textbf{b. Dr. Noll’s Assumption About Internet-TV Substitution Is Plausible}

Defendants’ second argument — while more promising — goes to the weight, not the reliability, of Dr. Noll’s analysis of the Supply Side. For analytic

\textsuperscript{140} Opp. Mem. at 12.

\textsuperscript{141} Day 2 Tr. at 304.

\textsuperscript{142} \textit{Amorgianos}, 303 F.3d at 267 (internal citations omitted).
purposes, Dr. Noll’s rationale for jettisoning bargaining can be expressed in conditional form — if (1) the Internet distribution of baseball and hockey broadcasting is a competitive substitute for the television distribution of such broadcasting, then (2) MVPDs will lack bargaining power in the BFW.

Defendants dispute both steps of this logic. First, they argue that Dr. Noll has not proven his factual hypothesis — he has not shown that Internet distribution serves as a competitive substitute for television distribution. Furthermore, even if Dr. Noll has proven his hypothesis prospectively — that plaintiffs are correct that Internet distribution increasingly will serve as a competitive substitute for television distribution — it did not do so during much of the class period. Defendants are correct — plaintiffs have not convincingly shown that Dr. Noll’s assumptions regarding Internet distribution were true at all points during the class period. But this observation is only relevant for the purpose of damages, not for the purpose of injunctive and declaratory relief. With respect to the latter, Dr. Noll’s assumption carries its burden. In light of the way content distribution — across industries — has evolved in recent years and continues to evolve, it is plausible that Internet distribution will increasingly serve

\[\text{See Def. Mem. at 17.}\]

\[\text{See Certification Opinion (certifying an injunctive class under Rule 23(b)(2), but not a damages class under Rule 23(b)(3)).}\]
as a competitive substitute for television distribution. This is not to say that Dr. Noll’s premise is ultimately correct. But it is sturdy enough to survive a Daubert challenge.

Second, defendants also take issue with the conclusion of Dr. Noll’s argument regarding Internet distribution. Assuming, arguendo, that Internet distribution and television distribution would serve as competitive substitutes from the perspective of consumers, it does not follow, in defendants’ view, that MVPDs would lack bargaining power. For support, defendants point to the fact that in the actual world, “the RSNs’ [] business model is premised upon negotiating for carriage [of the content they produce] on MVPDs.”¹⁴⁵ In other words, RSNs receive most of their revenue today from “carriage fees” paid by MVPDs in exchange for the right to distribute baseball and hockey broadcasts. According to defendants, it therefore strains credulity to conclude that RSNs’ negotiation for carriage on MVPDs, a key source of revenue today, would disappear entirely from the BFW.

This argument is a red herring. The observation that RSNs currently derive much of their business from carriage on MVPDs, though true, sheds no light on the contours of the BFW. In the actual world, RSNs are effectively forced to

¹⁴⁵ Def. Mem. at 17.
derive business from carriage on MVPDs. The whole point of plaintiffs’ legal theory is that in the BFW, RSNs would have another way of making profits — by selling directly to consumers via the Internet.

If RSNs made a greater share of their profits by selling directly to consumers, it follows logically that they would make a lesser share of their profits from carriage fees. But this observation, on its own, does not help defendants’ position. They argue that “MVPDs will not pay [the same] carriage fees” they do in the actual world, if, in the BFW, “consumers can bypass the MVPDs and obtain the same programming [online].” While true, all this implies is that in the BFW, RSN profits would have a different composition — that a greater ratio of profit would come from Internet distribution — as a result of a new equilibrium in the market for baseball and hockey broadcasting. From that, however, it does not follow that MVPDs will have bargaining power in the BFW. On the contrary, the upshot of Dr. Noll’s analysis is that whatever equilibrium emerges in the BFW, it will be the product of Supply Side renegotiations in which RSNs have a much stronger bargaining position.

c. The Existence of RSNs in the BFW

Finally, defendants argue that Dr. Noll has not justified his threshold

146 Id.
assumption that RSNs would exist in the BFW. According to defendants, this is hardly a foregone conclusion, for “it is not clear what role, if any, [RSNs] would have in the BFW given that RSNs are by definition ‘regional’ and fundamentally a byproduct of [territorial restraints].” 147 Indeed, “in a world with no territorial limitations” — i.e., in the BFW — “popular clubs seeking national distribution could exercise leverage by threatening to negotiate deals directly with national networks or [] MVPDs.” 148 If so, then RSNs, far from having more bargaining power in the BFW, would have virtually none.

The problem with this argument is that the issue of who produces baseball and hockey broadcasts has no bearing on how those broadcasts are priced. When Dr. Noll describes the BFW in narrative form, defendants are correct that he identifies RSNs as the producers of baseball and hockey broadcasts. But Dr. Noll’s invocation of RSNs is simply a holdover from the actual world, not an essential feature of his analysis. The point is that whoever produces the broadcasts, Dr. Noll’s prediction is that the broadcasts will end up being distributed to consumers at lower prices than in the actual world — i.e., that the supply chain in the BFW, however it is precisely configured, will settle to a competitive, profit-

147 Id. at 18.
148 Id.
maximizing equilibrium. That prediction may end up being wrong. But if so, it will be wrong for reasons that have nothing to do with what entity — RSNs, other production outfits, or the clubs themselves, producing broadcasts in-house — is responsible for creating content in the BFW. Not surprisingly, defendants have made no effort to connect their observation that clubs could bypass RSNs in the BFW to a claim about *prices* in the BFW. No such connection exists.

2. Dr. Noll’s Other Assumptions Go to the Weight, Not the Reliability, of His Supply Side Analysis

   a. No Double Marginalization

   *First*, defendants fault Dr. Noll for failing to account for the phenomenon of “double marginalization,” which, according to defendants, stems from “the fact that independent businesses in vertical supply relationships” — here, RSNs and MVPDs — “*each* set a price to earn a profit.”\(^{149}\) This complaint mirrors defendants’ complaint about the lack of bargaining, in that defendants are essentially taking the position that *all* supply-chains with tiered mark-ups result in double marginalization — just as they take the position that all structural models should incorporate bargaining — while plaintiffs maintain that only *some* supply-chains with tiered mark-ups result in double marginalization.

   Plaintiffs have the better of this argument. Double marginalization

\(^{149}\) Reply Mem. at 9.
refers to the adverse economic consequences that flow from a supply chain in which two monopolists command super-competitive prices in vertical sequence. When this occurs, the result is that prices rise so high, and output diminishes so much, that (1) consumers lose out, but also (2) both monopolists are worse off than they would be if they acted in concert. In this sense, double marginalization is bad for all parties involved — producers as well as consumers — because prices are marked up to super-competitive levels twice over, which causes demand to plummet, curbing overall profit. Accordingly, producers always have an incentive to avoid double marginalization whenever possible.

This observation alone disposes of defendants’ argument. Given that producers have a natural incentive to avoid double marginalization whenever possible, the question is whether it is possible, in this particular market, for producers to avoid double marginalization. That is an issue of fact, not one of methodological integrity. As such, it does not support a Daubert challenge. Plaintiffs argue that in the BFW, RSNs and MVPDs would not tolerate any significant amount of double marginalization, and that they would use profit-sharing mechanisms — mechanisms already established in the industry — to circumvent double marginalization.150 To this, defendants respond that certain

150 See Opp. Mem. at 14 nn.15-16 and accompanying text (explaining how, in the actual world, contracts between clubs, RSNs, and MVPDs are designed
features of the sports broadcasting industry are likely to frustrate the circumvention
effort.\textsuperscript{151}

There is room for reasonable disagreement about which side has the
more compelling view of the sports broadcasting industry.\textsuperscript{152} At this stage, suffice
it to say that Dr. Noll’s decision to assume the existence of an outcome that
generally works to the benefit of \textit{all} interested parties does not warrant the
exclusion of his testimony under \textit{Daubert}.

\textbf{b. Feeds to the OMP}

\textit{Second}, defendants believe Dr. Noll has made the implausible
assumption that RSNs would pledge their broadcasts to the OMPs in exchange for
one-thirtieth of the OMPs’ overall profits (in baseball). According to defendants,

\textsuperscript{151} \textit{See} Reply Mem. at 9-10. \textit{Accord} Day 1 Tr. 152-154 (Dr. Noll discussed
the mechanisms currently in use, and that would continue to be used, to avoid
double marginalization in sports broadcasting — \textit{e.g.}, setting mandatory retail
prices).

\textsuperscript{152} In passing, it bears note that even the authors of the C\&Y Model —
Crawford and Yurukoglu — appreciated this feature of the television broadcasting
industry. \textit{See} C\&Y at 14 n.43 (acknowledg[ing] that their pricing assumptions are
“often considered unrealistic” due to the availability of means to circumvent
double-marginalization).
more popular clubs — e.g., the Yankees — would have an incentive to demand more than one-thirtieth of the overall share, because their broadcasts are comparatively more valuable than other clubs’ broadcasts. In short, why would clubs like the Yankees not simply withdraw from the bundle and sell their content exclusively a la carte?

To this, plaintiffs offer two responses. First, they point out that in the actual world, teams are prohibited — by league rules — from withdrawing from the bundle. In this sense, Dr. Noll is simply making the modest assumption that current league rules would stay intact. Second, plaintiffs argue that even granting defendants’ premise — that the league rules could change in the BFW — there is no economic reason to think they would change.

Because plaintiffs’ first response disposes of the Daubert question, it is unnecessary to address the second. Regardless of whether Dr. Noll was ultimately right to assume that league rules would stay constant in the BFW, the assumption is not an economic one. Rather, it is a factual assumption about the leagues as institutions. That this assumption has economic implications — potentially quite significant ones — does not change its nature. Assuming that current league rules will stay intact in the BFW is akin to assuming that in the BFW, the baseball season will continue to be one hundred and sixty-two games, or
that baseball playoffs will continue to consist of three rounds (rather than — as is
the case in hockey — four). In principle, there is nothing stopping the league from
modifying the length of the season, or changing the format of playoffs; just as, in
principle, there is nothing stopping the league from reforming its rules regarding
RSN feeds. To hypothesize that the status quo will persist, however, is not an
unreasonable factual assumption, even if it is a factual assumption that ends up
being wrong.

The thrust of defendants’ argument to the contrary is that
economically, there are reasons to think that current league rules will not stay
intact in the BFW — because it would be in the interest of many clubs to dissolve
the rules and permit deviation from the bundle. Plaintiffs disagree.153 But

153 Defendants argue that if the Yankees were to withdraw from the OMP
in the BFW (assuming the parameters of the BFW set by Dr. Noll’s analysis), all
teams would be better off — making the result economically rational. See Reply
Mem. 10-11. In response, plaintiffs suggest that this result, though accurate, is
misleading. Every lucrative club would have an incentive to withdraw, to the point
that the OMP, having lost its most valuable content, would cease to exist.
According to plaintiffs, it is well-established that, on balance, the OMP is lucrative
— i.e., the clubs would prefer that the OMP exist. Given this, and given the fact
that allowing individual clubs to withdraw from the OMP would result in the
OMP’s demise, plaintiffs reason that the league would decide to preclude
individual clubs from peeling off — just as it does today. As Dr. Noll put it, this
“problem [] is always true of collaborations [] in a world in which there is revenue
sharing,” because “it’s always the case that the most valuable member of the
collaboration doesn’t have a private incentive to participate” but “[will] still agree
to [collaborate] because it’s in their collective interests to do so.” Day 3 Tr. at 464-
465. In plaintiffs’ view, in other words, the league-mandated inclusion of feeds for
regardless of which side is ultimately correct, the important point at this stage is that defendants’ argument is not only an economic claim; it is also a claim about how the leagues operate. Specifically, defendants’ argument rests on the premise that individual clubs’ economic interests determine the content of league rules. This is not necessarily true. Leagues self-govern in different ways, with any number of motivations. The economic impact of league rules on individual clubs is one motivation — but hardly the only one. At trial, defendants are free to argue that the league rules would change in the BFW. But that argument will bear on the weight of Dr. Noll’s testimony, not its admissibility.

In a sense, defendants’ argument about league rules falls prey to the same problem as their argument about double marginalization. In each setting, Dr. Noll has made an assumption that, even if it proves unconvincing on the facts, is facially plausible — indeed, a good deal more plausible than the contrary assumption. First, Dr. Noll has assumed that RSNs and MVPDs will take steps to circumvent an outcome — double marginalization — that typically undermines the interests of all actors within the market. Second, Dr. Noll has assumed that current league rules will stay intact. For the reasons just discussed, this position may turn out to be wrong. But it strains credulity to suggest that this assumption is so
unreliable as to merit discarding Dr. Noll’s Supply Side analysis.

c. Joint Venture Pricing

Third, and finally, defendants argue that Dr. Noll erred in assuming that in the BFW (1) the price of the OMPs and (2) the prices of a la carte channels would be set competitively — as though the league and its clubs operate at arm’s length. According to defendants, the more accurate model of the leagues and its clubs would be that of a joint venture. If so, the proper framework for predicting prices would be a “multi-product pricing” model — a framework whose economic viability is “uncontested,” and whose application “would result in higher prices for the two products” at issue here, the OMPs and the a la carte channels. 

Plaintiffs’ response is simple. If the league and the clubs were to set prices as a joint venture, according to a “multi-product pricing” model, that itself would be collusive. Put simply, the reason Dr. Noll assumed that prices would be set competitively in the BFW is that to assume otherwise would be, in effect, to allow “the leagues [to] replace the current anticompetitive prices (and inflated prices) with other anticompetitive prices in the BFW.” This is a legal argument, not an economic argument — but it is a legal argument that, in Dr. Noll’s view,

154 Reply Mem. at 12.
155 Opp. Mem. at 16.
sets the parameters of “legitimate” economic modeling. Indeed, when defense counsel pressed Dr. Noll during the hearing about his decision to model prices competitively, the following exchange ensued:

Dr. Noll: [Your experts] think it’s perfectly fine for a standalone joint venture to act in a way that attempts to maximize the horizontal competitors’ joint profits. That’s fine. I don’t think that’s a legitimate way to model it; your experts do.

Defense Counsel: Are you saying it’s unlawful?

Dr. Noll: I don’t know whether it’s unlawful. I’m simply saying I believe that it’s illegitimate as [an] economist to have cooperative price-setting among horizontal competitors as the way you try to figure out damages in an antitrust case. I think that’s not [correct].

In response, defendants argue that Dr. Noll has overlooked the fact that in the BFW, each club would “have a unilateral incentive to take into account the effect on the related party” — i.e., the league — “when setting price[s].” In other words, multi-product pricing would occur as a natural byproduct of the fact that the clubs and the league have intertwined interests; no top-down coordination would be necessary. It is one thing to hypothesize that the clubs would “take into account the effect” of their prices on the league, and on the OMP. It is quite

156 Day 3 Tr. at 505.
157 Id.
158 Reply Mem. at 12 (emphasis in original).
another to model prices in the BFW the same way that — to borrow an example from defendants’ expert, Dr. Pakes — a car company (“GM”) sets the prices of two different brands that it owns (“Chevy” and “Pontiac”). If Chevy and Pontiac were owned by different companies, the prices of both cars would naturally settle at a competitive equilibrium — just as Dr. Noll argues that prices of the OMP and the a la carte channels would. But “what happens if Chevy and Pontiac are [both owned by] GM?” According to Dr. Pakes:

[N]ow GM is setting the price for both. They own both products. They get the profits from both products. So [GM would] increase the price of the Pontiac by one dollar. It gets a dollar from everybody who stays, and some people leave, but [unlike in the scenario where Chevy is owned by another company] they don’t lose the mark-up on everybody who leaves. Why? Because some of the people who leave go to the Chevy because it’s also a family-sized car. So they’ll keep increasing the price more until that equilibrium is established again. So that’s what’s going on in multiproduct pricing. [And] [y]ou can . . . show [mathematically that] it has to increase pricing.

Dr. Noll decided that analyzing BFW prices this way would violate “legitimate” principles of economic modeling — in essence, because he thought it would reflect collusion. Defendants respond that Dr. Noll is wrong on the law; that in fact, multi-product pricing would occur in the BFW “without []

159 Day 2 Tr. at 306.
collusion.” But this does not dispose of the legal question — it *begs* the legal question. The Supreme Court has made it quite clear that joint ventures are not immune from the antitrust laws. In this setting, they are subject to Rule of Reason analysis. Whether or not the particular type of multi-product pricing hypothesized by defendants would survive Rule of Reason scrutiny is unclear. It presents a complicated legal question. What *is* clear is that Dr. Noll can hardly be faulted, at this stage, for failing to incorporate into his analysis “a collusive practice that he [] believes is illegal.” For now, the assumption about competitive pricing stands.

3. Dr. Noll’s Testimony About the Supply Side, Extracted from the Damages Model, Is Admissible

160 Reply Mem. at 12.

161 *See American Needle, Inc. v. National Football League*, 560 U.S. 183, 200-02 (2010) (explaining that joint ventures, insofar as they give would-be competitors cover for collusive action, trigger antitrust scrutiny). *See also Starr v. Sony BMG Music Entm’t*, 592 F.3d 314, 327 (2d Cir. 2010) (noting that the activities of joint ventures are subject to the Rule of Reason). For further background on the Rule of Reason itself, see *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 885 (2007) (“The rule of reason is the accepted standard for testing whether a practice restrains trade in violation of § 1 [of the Sherman Act]. . . . ‘Under this rule, the factfinder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition.’”) (citing *Continental T. V., Inc. v. GTE Sylvania*, 433 U.S. 36, 49 (1977)).

162 Day 3 Tr. at 524.
The final question is whether the Supply Side analysis can be analytically severed from Dr. Noll’s damages model. The answer is yes. Because the damages model lacks a solid foundation in existing data, it does not reliably demonstrate whether, and how much, class members were overcharged for OMPs. But nothing about that defect spills over to Dr. Noll’s Supply Side analysis. The shortcoming of Dr. Noll’s Demand Side analysis — and the unreliability of his damage calculations — holds true whether or not the Supply Side is properly configured. The admissibility of Dr. Noll’s Supply Side analysis stands (or falls) on its own.

For the reasons set forth above, I conclude that Dr. Noll’s Supply Side analysis, extracted from the damages model, survives scrutiny under Rule 702. Some or all of Dr. Noll’s assumptions about the Supply Side may end up being unconvincing — which would weaken plaintiffs’ case on the merits. But that issue must be resolved by a fact-finder. It would be inappropriate for the Court to exclude Dr. Noll’s Supply Side analysis at this stage.

VI. CONCLUSION

For the reasons set forth above, defendants’ motion to exclude the opinions and testimony of Dr. Roger Noll is GRANTED in part and DENIED in part. The Clerk of the Court is directed to close this motion, Dkt. No. 277 in 12
Civ. 1817, and Dkt. No. 354 in 12 Civ. 3704.

SO ORDERED:

[Signature]
Shira A. Scheindlin
U.S.D.J.

Dated: May 14, 2015
New York, New York
- Appearances -

For Plaintiffs:

Edward A. Diver, Esq.
Howard I. Langer, Esq.
Peter E. Leckman, Esq.
Langer Grogan & Diver, P.C.
Three Logan Square, Suite 4130
1717 Arch Street
Philadelphia, Pennsylvania 19103
(215) 320-5663

Kevin M. Costello, Esq.
Gary E. Klein, Esq.
Klein Kavanagh Costello, LLP
85 Merrimac St., 4th Floor
Boston, Massachusetts 02114
(617) 357-5034

Michael Morris Buchman, Esq.
John A. Ioannou, Esq.
Motley Rice, LLC
600 Third Avenue
New York, New York 10016
(212) 577-0040

Marc I. Gross, Esq.
Adam G. Kurtz, Esq.
Pomerantz, LLP
600 Third Avenue
New York, New York 10016
(212) 661-1100

Robert LaRocca, Esq.
Kohn, Swift & Graf, P.C.
One South Broad Street
Suite 2100
Philadelphia, Pennsylvania 19107
(215) 238-1700

J. Douglas Richards, Esq.
Jeffrey Dubner, Esq.
Cohen, Milstein, Sellers & Toll, PLLC
88 Pine Street
New York, New York 10005
(212) 838-7797

Michael J. Boni, Esq.
Joshua D. Snyder, Esq.
Boni & Zack, LLC
15 St. Asaphs Road
Bala Cynwyd, Pennsylvania 19004
(610) 822-0200


Beth A. Wilkinson, Esq.
Samantha P. Bateman, Esq.
Paul, Weiss, Rifkind Wharton & Garrison LLP
2001 K St. NW
Washington, D.C. 20006
(202) 223-7300

Bradley I. Ruskin, Esq.
Helene Debra Jaffe, Esq.
Jennifer R. Scullion, Esq.
Colin Kass, Esq.
Proskauer Rose LLP
11 Times Square
New York, New York 10036
(212) 969-3465

Thomas J. Ostertag, Esq.
Senior Vice President and General Counsel
Office of the Commissioner of Baseball
245 Park Avenue
New York, New York 10167
(212) 931-7855


Shepard Goldfein, Esq.
James A. Keyte, Esq.
Paul M. Eckles, Esq.
Matthew M. Martino, Esq.
Skadden, Arps, Slate, Meagher & Flom LLP
Four Times Square
New York, New York 10036
(212) 735-3000


Arthur J. Burke, Esq.
James W. Haldin, Esq.
Davis Polk & Wardwell
450 Lexington Avenue
New York, New York 10017
(212) 450-4000

For Defendants DIRECTV, LLC, DIRECTV Sports Networks, LLC, DIRECTV Sports Net Pittsburgh, LLC a/k/a Root Sports Pittsburgh, DIRECTV Sports Net Rocky Mountain, LLC a/k/a Root Sports Rocky
Mountain, and DIRECTV Sports Net Northwest, LLC a/ka/a Root Sports Northwest:

Louis A. Karasik, Esq.
Andrew E. Paris, Esq.
Stephanie A. Jones, Esq.
Alston & Bird LLP
333 South Hope Street, 16th Floor
Los Angeles, California 90071
(213) 576-1000

For Defendant New York Yankees Partnership:

Jonathan Schiller, Esq.
Alan Vickery, Esq.
Christopher Duffy, Esq.
Boies, Schiller & Flexner LLP
575 Lexington Avenue
New York, New York 10022
(212) 849-2300

For Defendants The Madison Square Garden Company and New York Rangers Hockey Club:

Stephen R. Neuwirth, Esq.
Deborah Brown, Esq.
Richard I. Werder, Jr., Esq.
Quinn Emanuel Urquhart & Sullivan, LLP
51 Madison Avenue, 22nd Floor
New York, New York 10010
(212) 849-7000

For Defendant Yankees Entertainment Sports Network, LLC:

John E. Schmidtlein, Esq.
Kenneth Charles Smurzynski, Esq.
James Harris Weingarten, Esq.
William Jefferson Vigen, Esq.
In a companion Opinion issued today, I held that the damages model
submitted by plaintiffs’ expert, Dr. Roger Noll, must be excluded as unreliable under Daubert.\(^1\) The purpose of this Opinion (the “Certification Opinion”) is to address whether the litigation may proceed on a class-wide basis. Plaintiffs have moved to certify two classes — first, the class of consumers “who purchased [] ‘out-of-market package[s]’ . . . online” (the “Internet Class”),\(^2\) and second, the class of consumers “who purchased [] ‘out-of-market packages’ . . . through their television provider” (the “TV Class”).\(^3\) With respect to both classes, plaintiffs seek

\(^1\) See Daubert Opinion.

\(^2\) Amended Class Action Complaint and Jury Trial Demand (“Complaint”) ¶ 15. Accord Memorandum of Law in Support of Plaintiffs’ Motion for Class Certification and Appointment of Class Counsel (“Pl. Mem.”), at 5.

\(^3\) Complaint ¶ 15. Accord Pl. Mem. at 5. Originally, plaintiffs identified a third class of plaintiffs — those who “purchased a cable package that includes a network that is protected from competition.” Complaint ¶ 15. This class was dismissed from the case, however, in December 2012, when I held that “[p]ermitting any plaintiff who simply purchased cable or satellite programming to sue would create a class of plaintiffs for whom it is merely coincidental that they purchased [baseball and hockey programming] at all,” and accordingly granted defendants’ motion to dismiss as to “plaintiffs who merely subscribe to [a basic cable package], but do not subscribe to an out-of-market package.” Laumann v. National Hockey League, 907 F. Supp. 2d 465, 484 (S.D.N.Y. 2012). Nevertheless, to say that consumers who purchased only a cable package are no longer in the case is not to say that no remaining plaintiffs have standing to challenge the allegedly elevated price of cable packages that stems from the complained-of restraints. If territorial exclusivity is responsible for raising the prices of cable packages in general — in addition to the other harms that plaintiffs have alleged, which relate to the league-wide bundles, specifically — all of these harms will be remedied by the same injunctive relief, should plaintiffs prevail on the merits. In other words, no independent class is necessary to address the
certification under Rule 23(b)(2) as well as Rule 23(b)(3). For the reasons set forth below, plaintiffs’ motion for (b)(2) certification is GRANTED, and their motion for (b)(3) certification is DENIED.

II. BACKGROUND

These actions — Garber v. MLB and Laumann v. NHL — are antitrust challenges to sports broadcasting. Both cases rest on the same legal theory. Plaintiffs allege that Major League Baseball (“MLB”) and the National Hockey League (“NHL”), along with the regional sports networks (“RSNs”) that produce their games, have entered into agreements with multichannel video programming distributors (“MVPDs”) — DirectTV and Comcast — that limit options, and increase prices, for baseball and hockey fans who want to watch teams from outside the home television territory (“HTT”) where the fans live. According to plaintiffs, defendants’ multilateral agreements impose conditions of “territorial exclusivity” that restrain individual teams and RSNs — such as the Yankees Entertainment Sports Network (“YES Network”) — from selling their content directly to fans outside the HTT (in the Yankees’ case, New York and New

elevated price of cable packages. Rather, the TV Class, by challenging the impact of territorial restraints on league-wide bundles, will simultaneously challenge the elevated cost of cable packages, if any, that stems from those same restraints.
According to plaintiffs, the ultimate consequence of this arrangement is that a Yankees fan living in Iowa who wants full access to a season’s worth of Yankees games has to buy an “out-of-market package” ("OMP") — a bundle of all out-of-market games, from every team — instead of simply buying the YES Network. In plaintiffs’ view, this restraint is unnatural and anticompetitive. In its absence, RSNs would distribute their content nationwide in a la carte form, and an Iowa-based Yankees fan (for instance) would be able to choose between (1) buying the YES Network by itself, or (2) buying an OMP. Furthermore, the competition between these options would also push the price of the OMP down. For the Yankees fan in Iowa, therefore, the “but-for world” ("BFW") — the world without the complained-of restraints — would involve two distinct but mutually reinforcing benefits. First, out-of-market fans would have more options for

4 See Pl. Mem. at 2, 4.

5 See id. at 4 ("Clubs and their RSN partners are prevented from distributing their games outside [HTTs] to prevent consumers from choosing to watch their programming instead of the programming of the protected broadcaster in the consumer’s territory. These restraints limit the choices that would [otherwise] be available to all class members.").

6 See id. at 4-5.

7 See id.
watching the games of their preferred teams. *Second*, all fans, whether they primarily follow their home teams or out-of-market teams, would be able to pay less for the OMP.

Defendants have a less sanguine vision of the BFW. Although they concede — as they must — that the complained-of restraints limit consumer choice, defendants argue that the restraints are what make it profitable for teams and RSNs to broadcast their games at all. In this sense, plaintiffs’ position overlooks the “incentives that drive the telecasting of MLB and NHL games in the actual world.”

Lift the restraints, defendants argue, and “[t]he end result would be that the [OMP] either would not be available at all in the BFW, or else [it] would be priced much higher than [it is] today.” The implication here, according to defendants, is that the BFW would contain “winners and losers.” The winners would be out-of-market consumers who, given the choice, would prefer to buy an a la carte RSN (and, in the actual world, are unable to do so). The losers would be consumers who, even given the choice to buy a la carte, would continue to prefer the OMP. They would “lose” insofar as the OMP would either cost more or disappear.

8 Defendants’ Corrected Joint Memorandum of Law in Opposition to Class Certification (‘Def. Mem.’), at 1.

9 Id. at 2.
With respect to class certification, defendants make essentially two arguments. First, they argue that the winners and losers hypothesis — the likelihood that the BFW would be favorable to some consumers and detrimental to others — makes the putative classes inherently fractious, frustrating certification. Put simply, “no class can be certified where a substantial number of class members [would be] worse off” absent the disputed conduct. Second, with respect to certification under Rule 23(b)(2), in particular, defendants argue that many members of the putative class have no standing to request injunctive or declaratory relief, because they no longer subscribe to OMPs, and therefore they are no longer consumers in the relevant market.

A. Different Forms of Exclusivity

Confusion persists — even this many years into the case — about the exact practices that plaintiffs are challenging. Therefore, it will be helpful to begin by carefully distinguishing three different types of “exclusivity.”

In addition to these arguments, defendants also argue that plaintiffs’ damages model is not sufficiently related to their theory of liability, making (b)(3) certification inappropriate under Comcast v. Behrend. See 133 S. Ct. 1426 (2013). See also Roach v. T.L. Cannon Corp., 778 F.3d 401, 407 (2d Cir. 2015) (“Comcast held that a model for determining class-wide damages relied upon to certify a class under Rule 23(b)(3) must actually measure damages that result from the class’s asserted theory of injury.”). Because I conclude that (b)(3) certification is inappropriate on other grounds, the Comcast objection is moot.

Def. Mem. at 4.
1. **Territorial Exclusivity**

First, there is “territorial exclusivity,” which refers to the inability of individual teams and RSNs to sell their content directly to consumers outside of their HTTs. Territorial exclusivity is a product of multilateral agreements among the leagues, the RSNs, and the MVPDs. In the absence of such agreements, it would be in the interest of at least some (and perhaps all) RSNs to sell their content a la carte, either over the Internet or through the MVPDs. Defendants do not dispute the existence of territorial exclusivity in the actual world; nor do they dispute that territorial exclusivity is the product of deliberate cooperation among actors in the supply chain. Rather, the core dispute in this case — on the merits — is whether the procompetitive benefits of territorial exclusivity outstrip its anticompetitive effects, once all of its economic effects are taken into account. There can be no question, however, that territorial exclusivity is anticompetitive — it reflects an explicit agreement among competitors, purposely designed to prevent competition. The question is whether, by doing so, territorial exclusivity enhances consumer welfare overall.

2. **Content Exclusivity**

Second, there is “context exclusivity,” which refers to the ability of an individual RSN to “make its games available,” if it sees fit, “only to an exclusive
producer in its home market.” Unlike territorial exclusivity, which constrains RSNs, content exclusivity empowers RSNs. Content exclusivity stems from the fact that individual RSNs hold broadcast rights to the games they produce — and under normal principles of intellectual property (“IP”), they are free to license or sell those rights as they see fit. There is, in this sense, nothing anticompetitive about content exclusivity.\(^ {13}\)

3. Game Exclusivity

Third, there is “game exclusivity,” which refers to the monopolization of broadcast rights of a local team’s games within its HTT. Game exclusivity is similar to content exclusivity in that it concerns the ability of an RSN to control the flow of content within its HTT. But game exclusivity is also different from content exclusivity — and more restrictive — insofar as it requires limiting the ability of other RSNs from controlling the flow of their content.\(^ {14}\)

\(^{12}\) Reply Memorandum in Support of Plaintiffs’ Motion for Class Certification (“Reply Mem.”) at 10.

\(^{13}\) To be clear, there is nothing anitcompetitive about content exclusivity beyond the inherently anticompetitive nature of the IP rights from which content exclusivity stems. IP rights operate, conceptually and doctrinally, as an exception to the antitrust laws. Content exclusivity falls within that exception.

\(^{14}\) See id. at 11 (distinguishing between the maintenance of “control over the distribution of particular content” — i.e., content exclusivity — and the “right to constrain distribution of other broadcasts of that sport,” which, in certain forms, can produce game exclusivity).
 Practically speaking, this means that in the actual world, RSNs have both content exclusivity and game exclusivity within their HTT. The YES Network, for example, enjoys content exclusivity insofar as it can dictate how its productions of Yankees games are distributed within its HTT. YES is free to veto certain forms of distribution, or to condition the licensing of its productions on certain constraints — such as blackouts within the OMP. YES is free to do this because its productions are its IP, and, as with any IP-owner, it may do with its IP as it wishes. That would be equally true in the BFW.

In the actual world — unlike the BFW — the YES Network also enjoys game exclusivity over the broadcast of Yankees games in its HTT. Pursuant to multilateral agreement among the teams, the RSNs, and the MVPDs, OMPs currently black out the feeds of both (1) RSNs of the teams within the viewer’s HTT and (2) RSNs of the teams that are playing against the teams within the viewer’s HTT. Concretely, a baseball fan in Brooklyn who purchases an OMP will not be able to watch YES’s content on the OMP; it will be blacked out, forcing her (if she cares about seeing the Yankees) to subscribe to a local cable package. In addition to this, however, the OMP will also black out the feed of whatever team the Yankees are playing. If the Yankees are playing the Red Sox, for example, the New England Sports Network (“NESN Network”) feed will be
unavailable to the Brooklyn subscriber on her OMP. This is what gives the YES Network not just content exclusivity, but *game* exclusivity — it is the only RSN that can broadcast Yankees games within the Yankees’ HTT.

4. The Nature of Plaintiffs’ Challenge

Of these forms of exclusivity, plaintiffs are challenging territorial exclusivity, but they are *not* challenging content exclusivity.\(^{15}\) Furthermore, as a result of plaintiffs’ challenge to territorial exclusivity, game exclusivity would also evaporate in the BFW — not because plaintiffs directly challenge it, but because its existence depends on the existence of territorial exclusivity. In the BFW, all RSNs would be able to (1) sell a la carte programming to out-of-market consumers, and (2) distribute their content through the OMP without blackouts. In practice, this means that RSNs would no longer enjoy game exclusivity with respect to their home team, because *another* RSN — the RSN of whichever team happens to be playing against the home team on a given day — would also be able to broadcast the same game (albeit with different announcers, and so on).

For example, if the Yankees are playing the Red Sox, in the actual

\(^{15}\) *See id.* at 10 (“Plaintiffs are not challenging each individual club’s ability to make its games available only to an exclusive producer in its home market, and nothing in [plaintiffs’ view of the BFW] assumes that clubs will cease to maintain an exclusive relationship with a single RSN for each game in its local territory.”).
world a Yankees fan in Brooklyn would have to watch the game on the YES Network. Even if she subscribed to the OMP, the NESN Network would be blacked out, so as to preserve the YES Network’s game exclusivity. And of course the Yankees fan also would not be able to buy the NESN Network a la carte — that is the point of this lawsuit. In the BFW, by contrast, a Brooklyn resident would be able to watch the Yankees-Red Sox game on either the YES Network or the NESN Network (assuming she had access to the latter through an a la carte channel or the OMP). In this sense, even though the YES Network would still have content exclusivity — it would be free to do as it pleases with the games it produces — it would no longer have game exclusivity in the Yankees’ HTT.

B. The Market for MLB and NHL Broadcasting in the Actual World

With the different forms of exclusivity in mind, this section provides an overview of the Supply Side in the market for sports broadcasting, as it exists today.

1. The Supply Side Overall

RSNs produce baseball and hockey games, which are distributed to consumers in two different ways. First, an individual RSN’s productions are included in local television programming. When a consumer purchases a cable package from an MVPD, that will typically enable her to watch the RSN (or RSNs)
operating within her HTT. Second, game productions — from all RSNs — are bundled together in the OMP, which a consumer can purchase either online or through her MVPD.

Ultimately, then, three different supply chains operate in parallel in the actual world.\(^\text{16}\) In each supply chain, content flows to the right, and payment flows to the left:

**Supply chain one (in-market telecasts)**

Individual team → RSN → MVPDs → In-market consumers that purchase cable packages

**Supply chain two (out-of-market telecasts)**

All teams → RSNs (bundled together) → MVPDs → Consumers that purchase OMPs

**Supply chain three (out-of-market Internet streaming)**

All teams → RSNs (bundled together) → Consumers that purchase OMPs

The question, then, is how these supply chains translate into concrete options for different classes of consumers. The following pair of examples should help answer

\(^{16}\) In-market Internet distribution is not addressed here. For reasons explained in previous opinions, in the actual world “there is no authorized method for viewing local games on the internet.” Laumann, 907 F. Supp. 2d at 475.
this question.

2. Case One — A Yankees Fan in Brooklyn

First, consider a Yankees fan who lives in Brooklyn. In the actual world, she can enjoy full access to Yankees games, through the YES Network, by purchasing a local cable package — because she lives within the HTT, that package will include YES. To watch other teams, however, she will have to purchase an OMP, either through her MVPD or over the Internet. If she does, some of the OMP’s RSN feeds will be blacked out. Specifically, for the entire season, she will be unable to watch the YES Network through the OMP; and on specific nights, she will be unable to watch the RSN of whatever team is playing against the Yankees. Therefore, if she wants access both to Yankees games and to the full slate of other teams’ games, she will have to buy a cable package in addition to an OMP.

3. Case Two — A Yankees Fan in Iowa

Second, consider a Yankees fan who lives in Iowa. In the actual world, if she wants to watch the Yankees, she will have to buy an OMP. There is

17 She will also be able to see games that are carried nationally — as is true of anyone with a basic cable package. Nationwide broadcasts have no bearing on these antitrust actions.

18 Of course, if the Iowa-based Yankees fan has a local cable package, she will be able to watch the Yankees play whenever the opposing teams hails
no way for an Iowa-based fan to get access to Yankees broadcasts through the YES Network — the very same broadcasts that her counterpart in Brooklyn would be able to access simply by virtue of buying a cable package — unless she purchases an OMP. Indeed, even if she subscribes to a local cable package, and the package for some reason includes the YES Network, the actual games played by the Yankees will be blacked out on that channel.\textsuperscript{19}

\textbf{C. The Market for MLB and NHL Broadcasting in the BFW}

What is conspicuously lacking in this picture — and what plaintiffs believe would exist in the absence of league-wide territorial restraints — is direct distribution from RSNs to \textit{out-of-market} consumers. In essence, plaintiffs’ position is that two more supply chains should be added (and, in the BFW, would be added) to the Supply Side. Beyond the three supply chains outlined above, the BFW would also include:

\begin{center}
\textit{from the HTT of Iowa. (Even then, she will have to watch that team’s broadcast, not the YES Network.)} The larger point, however, is that out-of-market fans are forced to buy packages if they want consistent access to the games of their preferred teams.
\end{center}

\textsuperscript{19} Both sides appear to agree that this state of affairs, though uncommon, is possible. \textit{See, e.g.}, 3/19/15 Transcript of Proceedings, Dkt. 343, at 550 (where plaintiffs’ counsel explains that in the actual world, a small number of fans subscribe to out-of-market RSNs as part of their local cable packages, with the games are blacked out, because they “like to watch the shoulder programming”).
Supply chain four (a la carte out-of-market telecasts)
Individual team –> RSN –> MVPDs –> Out-of-market consumers that buy a la carte channels

Supply chain five (a la carte out-of-market Internet streaming)
Individual team –> RSN –> Out-of-market consumers that buy a la carte channels

The next question, then, is what would be the result for consumers if these additional supply chains were, in fact, to emerge. Considering the same pair of examples as before will help answer this question.

1. **Case One — Yankees Fan in Brooklyn**

In the BFW, the Yankees fan in Brooklyn will face similar conditions to the conditions she faces in the actual world. If she purchases an OMP, the YES Network will still be blacked out. So if she wants access to both Yankees games and out-of-market games, she will have to buy a cable package in addition to an OMP. The one thing that will be different about the BFW, however, is that a Brooklyn-based Yankees fan that does not want to buy a cable package will have the option (unlike in the actual world) to watch the Yankees by (1) viewing the

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20 According to plaintiffs, there are economic grounds for hypothesizing that in-market blackouts will subside in the BFW. That may be so. For present purposes, however, the point is that nothing about plaintiffs’ antitrust challenge requires the disappearance of in-market blackouts, because plaintiffs are not challenging content exclusivity.
RSN of the Yankees’ *opposing* team (on any given day) through the OMP, or (2) buying the a la carte RSN of a different team (say, the Red Sox) that frequently plays against the Yankees. But for the large majority of fans that live in the HTT of their preferred team, these changes are likely to be marginal — and practically irrelevant — departures from the status quo.

2. **Case Two — Yankees Fan in Iowa**

   The same is not true of out-of-market fans. If the Brooklyn-based Yankees fan is likely to see little difference — and therefore little upside — from the transition to the BFW, the Iowa-based Yankees fan is likely to see a substantial upside. For her, the BFW will include an option that is unavailable in the actual world — a la carte RSNs. She will be able to purchase the YES Network, either through an MVPD (via her cable package) or directly over the Internet. Furthermore, if she purchases an OMP, she will be able to watch the YES Network, through the OMP, even when the Yankees are playing against a team from her HTT. In the actual word, such broadcasts are blacked out — in order to preserve game exclusivity for RSNs in the Iowa HTT.

D. **The Class-Wide Challenge**

   Plaintiffs seek to certify the TV Class and the Internet Class on the same antitrust theory. According to plaintiffs, every consumer in both classes
faced — and continues to face — a market for baseball and hockey broadcasting in which options are limited, and the prices of existing options are inflated, as a consequence of defendants’ coordinated maintenance of territorial exclusivity. For an in-market fan — a Yankees fan in Brooklyn — this injury takes the form of (1) paying a higher price for the OMP, (2) being subject to black-outs of competing broadcasts within the OMP (e.g., the blacking out of the NESN network when the Yankees play the Red Sox), and (3) lacking the option of subscribing to another team’s a la carte RSN (or multiple teams’ RSNs) in lieu of buying the OMP. For an out-of-market fan — a Yankees fan in Iowa — the injury takes the form of (1) paying a higher price for the OMP and (2) lacking the option of subscribing to another team’s a la carte RSN (or multiple teams’ RSNs) in lieu of buying the OMP.

III. APPLICABLE LAW

A. Class Certification

1. Rule 23(a)

Rule 23(a) permits individuals to sue as representatives of an aggrieved class. To be certified, a putative class must first meet all four prerequisites set forth in Rule 23(a), generally referred to as numerosity,
commonality, typicality, and adequacy.\(^{21}\) District courts have broad discretion in deciding whether to certify a proposed class under Rule 23.\(^{22}\) Here, numerosity is not disputed.\(^{23}\)

\(\textbf{a. Commonality}\)

Rule 23(a)(2) requires that there be “questions of law or fact common to the class.” Commonality thus requires plaintiffs “to demonstrate that the class members ‘have suffered the same injury.’”\(^{24}\) Commonality further requires that the claims asserted “must depend upon a common contention . . . of such a nature that

\(^{21}\) See Teamsters Local 445 Freight Div. Pension Fund v. Bombardier Inc., 546 F.3d 196, 201–02 (2d Cir. 2008). In addition to these requirements — which are explicitly codified in Rule 23 — some courts have also added an “implied requirement of ascertainability” to the express requirements of Rule 23(a).” In re Initial Pub. Offerings Sec. Litig., 471 F.3d 24, 42 (2d Cir. 2006). Accord 7A Charles Alan Wright, Arthur R. Miller, & Mary Kay Kane, Federal Practice and Procedure § 1764 (3d ed. 2008) (“[T]he requirement that there be a class will not be deemed satisfied unless the class description is sufficiently definite so that it is administratively feasible for the court to determine whether a particular individual is a member.”). Here, however, neither of the proposed classes presents such problems. Both classes are readily and precisely ascertainable. Their definitions are tethered directly to a specific, easily-traceable economic decision — i.e., to purchase OMPs.

\(^{22}\) See Parker v. Time Warner Entm’t Co. L.P., 331 F.3d 13, 28 (2d Cir. 2003).

\(^{23}\) See Pl. Mem. at 6 n.4 (“Defendants have indicated that they will not contest numerosity, which is indisputably satisfied.”).

it is capable of classwide resolution — which means that determination of its truth
or falsity will resolve an issue that is central to the validity of each one of the
claims in one stroke.”

b. Typicality

“Typicality ‘requires that the claims of the class representatives be
typical of those of the class, and is satisfied when each class member’s claim arises
from the same course of events[] and each class member makes similar legal
arguments to prove the defendant’s liability.’” The typicality requirement may be
satisfied where “injuries derive from a unitary course of conduct by a single
system.” The purpose of typicality is to ensure that class representatives “have
the incentive to prove all the elements of the cause of action which would be
presented by the individual members of the class were they initiating
individualized actions.”

c. Adequacy

“Adequacy is twofold: the proposed class representative must have an

25 Id.

26 Central States, 504 F.3d at 245 (quoting Robinson v. Metro-N.
Commuter R.R. Co., 267 F.3d 147, 155 (2d Cir. 2001)).


interest in vigorously pursuing the claims of the class, and must have no interests antagonistic to the interests of other class members.\textsuperscript{29} Thus, the question of adequacy “entails inquiry as to whether: 1) plaintiffs’ interests are antagonistic to the interest of other members of the class and 2) plaintiffs’ attorneys are qualified, experienced and able to conduct the litigation.”\textsuperscript{30} In order to defeat a motion for certification, any conflicts between the class representative and members of the putative class must be “fundamental.”\textsuperscript{31}

1. Rule 23(b)

If the requirements of Rule 23(a) are met, the court “must next determine whether the class can be maintained under any one of the three subdivisions of Rule 23(b).”\textsuperscript{32} Here, plaintiffs have moved for certification under Rule 23(b)(2) and Rule 23(b)(3). The standards for each will be discussed in turn.

a. Rule 23(b)(2)

Under Rule 23(b)(2), plaintiffs must show that defendants “acted or

\textsuperscript{29} Denney v. Deutsche Bank AG, 443 F.3d 253, 268 (2d Cir. 2006).

\textsuperscript{30} Baffa v. Donaldson, Lufkin & Jenrette Sec. Corp., 222 F.3d 52, 60 (2d Cir. 2000).

\textsuperscript{31} In re Flag Telecom Holdings, Ltd. Sec. Litig., 574 F.3d 29, 35 (2d Cir. 2009).

\textsuperscript{32} McLaughlin v. American Tobacco Co., 522 F.3d 215, 222 (2d Cir. 2008).
refused to act on grounds that apply generally to the class, so that final injunctive relief or corresponding declaratory relief is appropriate respecting the class as a whole.” As the Supreme Court explained in *Wal-Mart v. Dukes*, with respect to 23(b)(2) classes in particular,

> When a class seeks an indivisible injunction benefitting all its members at once, there is no reason to undertake a case-specific inquiry into whether class issues predominate or whether class action is a superior method of adjudicating the dispute. Predominance and superiority are self-evident.

There are, however, two additional hurdles that plaintiffs must clear in order to certify a (b)(2) class. *First*, plaintiffs must demonstrate that the class is “cohesive.” This requirement is similar, conceptually, to the commonality requirement under Rule 23(a). *Second*, plaintiffs must demonstrate that class certification is, in the first instance, necessary. Because the relief available under Rule 23(b)(2) is injunctive and declaratory — rather than monetary — certification is not always required to secure the rights in question. As the Second Circuit has


*34* 131 S. Ct. 2541 (2011).

*35* *Id.* at 2558.

*36* *See* Newberg on Class Actions § 4:34. *See also* Barnes v. American Tobacco Co., 161 F.3d 127, 143 (3d Cir. 1998) (“While 23(b)(2) class actions have no predominance or superiority requirements, it is well established that the class claims must be cohesive.”); In re MTBE Prods. Liab. Litig., 209 F.R.D. 323, 342-43 (S.D.N.Y. 2002).
explained, certification under Rule 23(b)(2) is unnecessary when “prospective relief will benefit all members of a proposed class to such an extent that the certification of a class would not further the implementation of the judgment.”

This principle is typically reserved, however, to situations where the defendant has stipulated that, in practice, an injunction granted to one plaintiff will be observed on a more general basis — thereby defeating the need for formal certification.

b. Rule 23(b)(3)

Under Rule 23(b)(3), certification is appropriate where “questions of law or fact common to the members of the class predominate over any questions affecting only individual members,” and class litigation “is superior to other available methods for the fair and efficient adjudication of the controversy.”

The matters pertinent to these findings include the class members’ interests in individually controlling the prosecution or defense of separate actions; the extent and nature of any litigation concerning the controversy already begun by or against class members; the desirability or undesirability of concentrating the litigation of the claims in the particular forum; and the likely difficulties in

37 Berger v. Heckler, 771 F.2d 1556, 1566 (2d Cir. 1985) (citing Galvan v. Levine, 490 F.2d 1255, 1261 (2d Cir. 1973)).

38 See Daniels v. City of New York, 199 F.R.D. 513 (S.D.N.Y. 2001) (holding that certification was appropriate even when it was unclear whether a class-wide injunction would have substantially different effects than an individual injunction, because, inter alia, defendants continued to “deny that there [was] any [] policy to withdraw”).
managing a class action.\textsuperscript{39}

The predominance inquiry focuses on whether “a proposed class is ‘sufficiently cohesive to warrant adjudication by representation.’”\textsuperscript{40} It is akin to, but ultimately “a more demanding criterion than,” the “commonality inquiry under Rule 23(a).”\textsuperscript{41} Class-wide issues predominate “if resolution of some of the legal or factual questions that qualify each class member’s case as a genuine controversy can be achieved through generalized proof, and if these particular issues are more substantial than the issues subject only to individualized proof.”\textsuperscript{42} The Second Circuit has emphasized that “Rule 23(b)(3) requires that common questions predominate, not that the action include only common questions.”\textsuperscript{43} In carrying out this inquiry, the court may “consider the ‘. . . improbability that large numbers of class members would possess the initiative to litigate individually.’”\textsuperscript{44}

\begin{footnotes}

\textsuperscript{40} Amgen Inc. v. Connecticut Ret. Plans & Trust Funds, 133 S. Ct. 1184, 1196 (2013) (quoting Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 623 (1997)).

\textsuperscript{41} In re Nassau County Strip Search Cases, 461 F.3d 219, 225 (2d Cir. 2006) (citing Amchem, 521 U.S. at 623-24).

\textsuperscript{42} In re U.S. Foodservice Inc. Pricing Litig., 729 F.3d 108, 118 (2d Cir. 2013) (internal citations omitted).

\textsuperscript{43} Brown v. Kelly, 609 F.3d 467, 484 (2d Cir. 2010).


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B. Antitrust Injuries

Antitrust injuries come in two basic forms. First, anticompetitive conduct is injurious if it results in higher prices. Second, anticompetitive conduct is injurious if it limits consumer options. Although these injuries often overlap in practice, they are economically and analytically distinct. Some restraints raise prices without limiting the qualitative options available to consumers. For example, price-fixing by oil companies would certainly inflate the price of gas, but it would be unlikely to diminish the type of products available to consumers (i.e., whether or not the restraint existed, everyone would buy the same good — gas). The converse is also true. Some restraints limit the number of products in existence without having a significant effect on prices. For example, if banks were to decide, collusively, to include stringent arbitration clauses in all credit card

45 See Port Dock & Stone Corp. v. Oldcastle Northeast Inc., 507 F.3d 117, 123-24 (2d Cir. 2007) (explaining that the “danger” of antitrust violations is that they “raise prices and restrict output,” and compiling case law to that effect).

46 See Ross v. Bank of America, 524 F.3d 217, 226 (2d Cir. 2008) (concluding that reductions in “consumer choice” and the “equality of [] services offered” are antitrust injuries); United States v. Visa USA, 344 F.3d 229, 243 (2d Cir. 2003) (explaining that restraints that discourage firms from “design[ing] . . . their products more competitively” can give rise to antitrust injury); Laumann, 907 F. Supp. 2d at 480 (“Reduced consumer choice . . . when [it is] the result of an anticompetitive practice, constitute[s] antitrust injury.”).
contracts, this would be unlikely to affect the price of anything, but it would
certainly diminish consumer choice — and constitute an antitrust injury on that
basis alone.\textsuperscript{47}

\section*{C. Standing}

As discussed at length in my December 5, 2012 opinion — and
rehearsed only briefly here — for an antitrust claim to be justiciable, a plaintiff (or
class of plaintiffs) must demonstrate two distinct types of standing.\textsuperscript{48} \textit{First}, as in
all federal actions, a plaintiff must satisfy the threshold requirements of Article III.
If those requirements are wanting, the Court lacks jurisdiction to adjudicate the
dispute. \textit{Second}, a plaintiff must satisfy the requirements of “antitrust standing” —
a more granular set of requirements fashioned by the Supreme Court to ensure that
plaintiffs are well-situated to redress harm that, due to the nature of antitrust
injuries, often impact the economy as a whole.

\subsection*{1. Article III Standing}

\textsuperscript{47} \textit{See Ross}, 524 F.3d at 222-25.

\textsuperscript{48} \textit{See Laumann}, 907 F. Supp. 2d at 480-85. \textit{See also Ross}, 524 F.3d at
223-25 (distinguishing between “adequately alleg[ing] antitrust injuries in fact,”
sufficient to trigger constitutional standing, and satisfying the requirements of
antitrust standing, which “demands a much more detailed and focused inquiry into
a plaintiff’s [] claims”); \textit{KSW Mechanical Serv., Inc. v. Mechanical Contractors
(explaining the difference between constitutional and antitrust standing).
Because “Article III, Section 2, of the United States Constitution limits federal courts’ jurisdiction to ‘Cases’ and ‘Controversies,’” a party “seeking to bring suit in federal court must establish standing under Article III.”\textsuperscript{49} To do so, the party must show, \textit{inter alia}, that she “ha[s] suffered an ‘injury in fact’— that is, ‘an invasion of a legally protected interest which is (a) concrete and particularized and (b) actual or imminent, not conjectural or hypothetical.’”\textsuperscript{50}

2. \textbf{Antitrust Standing}

Not every party that satisfies the requirements of Article III standing may bring a private antitrust suit. Because anticompetitive conduct, by its nature, often affects many different actors within a given market, the Supreme Court has erected two additional criteria to limit who has “antitrust standing.” \textit{First}, under \textit{Illinois Brick v. Illinois},\textsuperscript{51} a plaintiff must either (1) be a “direct purchaser” in the market where the antitrust violation is alleged, or (2) qualify for one of the recognized exceptions to the “direct purchaser” requirement.\textsuperscript{52} \textit{Second}, under

\begin{footnotesize}
\footnote{\textit{E.M. v. New York City Dep’t of Ed.}, 758 F.3d 442, 449 (2d Cir. 2014).}
\footnote{\textit{Id.} (quoting \textit{Lujan v. Defenders of Wildlife}, 504 U.S. 555, 560 (1992)). In addition to the injury-in-fact requirement, Article III standing also requires a party to show (1) that the injury was caused by defendant, and (2) that it can be redressed in court. There is no dispute about these two elements here.}
\footnote{431 U.S. 720 (1977).}
\footnote{For background on these exceptions, see \textit{Laumann}, 907 F. Supp. 2d at 480-83.}
\end{footnotesize}
Associated General Contractors of California v. California State Council of Carpenters, a plaintiff must be “a consumer . . . in the market in which trade was restrained.” Both requirements are designed to ensure that a plaintiff’s injuries are not “too remote from the alleged conduct” to qualify as antitrust harms.

IV. DISCUSSION

As discussed at length in a companion Opinion issued today, I find the


54 Laumann, 907 F. Supp. 2d at 480. In my December 5, 2012 opinion, I explained that consumers who subscribe (or who previously subscribed) to television OMPs — i.e., members of the TV Class — are not direct purchasers of baseball and hockey broadcasts, because they purchase such broadcasts from MVPDs. Nevertheless, I held that members of the TV Class have standing to bring the present challenge, in light of the “co-conspirator” exception to Illinois Brick. Because the MVPDs are named as co-defendants to this suit, it would be perverse to conclude that their position in the market — sitting between the RSNs that produce broadcasts and the consumers who watch them — somehow strips consumers of antitrust standing. The whole point of plaintiffs’ challenge is that multiple actors in the supply chain, including the MVPDs, conspired to restrain trade. Clearly, the “purpose of Illinois Brick was not to prevent the only non-conspirators in a multi-level distribution chain — consumers no less — from bringing a private antitrust suit.” Id. at 482. Accord In re DDAVP Direct Purchaser Antitrust Litig., 585 F.3d 677, 688 (2d Cir. 2009) (“[B]eing forced to pay supra-competitive prices as a result of the defendants’ anticompetitive conduct [] . . . plainly is [an injury] ‘of the type the antitrust laws were intended to prevent.’”) (citing Brunswick Corp. v. Pueblo Bowl-o-Mat, Inc., 429 U.S. 477, 489 (1977)). Accordingly, I held that members of the TV Class satisfied the Illinois Brick requirement for antitrust standing. This determination comports with Second Circuit and Supreme Court precedent; and it is also law of the case. Thus, the only remaining question of antitrust standing — discussed below — is if previous OMP subscribers still qualify as consumers in the market where trade is restrained.
damages model submitted by plaintiffs’ expert, Dr. Noll, to be inadmissible. As a result, plaintiffs cannot prove their damages case on a class-wide basis. As the Second Circuit has explained, while the need for individualized inquiry into damages does not defeat (b)(3) certification, plaintiffs must nevertheless “show that they can prove, through common evidence, that all class members were . . . injured by the alleged conspiracy.” Here, Dr. Noll’s model was the common evidence — and the model has been excluded. Therefore, no (b)(3) class may be

55 See Roach, 778 F.3d at 405 (“[I]t [is] well-established in [the Second] Circuit that the fact that damages may have to be ascertained on an individual basis is not sufficient to defeat class certification.”) (internal citations omitted).

56 Sykes v. Mel S. Harris & Assoc., 780 F.3d 70, 82 (2d Cir. 2015) (internal citations omitted). Accord Comcast, 133 S. Ct. at 1433 (“Without presenting [a model], respondents cannot show Rule 23(b)(3) predominance: Questions of individual damage calculations will inevitably overwhelm questions common to the class.”).

57 See In re Rail Freight Surcharge Antitrust Litig., 725 F.3d 244, 255 (D.C. Cir. 2013) (“[Plaintiffs’ expert’s] models are essential to the plaintiffs’ claim [that] they can offer common evidence of class-wide injury. No damages model, no predominance, no class certification.”). At the hearing, plaintiffs’ counsel conceded that if the model was stricken on Daubert grounds, the case would have to proceed exclusively on an injunctive basis — under Rule 23(b)(2). See 3/17/15 Transcript of Proceedings, Dkt. 339, at 4-5 (“THE COURT: If I struck [the model] based on the Daubert challenge, could you proceed? COUNSEL: Could we proceed in this case? Absolutely, your Honor. THE COURT: Could you proceed as a class in this case? COUNSEL: Absolutely, your Honor, because, remember, we are seeking not only damages but [also] injunctive relief. And our theory of damages is [an overcharge theory]. If we fail to prove that there is an overcharge” — which would be impossible with the model — “then the result would be that the class members as a whole have not shown any calculable
certified.

But the issue of (b)(2) certification remains. On that front, defendants make essentially two arguments. *First*, they argue that the putative class consists of winners and losers. In defendants’ view, some purchasers of OMPs actually *benefit* from the restraints in dispute, which both defeats the commonality of injury and frustrates the ability of named plaintiffs to adequately represent the interests of all class members. *Second*, defendants argue that because some members of the class no longer subscribe to OMPs, they have no legal interest in the prospective relief sought by named plaintiffs — *i.e.*, they are no longer “consumers in the market where trade is allegedly restrained,” so they have no standing to seek injunctive or declaratory relief going forward. The winners and losers argument is, according to defendants, germane both to the threshold criteria of Rule 23(a) and to the cohesion requirement of Rule 23(b)(2). The standing argument, by contrast, bears exclusively on the cohesion requirement of Rule 23(b)(2).

**A. Winners and Losers**

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58 *Daniel v. American Bd. of Emergency Medicine*, 428 F.3d 408, 451 (2d Cir. 2001). *Accord Associated Gen. Contractors*, 459 U.S. at 539 (the question, for standing purposes, is whether a given plaintiff was “a consumer [] or a competitor in the market in which trade was restrained”).
According to defendants, putting an end to territorial exclusivity would likely result in either (1) consumers having to pay more for OMPs, or (2) the disappearance of OMPs entirely. From this premise, defendants conclude that certain consumers are better off in the actual world than they would be in the BFW — specifically, those consumers that would prefer to buy an OMP, even assuming the availability of a la carte channels. Given this ostensible conflict of interest among the class members, defendants argue that the relief sought by lead plaintiffs is “likely [to] harm a great many absent class members.” Therefore, certification is inappropriate.

In response, plaintiffs offer two counterarguments — the first questioning defendants’ premise, the second, attacking defendants’ conclusion. *First*, plaintiffs disagree with defendants’ portrait of the BFW. According to plaintiffs, beyond the “self-serving affidavits of party witnesses,” such as league executives, there is little reason to think that OMPs would be more expensive or non-existent in the BFW. Indeed, plaintiffs believe that copious evidence exists

59 Def. Mem. at 43.

60 Reply Mem. at 19. See also, e.g., Declaration of Gary B. Bettman, Commissioner of the National Hockey League, Exhibit (“Ex.”) 10 to Joint Appendix in Support of Defendants’ Daubert Motion and in Opposition to Plaintiffs’ Motion for Class Certification (“Joint App’x”), ¶¶ 7-15 (arguing that the disappearance of territorial exclusivity would diminish the number of options available to consumers in the BFW).
to the contrary. *Second*, plaintiffs argue that even assuming, *arguendo*, that defendants are right about the composition of the BFW, class certification is still appropriate because “the supposed conflicts [defendants] identify are not fundamental [...] and have never been accepted by any court.”\textsuperscript{61}

Because I agree with plaintiffs’ second argument — that defendants’ theory of intra-class conflict, even if true, is no basis for denying certification — there is no need to address which side has painted a more accurate portrait of the BFW. In effect, defendants’ position is that certain class members would prefer the status quo to persist, antitrust violation or no. Put more bluntly, defendants believe that some class members, even if they are currently suffering an antitrust injury, would prefer to be injured than for the injury to be redressed — because the injury carries collateral benefits.\textsuperscript{62}

Defendants’ claim fails three times over. *First*, it confuses the question of whether a common injury unites the class with the distinct question of whether all class members agree about how best to *respond* to the injury. It is the

\textsuperscript{61} Reply Mem. at 23 (internal citations omitted).

\textsuperscript{62} Here, unlike most class certification disputes, the parties’ papers do not follow the typical element-based analysis of Rule 23. Rather, because defendants’ winners and losers theory reaches multiple components of Rule 23(a) simultaneously, the parties have — understandably — addressed the viability of that theory *in general*, instead of trying to limit it to particular sub-parts of Rule 23. This Opinion follows suit.
former, not the latter, that drives the Rule 23 analysis — and there is no question that here, a common injury exists in the form of diminished consumer choice.  

Second, at a policy level, defendants’ argument threatens the integrity of the antitrust laws. If the fact that illegal restraints operate to the economic advantage of certain class members were enough to defeat certification, the efficacy of class-wide antitrust suits — and the deterrence function they serve — would wither.  

Third, defendants’ argument subverts the purpose of Rule 23(b)(2). When the remedy sought is injunctive rather than monetary, divergent interests within the class militate in favor of certification — because certification gives affected parties a greater voice in the litigation.  

1. Class Certification Versus Merits Analysis  

Defendants point to a number of antitrust cases where courts have embraced a winners and losers argument against class certification. For example, defendants refer a number of times to Valley Drug Company v. Geneva Pharmaceuticals, in which the Eleventh Circuit reversed the district court’s certification of a class of drug distributors, who brought an antitrust challenge to a pharmaceutical company’s alleged effort to stymie the development of generic alternatives to one of its patented drugs. According to the plaintiff-distributors, the

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63 350 F.3d 1181 (11th Cir. 2003).
absence of generic alternatives allowed defendant to command super-competitive prices, resulting in losses for the plaintiffs downstream. In response, defendant argued that some class members actually saw an economic upside from the absence of generic alternatives — because they were able to pass on the super-competitive prices to their customers, and in some cases, even to charge further premiums on top of the super-competitive input costs. According to defendant, this created a schism within the class — winners and losers — sufficient to render certification inappropriate. The court agreed.\textsuperscript{64}

Further examples abound in defendants’ papers.\textsuperscript{65} What all of them

\textsuperscript{64} See id. at 1191 (“[Because some] class members appear to benefit from the effects of the conduct alleged to be wrongful by the named plaintiffs because their net economic situation is better off when branded drugs dominate the market [] . . . certification under these circumstances would be inappropriate.”).

\textsuperscript{65} See, e.g., Duchardt v. Midland Nat’l Life Ins. Co., 265 F.R.D. 436, (S.D. Iowa 2009) (holding that a challenge to a specific method of calculating insurance claims was not amenable to class-wide adjudication, because certain plan-holders benefitted financially from the method); Allied Orthopedic Appliances, Inc. v. Tyco Healthcare Grp., 247 F.R.D. 156, 168-69 (C.D. Cal. 2007) (declining to certify a class-wide challenge to a medical device company’s allegedly super-competitive prices, on the grounds that “many individual class members may have benefitted from discounts and deals on [defendant’s] products” that were the result of anticompetitive conduct, and therefore “would be unavailable to [class members] in the but-for world”) (emphasis in original); Auto Ventures, Inc. v. Moran, No. 92 Civ. 426, 1997 WL 306895, at *5 (S.D. Fla. Apr. 3, 1997) (holding that class certification was inappropriate in light of the allegation that defendants — a group of car dealerships — had perpetuated their coercive market position “through a rewards and punishment system, by which cooperating [entities] were befriended and rewarded, while resisting [entities] were penalized,”
have in common — and what sets them apart from this case — is the presence of class members who, in the actual world, suffered no injury. In every case cited by defendants, the upshot of the court’s analysis is that as a result of the disputed conduct, some class members either (1) saw no effect or (2) received a benefit without any downside. Thus, some class members — because they were not injured — did not belong in the case. They would have lacked standing to advance on their own behalf the very claim that was purportedly being advanced on their behalf by others. For obvious reasons, this frustrated class certification — it would have required the named plaintiffs to represent the “interests” of unnamed parties who had no cognizable interests to begin with.66

The same is not true in this case. Here, every class member has suffered an injury, because every class member, as a consumer in the market for baseball or hockey broadcasting, has been deprived of an option — a la carte channels — that would have been available absent the territorial restraints (“Injury One”). On top of this general injury, certain class members have also suffered the additional injury of having to pay too much for the content they wanted (“Injury

66 See Kohen v. Pacific Invest. Mgmt. Co., 571 F.3d 672, 678 (7th Cir. 2009) (“[A] class should not be certified if it is apparent that it contains a great many persons who have suffered no injury at the hands of the defendant[s].”).
Two”). Plaintiffs and defendants disagree about how many class members fall into
the latter category. In plaintiffs’ view, every class member does — Injury Two is
universal, because all prices would go down in the BFW. In defendants’ view, by
contrast, only some class members suffered Injury Two. Other class members —
those who are interested in watching many teams and would therefore be likely to
buy the OMP, even in the BFW (“league-wide fans”) — suffered no price-based
injury. In fact, according to defendants, league-wide fans derived a price-based
benefit from the restraints. That is the point of their winners and losers argument.

Regardless of which side is ultimately correct about the scope of
Injury Two — a question that depends not only on economic analysis, but also on
speculation about consumer psychology — Injury One unites the class. The

67 Plaintiffs would draw the distinction (between this case and other
cases where defendants successfully invoked the winners and losers logic)
somewhat differently. In plaintiffs’ view, the key issue is that in the instant case,
“all class members were treated equally in the real world,” whereas in “in every
one of [defendants’] cases, [] some class members received a direct and concrete
benefit from the challenged conduct that others did not.” Reply Mem. at 23-24. In
other words, plaintiffs would focus on the equality (or lack thereof) of class
members’ treatment by entities allegedly engaged in an antitrust violation. Here,
all class members received the same treatment — paying a uniform subscription
fee for the OMP — whereas in defendants’ examples, different class members
received disparate treatment. For example, in Allied Orthopedic Appliances, some
class members were afforded “discounts and deals” that other class members were
not. 247 F.R.D. at 169. And this meant that the identification of disparities within
the class was not merely a hypothesis about how, in the BFW, the market might
operate — it was a reflection of how, in the actual world, the market did operate.

There are two problems with this formulation — the first is factual,
restriction of consumer options is an *ipso facto* antitrust harm, and conversely, the creation of new options is a benefit to the market as a whole. This is true for all consumers — even consumers, like league-wide fans, who are not interested in new options. The mere existence of new options increases the dynamism of the marketplace, spurring innovation and maintaining downward pressure on prices. Put simply, Injury One is universal.

Against this backdrop, there are two ways to understand defendants’ position. *First*, defendants might be arguing that Injury One is outweighed, on the second, conceptual. *First*, it is unclear (and seemingly disputed) to what extent all class members here actually receive the same treatment in the actual world. Defendants have repeatedly suggested that different consumers pay different prices for the OMP — a fact that casts doubt on plaintiffs’ claim that here, unlike other winners and losers cases, every class member faces the same treatment from defendants. *See, e.g.*, Declaration of Daniel L. McFadden (Dkt. No. 358), ¶ 38. *Second*, even if all class members here did receive the same treatment — or effectively the same treatment — from defendants, it is unclear if the “equal treatment” principle can shoulder its analytic burden. In some cases, even if all class members were treated the same way, no injury unites the class. Indeed, *Valley Drug Co. v. Geneva Pharmaceuticals* — defendants’ prime example — may well be that kind of case. There, the court declined to certify the class on the basis that certain distributors saw no economic downside (and some possibly saw an upside) from defendant’s anticompetitive conduct. This was so in spite of the fact that all distributors were treated the same way. All of them were forced to pay the same (allegedly super-competitive) input costs for brand-name drugs. But there was nevertheless a schism within the class, because some distributors were able to pass on the super-competitive costs to consumers, or even to hike up the label price further, while other distributors were not. In this sense, the holding in *Valley Drug* is difficult to square with the proposition that equal treatment, rather than unity of injury, is the wedge separating defendants’ use of the winners and losers logic here from its application in earlier cases.
balance, by the procompetitive benefits of the territorial restraints for league-wide
fans — i.e., that the absence of a la carte options, despite constituting an antitrust
injury, is justified by the availability and (comparatively) low price of OMPs. If
this is true, it would make the territorial restraints lawful under the Rule of
Reason. Second, defendants might be arguing that even if the complained-of
restraints are illegal — even if the anticompetitive harm of the complained-of
restraints is not outweighed by their procompetitive benefits — league-wide fans
would nonetheless prefer for Injury One to persist unremedied, in light of the
collateral benefits they derive from defendants’ injurious conduct.

One or both of these arguments may be correct, but neither is an
argument against class certification. The first is a merits argument. Defendants
believe that the complained-of restraints, though anticompetitive to the extent that
they preclude the existence of a la carte channels, are also procompetitive to the
extent that they facilitate the existence of a well-priced OMP. If defendants can
convince the trier-of-fact of this point, they will have a strong defense against

68 See Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 885 (2007) (“The rule of reason is the accepted standard for testing whether a practice restrains trade in violation of § 1 [of the Sherman Act]. . . . ‘Under this rule, the factfinder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition.’”) (citing Continental T. V., Inc. v. GTE Sylvania, 433 U.S. 36, 49 (1977)). See also Laumann, 907 F. Supp. 2d at 478-79 (providing further background on the Rule of Reason standard).
antitrust liability — a strong argument for why the restraints satisfy the Rule of Reason and may continue to exist. If this is true, it is true across the class. Indeed, far from creating intra-class conflict, the question of whether the restraints are more procompetitive than anticompetitive is exactly the question of whether a class-wide antitrust injury exists.

Defendants’ effort to cast the balance of economic effects as an issue of adequacy under Rule 23(a), rather than a merits issue, is unavailing. In Freeland v. AT&T, Judge Denise Cote of this District considered — and rejected — an analogous argument against class certification. There, the allegation was that AT&T had unlawfully tied the sale of telephones to the sale of wireless service. At the certification stage, AT&T argued, inter alia, that “many, [] perhaps most, class members actually benefit from the subsidization that accompanies the [tying] that the named plaintiffs claim is illegal,” and that certain class members “benefit from the deployment of newer, more efficient [phones], which is encouraged by defendants’ . . . tying practices.” In light of this, AT&T argued that “the interest[s] of the named plaintiffs [were] antagonistic to the interests of other class members.”

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69 238 F.R.D. 130 (S.D.N.Y. 2006).
70 Id. at 141.
members.” Judge Cote rejected this logic in *Freeland* for the same reason that I reject defendants’ logic here. Ultimately, the argument “reduce[s] to a claim that most plaintiffs actually benefit from the defendants’ [] practices,” which is not properly addressed to the adequacy of the named plaintiffs to represent the class. Rather, it is “a repackaging of the defendants’ claim that their . . . practices have not caused an antitrust injury on a class-wide basis.”

71 *Id.*

72 *Id.* In defendants’ opposition papers, they argue that “[i]n *Freeland*, Judge Cote, denied [(b)(2)] certification . . . because some proposed class members may have benefitted from the allegedly anticompetitive bundling of products.” Def. Mem. at 44. This interpretation strains the limits of good faith. In fact, it is crystal clear from Judge Cote’s opinion that intra-class conflict had nothing to do with the disposition of the (b)(2) issue. Rather, the problem was that plaintiffs had failed to establish a necessary element of their tying claim — coercion — on a class-wide basis. Because coercion would have to be proven in an individualized manner, “even if the named plaintiffs succeed on the merits of their claims, only they would be entitled to injunctive relief.” *Freeland*, 238 F.R.D. at 157. This outcome flowed from the absence of proof as to an element of the claim, *not* from the fact that “some [] class members may have benefitted from the [complained-of conduct].” Def. Mem. at 44.

73 *Freeland*, 238 F.R.D. at 142. Judge Cote’s reasoning also underscores why the Second Circuit’s holding in *In re Literary Works in Electronic Databases Copyright Litigation* does not control — indeed, does not even bear on — this case. There, the question was whether a class-wide settlement of copyright claims, brought by freelance authors whose works had been reproduced without their permission, was adequately protective of the class as a whole. The central issue concerned copyright holdings whose infringement only gave rise to damages, as a matter of law, insofar as the underlying copyrights were registered with the Copyright Office. Although these subordinate holdings comprised the vast majority of the total claims, they were, by a significant
The second way to parse defendants’ argument is not that the territorial restraints are lawful on the merits, but rather, that even if they are unlawful, “some class members have an interest in preserving the status quo, antitrust violation or no.”74 So formulated, defendants’ position is not about what the fate of the restraints will be, but rather what their fate should be. The argument, in other words, is that even if the restraints are illegal, some class members would nonetheless prefer for the restraints to exist — i.e., they would measure, the least valuable holding in the case. After much negotiation, a class-wide settlement was formulated, which treated the subordinate holdings as nearly valueless — triggering objections from class members with predominately subordinate holdings. The Second Circuit ultimately agreed with the objectors, determining that “the interests of class members who hold only [subordinate holdings] fundamentally conflict with those of class members who hold [lucrative] claims.” 654 F.3d 242, 254 (2d Cir. 2011). In light of this, the Court was not satisfied that “[n]amed plaintiffs,” to the extent they held lucrative copyrights, “had [an] incentive to maximize the recovery for [] plaintiffs [with subordinate holdings].” Id. On that basis, the settlement was vacated, and the case was remanded with instructions to delineate subclasses based on category of holding. See id. at 257-58.

In re Literary Works is inapplicable to the instant case. There, unlike here, it was undisputed that every class member’s rights had been violated. The question was how to divide the recovery — and whether the process for doing so safeguarded the interests of the class as a whole. In this sense, In re Literary Works raised an issue distinctive to (b)(3) actions, and in particular, to the settlements of (b)(3) actions — when the named plaintiffs negotiated settlement terms, did they allocate too large a share of damages to themselves? This question has no analogue with respect to (b)(2) classes. In that setting, it is nonsensical to speak of some class members getting a greater or lesser “share” of injunctive or declaratory relief. By its nature, the relief is uniform across the class.

74 Reply Mem. at 23.
prefers for the restraints *not* to be illegal, much as that result might clash with existing antitrust doctrine.

          Needless to say, the role of this Court is to apply the antitrust laws, not to rewrite them. It is possible, as defendants suggest, that many baseball and hockey fans would prefer for the complained-of restraints to be deemed lawful rather than unlawful. Indeed, it is even possible that many such fans would have preferred that the instant lawsuit not be brought. But the fundamental point remains. The restraints are either illegal or they are not — and whether they are is a merits question. To properly analyze that question, the preferences of class members — including class members who would prefer for the restraints to remain in place — will certainly be relevant. Those preferences are one consideration for the jury (or, in the case of a (b)(2) class, the Court) as it assesses the restraints’ procompetitive benefits. But if the trier-of-fact decides that the restraints’ procompetitive benefits are insufficient to overcome their anticompetitive effects, that will be the end of the matter. An arrangement that unlawfully restrains the market as a whole cannot be salvaged by the preferences, however fervent, of a subset of class members.

2. **Enforcing the Antitrust Laws**

Furthermore, even if this case were indistinguishable from others
where courts have embraced the winners and losers logic, there is still good reason to reject that logic. Defendants’ argument sweeps much too broadly. If it prevails, all anticompetitive conduct — regardless of the particular market in which it occurs — would be immunized from class-wide scrutiny on the basis that certain members of the class derive benefits from the conduct. For example, consider the argument championed by defendants’ class certification expert — Dr. Janusz Ordover — that territorial restraints generate super-competitive profits for the teams and RSNs, which in turn provides them with the “incentive[] to produce live-game content.”

Lift the territorial restraints, in other words, and defendants believe that fewer broadcasts will be produced.

This argument suffers the fatal defect of universal applicability. A monopolist could always argue that being forced to operate at competitive rather than super-competitive margins — i.e., being forced to comply with the antitrust laws — would staunch the creation of capital-intensive goods. Operating competitively diminishes profits; diminished profit generates less disposable capital; less disposable capital means that fewer projects get funded. The problem with this reasoning is that it applies to all industries, at all times. Because it is in the nature of anticompetitive conduct to afford beneficiaries greater stores of

\[\text{Declaration of Dr. Janusz Ordover ("Ordover Decl."), Ex. 3 to Joint App’x, ¶ 32.}\]

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capital, it is also in the nature of anticompetitive conduct to produce the sort of “conflicts” that defendants identify here. If such “conflicts” were to preclude class certification, it would become all but impossible to adjudicate antitrust actions on a class-wide basis — meaning, in practice, that it would become all but impossible to adjudicate antitrust actions, period.  

This result is unacceptable. Moreover, although the result may be especially clear in antitrust cases, it is by no means unique to that setting. It is likely to be true in many cases where defendants’ conduct, despite being unlawful, works to the economic benefit of some class members. An analogy to employment

Dr. Ordover’s argument — that the OMP might not exist at all in the BFW — is but one variant of the idea that antitrust violations are in the consumer interest. Another example (also set forth by defendants, and bolstered by Dr. Ordover’s analysis) is that the OMP, if it did exist in the BFW, would include fewer broadcasts, because some RSNs rely on the protection conferred by territorial exclusivity to maintain profitability. If the territorial restraints are lifted, defendants argue that “RSNs for less popular clubs . . . would have difficulty obtaining carriage, both nationally and even on MVPDs within their local market.” Def. Mem. at 26. In that case, out-of-market fans of less popular clubs might find themselves in the doubly-unfortunate situation of being unable to purchase an OMP that includes their favorite team’s broadcasts, but also unable to watch their favorite team’s broadcasts on an individual RSN — because the broadcasts would not exist. This is a similar but distinct sense in which, according to defendants, the BFW might create winners and losers. This theory falls prey to the same problem as the theory that OMPs might not exist in the BFW — at bottom, both are arguments about the economic virtues of defendants’ conduct. Ultimately, of course, it may be that defendants’ conduct does have economic virtues — but that is a merits issue. Incorporating it into the Rule 23 analysis would hobble the ability of federal courts to effectively enforce the antitrust laws.
law underscores the point. Imagine that workers bring a class action against their employer — Company X — for failure to pay adequate wages. The allegation is very simple. Company X flouted state and federal labor laws by paying all hourly workers two dollars less, per hour, than the minimum wage. At the class certification stage, Company X makes the following argument. If it loses the lawsuit — if its workers were not, in fact, receiving minimum wage — the outcome will be (among other things) that Company X will lay off twenty-five percent of its workforce. This result, the company argues, is one that many workers would prefer to avoid — even if the only way to avoid it is to avoid exercising their legal rights. In light of this, the company maintains that certification is inappropriate, because some class members would prefer that the lawsuit not be brought.

Indulging this argument would stand Rule 23 on its head. Instead of serving as an “efficient means of compensating victims” by permitting the redress of common injuries,\(^77\) Rule 23 would become an efficient means of immunizing wrongdoing — by allowing defendants to invoke the positive effects of their illegal conduct to fend off liability. But even if it has positive effects, illegal conduct remains illegal. When Company X paid its workers, it either complied with the

\(^{77}\) *Amchem*, 521 U.S. at 628.
minimum wage laws or it did not. If Company X was non-compliant, then all class members were injured in the same way — they all were paid less than what they were owed. And if Company X was compliant, then no injury occurred. Either way, certification is warranted.

This example, while hypothetical, has plenty of real-world analogues. For instance, the Central District of California recently rejected a nearly identical argument in the context of a fraud suit against an insurance company. See Vaccinaro v. Midland Nat’l Life Ins. Co., No. 11 Civ. 5858, 2013 WL 3200500 (C.D. Cal. June 17, 2013).
members, that was “irrelevant” to the legal question.\textsuperscript{79} “An unlawful charge,” the court wrote, “is an unlawful charge.”\textsuperscript{80} And being unlawful, it “could not [possibly] give rise to intra-class conflicts.”\textsuperscript{81} Other courts have also rejected the winners and losers argument in the context of employment disputes,\textsuperscript{82} law enforcement searches,\textsuperscript{83} and the regulation of public unions.\textsuperscript{84}

\begin{itemize}
\item \textsuperscript{79} Id. at *9.
\item \textsuperscript{80} Id.
\item \textsuperscript{81} Id.
\item \textsuperscript{82} See In re FedEx Ground Package Sys., Inc., Employment Practices Litig., 273 F.R.D. 424, 438 (N. D. Ind. 2008) (permitting a class-wide challenge to FedEx’s practice of selectively categorizing employees as “contractors,” despite the fact that some employees categorized as contractors might prefer that categorization due to the “favorable relationship” it allows them to cultivate with the company).
\item \textsuperscript{83} See Horton v. Goose Creek Ind. School Dist., 677 F.2d 471, 487-88 (5th Cir. 1982) (rejecting the government’s argument that because some students might want canine “sniff” searches to be used at a school, whether or not the searches were lawful, the action should not adjudicated on a class-wide basis). The Horton court offered a helpful analogy — along the same lines as the minimum wage analogy — to emphasize the point. One familiar setting in which the winners and losers issue arises, the court argued, are “suit[s] [] in which one or more taxpayers of a community, suing on behalf of all, challenge the validity of a proposed public expenditure.” Id. at 490. Under such circumstances, it is very likely that “a good many taxpayers would not [] prefer[] to have their rights enforced, because of their interest in having the expenditure made,” but “no one has ever doubted the propriety of bringing such a suit as a class action.” Id.
\item \textsuperscript{84} See Stolz et al. v. United Brotherhood of Carpenters and Joiners, 620 F. Supp. 396, 405 (D. Nev. 1985) (holding that plaintiffs could bring a class-wide challenge to the propriety of voting procedures used to enact wage increases,
\end{itemize}
These results are not surprising. In a legal system where most individuals lack either the means or the will (or both) to enforce their rights, class actions serve important deterrence goals. They rein in bad behavior. This function is especially pressing in the context of antitrust claims brought by consumers, as opposed to antitrust claims brought by competitors. The former typically involve two dynamics that frustrate individual adjudication. First, from the consumer’s perspective, antitrust injuries often have wide but slight economic effects, which means that individual class members might suffer few tangible damages. This does not mean, however, that antitrust violations generate correspondingly little benefit for the entities that perpetrate them. To the contrary, anticompetitive conduct can be highly lucrative. And it is this asymmetry — that the very same conduct can reap enormous gain for the perpetrators, while simultaneously causing every individual consumer a small amount of harm — that makes class actions such an important enforcement device.85

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despite the fact that many class members would favor implementation of the wage increase, regardless of whether the proper procedures were followed).

85 See, e.g., In re Currency Conversion Fee Antitrust Litig., 264 F.R.D. 100 (S.D.N.Y. 2010) (certifying a nationwide class of credit card users on the theory that card companies conspired to charge a uniform “currency conversion fee” for transactions outside the United States — the monetary harm of which was in the single digits and for many consumers). See also Newberg on Class Actions § 4:66 (noting that “class actions are the primary vehicle in modern jurisprudence for the effective enforcement of the antitrust, securities laws, discrimination, and
Second, antitrust actions are very expensive to litigate. To make out a plausible antitrust claim — much less to convince a trier-of-fact that illegal conduct occurred — it is often necessary to retain an expert whose fees resemble, and might even dwarf, those of counsel. In many circumstances, this makes it practically impossible for individual plaintiffs to pursue antitrust suits. It is one thing if no common injury has occurred. In that case, class certification is inappropriate regardless of the underlying claim. But it is quite another thing to allow antitrust defendants to shut down class actions — even if a class-wide injury has occurred — because of speculation about what certain consumers might hypothetically prefer.

If this became the default rule, the consequences are not hard to imagine. Fewer antitrust suits would be brought, because would-be plaintiffs (and their attorneys) would have less incentive to initiate them. Litigants would be afraid of being told, many years and millions of dollars into a case, that the class

86 See Italian Colors v. American Express, 133 S. Ct. 2304, 2316 (2013) (J. Kagan, dissenting) (explaining that an expert report for a garden variety tying case can easily “cost between several hundred thousand and one million dollars”).

87 See id. (“No rational actor would bring a claim worth tens of thousands of dollars if doing so meant incurring costs in the hundreds of thousands.”).
could not be certified because it failed the all-important winners and losers test. Meanwhile, firms — appreciating this reconfiguration of incentives — would feel less compunction, due to diminished risk, about engaging in anticompetitive conduct in the first place. This is not an acceptable outcome.

3. The Purpose of Rule 23(b)(2)

The final counterpoint to defendants’ winners and losers logic is more specifically tethered to Rule 23(b)(2), and more overtly practical. Given the prospective relief contemplated by Rule 23(b)(2) — as opposed to the retrospective redress contemplated by Rule 23(b)(3) — divergent interests among the class members is a reason to certify the class, not to avoid certification. It is only by allowing an injunctive action to proceed class-wide that consumers whose interests differ in some respects from those of the named plaintiffs will have an opportunity to steer the course of the litigation. Absent certification, “losing” class members would likely be worse off — they would be at the mercy of individual plaintiffs seeking declaratory and injunctive relief that is likely to have sweeping effects on the market as a whole.

In this respect, injunctive classes are fundamentally different than damages classes. With regard to the latter, Rule 23 provides safeguards to protect against coercion. Specifically, Rule 23(c) erects stringent notice and opt-out
requirements that must be satisfied as a condition of certification under Rule (b)(3). In the absence of such requirements, (b)(3) certification would run the risk of usurping the rights of class members who would prefer (1) to pursue their own claims for damages, or (2) to maintain standing to bring future challenges.

With regard to injunctive classes, by contrast, coercion is harder to avoid. Indeed, in many settings the pursuit of structural remedies is inherently coercive — insofar as the outcome of the litigation often bears on the interests of many unnamed parties, whether or not the suit has been formally designated as a class action. When it comes to certain kinds of prospective relief — relief that aims to change policy, or, as here, to transform the dynamics of an entire market — “[t]here is no realistic sense of [class members] ‘opting out.’” Indeed, this is why certification operates to the advantage, not the detriment, of class members with divergent interests from the named plaintiffs. As a leading treatise puts it, “[i]n (b)(2) situations, an individual litigant’s case is likely to have an impact on

88 See Fed. R. Civ. P. 23(c)(2)(b). See also The American Law Institute Principles of the Law of Aggregate Litigation § 3.10 (outlining the notice requirements, codified in Rule 23(c)(2), that must be satisfied as a prerequisite of certification under Rule 23(b)(3)); id. § 3.11 (outlining the procedure for “second opt-out” rights in the event of a (b)(3) settlement).

89 Newberg on Class Actions § 4:36.
similarly situated parties,” which means that “certification [likely] helps the absent parties,” because it “guarantee[s] that their interests will be adequately represented.”

**B. Cohesion and Standing**

Putting the winners and losers issue to one side, defendants also argue that plaintiffs cannot satisfy the “cohesion” requirement of Rule 23(b)(2), because certain class members — indeed, even some named plaintiffs — are previous subscribers, but not current subscribers, to the OMP. According to defendants, previous subscribers lack standing to challenge the complained-of restraints on prospective grounds. Because they are no longer “consumer[s] . . . in the market in which trade was restrained,” their injuries are speculative, and they are not “efficient enforcers” of the antitrust laws.

In other words, defendants argue that even assuming, arguendo, that all class members were injured by the complained-of restraints, it does not follow

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90 Id. § 4:34.

91 Id.

92 Associated Gen. Contractors, 459 U.S. at 539.

93 See Def. Mem. at 44-46.

94 For background on the “efficient enforcer” standard, see Laumann, 907 F. Supp. 2d at 480-85.
that all class members will *continue* to be so injured. The continuity of injury depends on whether “each former subscriber among the absent class members intends to purchase an OMP in the future,” a question that defendants believe “impossible to ascertain . . . [using] objective criteria.”95 On that basis, defendants conclude that “many putative class members . . . would not benefit from an injunction,”96 rendering the class non-cohesive.97

This argument rests on a mistaken view of the injuries alleged in this case. Defendants are correct, of course, that a plaintiff who can *only* claim past injuries — who faces neither an ongoing injury nor a realistic chance of future injury — lacks standing to seek prospective relief. The problem with defendants’ argument does not lie with this unremarkable proposition. It lies with the implicit premise that past subscribers to OMPs, because they no longer subscribe, are no longer injured. That is false. Short of death, cognitive illness, or a complete loss of interest in baseball and hockey, previous subscribers to OMPs are still

95    Def. Mem. at 46.

96    *Id.* at 45.

97    It has already been established — in my December 5, 2012 opinion — that previous subscribers to the OMP satisfy the “direct purchaser” requirement of *Illinois Brick*. See Laumann, 907 F. Supp. 2d at 480. See also supra note 54. Defendants do not question that holding here. Instead, they focus exclusively on the “efficient enforcer” issue.
“consumer[s] . . . in the market in which trade [is] restrained” — here, the market for hockey and baseball broadcasting.

Put simply, if a consumer in the market for baseball and hockey broadcasting discontinues her subscription to an OMP, that decision does not remove her from the market for baseball and hockey broadcasting. Rather, it is precisely as a consumer in the market for baseball and hockey broadcasting that she chooses to discontinue her subscription. After all, one of the choices that consumers make is declining to buy products. There are various reasons that might happen. A product might be too expensive — as David Dillon, one of the named plaintiffs here, concluded of the OMP.98 Or a product might fail to meet a consumer’s specific needs — as the OMP did for Marc Lerner, another of the named plaintiffs.99

But regardless of what motivates a consumer to decide not to purchase a particular product, the point is that on the basis of that decision alone, there is no reason to infer — as defendants ask the Court to infer here — that the consumer is not in the market for such goods. Indeed, on the face of it, an explanation like the one offered by Plaintiff Dillon — that he chose not to renew his OMP subscription

98 See Def. Mem. at 46.
99 See id.
because it “wasn’t worth the money” — suggests that if the antitrust injury in this case were redressed, and Dillon had the option (1) to subscribe to a more affordable OMP or (2) to buy an a la carte RSN, he might well make a different choice. If he did so, he would be making that choice as a consumer in the market for hockey broadcasting.

Ultimately, defendants’ argument depends on the proposition that discontinuing one’s subscription to an OMP bespeaks a lack of interest in baseball and hockey broadcasting. There is little reason to think so. For support, defendants point to deposition testimony from named plaintiffs (such as Dillon), indicating that such plaintiffs “do not currently subscribe to an OMP [and] do not [] plan to purchase such a package.”100 But all this demonstrates is that some consumers, in the face of constrained options and artificially high prices, choose not to buy goods. That is not surprising. It is just what common sense — and economic theory — would predict.101 For the purpose of determining which class members have standing to seek prospective relief, the relevant question is not how

100 Def. Mem. at 46 (emphasis added).

101 It is axiomatic that one result of anticompetitive conduct is that output diminishes within the relevant market. See, e.g., Business Elec. Corp. v. Sharp Elec. Corp., 485 U.S. 717, 723 (1988) (explaining that monopolization — and other per se antitrust violations — “always or almost always tend to restrict competition and decrease output”).
consumers respond to a market infected by anticompetitive restraints. It is how consumers would behave if those restraints were lifted — *i.e.*, what choices they would make in the BFW.

With respect to *that* question, defendants have offered no reason to think, much less any evidence to show, that previous subscribers are less interested than current subscribers in seeing the restraints lifted. Both groups have the same interest — they want the market for baseball and hockey broadcasting to be as competitive as possible. And both groups, likewise, suffer the same ongoing injury — a market for baseball and hockey broadcasting in which choice is diminished, and prices elevated, by territorial restraints.

The same reasoning also disposes of any concern about Article III. According to defendants, even if previous subscribers qualify as consumers in the

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102 In fact, it is not just previous subscribers and current subscribers that share this interest. Everyone that watches hockey and baseball — all fans that have *some* appetite for viewing baseball and hockey broadcasts remotely — are consumers in the market for baseball and hockey broadcasting, with interests adversely affect by the complained-of restraints. In this respect, the class of individuals interested in the outcome of this litigation include a large swath of baseball and hockey fans who have *never* subscribed to OMPs, but who nevertheless enjoy watching baseball and hockey through currently-available channels and, in the BFW, might consider subscribing to an OMP (if it were cheaper) or might be interested in purchasing a la carte RSNs. If anything, the sheer size of the population whose interests are at stake in this litigation makes class-wide adjudication all the more appropriate. For the reasons set forth above, one of the purposes of (b)(2) certification is to expand the number of parties that have an opportunity to steer the course of litigation.
market for baseball and hockey broadcasting, they have suffered no injury that is amenable to prospective relief, rendering them constitutionally unqualified to bring a claim — and frustrating class certification.\footnote{See Denney, 443 F.3d at 263-64 (“[N]o class may be certified that contains members lacking Article III standing”).} In support of this argument, defendants point to two recent Supreme Court cases — \textit{Walmart v. Dukes},\footnote{See 131 S. Ct. 2541 (2011).} and \textit{Clapper v. Amnesty International}.\footnote{See 133 S. Ct. 1138 (2013).} In \textit{Dukes}, current and former female employees of Walmart brought a class action under Title VII, alleging that the company had engaged in systematic sex-based discrimination in their hiring and promotional decisions. After holding that the class lacked commonality — thus precluding certification under Rule 23(a) — the Court went on to note that (b)(2) certification was inappropriate on other grounds. Namely, former employees of Walmart “lack[ed] standing” — by which the Court meant Article III standing — “to seek injunctive or declaratory relief against [Wal-Mart’s] employment practices,” because they were no longer affected by those practices. Thus, they could not properly be included in a (b)(2) class.\footnote{See 131 S. Ct. at 2560.}

The \textit{Clapper} Court echoed this reasoning two terms later, when it held

\footnote{\textit{Denney}, 443 F.3d at 263-64 (“[N]o class may be certified that contains members lacking Article III standing”).}

\footnote{131 S. Ct. 2541 (2011).}

\footnote{See 133 S. Ct. 1138 (2013).}

\footnote{See 131 S. Ct. at 2560.}
that Amnesty International lacked standing to bring a constitutional challenge to section 702 of the Foreign Intelligence Surveillance Act (“FISA”). According to Amnesty International, because it tends to interact with individuals who are subject to overseas telephonic surveillance (as authorized by FISA), the organization faced “an objectively reasonable likelihood that [its] communications will be acquired . . . at some point in the future” — conferring standing on the organization to bring a constitutional claim.\(^\text{107}\) The Court disagreed, maintaining that a “future injury is too speculative to satisfy the well-established requirement that threatened injury must be certainly impending.”\(^\text{108}\) Therefore, the organization was not in a position to secure the prospective relief that it sought.

A common principle underlies \textit{Dukes} and \textit{Clapper}. It is the same principle that motivated \textit{City of Los Angeles v. Lyons}\(^\text{109}\) — an older case that is not cited in defendants’ papers, but that nevertheless bolsters its position. There, the Court held that the plaintiff, who had been subject to a choke-hold by an officer of the Los Angeles Police Department, lacked standing to enjoin the general \textit{practice} of using choke-holds, because he was unlikely to suffer a similar injury in the

\(^{107}\) \textit{Clapper}, 133 S. Ct. at 1143.

\(^{108}\) \textit{Id.} (emphasis in original).

future. Therefore — the Lyons Court reasoned — the plaintiff could not seek prospective relief.\footnote{110}

The principle uniting these cases is that, for purposes of Article III, neither a previously-inflicted injury nor a hypothetical future injury is sufficient to confer standing to pursue forward-looking remedies. To enjoy such standing, a plaintiff must show either that she currently \textit{is} injured, or that a future injury is “certainly impending.”\footnote{111}

Here, for the reasons set forth above, all class members — including previous subscribers to the OMPs — are consumers in the market for baseball and hockey broadcasting. All class members, therefore, suffer an ongoing injury in connection with the complained-of restraints — a dearth of choice in the market for baseball and hockey broadcasting. Accordingly, all class members have Article

\footnote{110}{See id. at 104-10.}

\footnote{111}{Clapper, 133 S. Ct. at 1143. Accord Susan B. Anthony List v. Driehaus 134 S. Ct. 2334, 2341 (2014); Whitmore v. Arkansas, 495 U.S. 149, 158 (1990). For an example of what constitutes an impending injury, see, for example, Deshawn E. v. Safir, 156 F.3d 340, 344-45 (2d Cir. 1998) (holding that plaintiffs had standing to seek an injunction against the involuntary coercion of statements by police officers because there was evidence of a department-wide policy in favor of coerced statements in \textit{all} cases, whereas in Lyons, the City’s policy afforded individual officers discretion in the use of choke-holds); Aguilar v. Department of Homeland Sec., 811 F. Supp. 2d 802, 826-27 (S.D.N.Y. 2011) (holding that plaintiffs had standing to seek prospective relief from searches by Immigration and Customs Enforcement [‘ICE’] officials, because those officials, having searched plaintiffs’ property once, threatened to return).}
III standing.

C. The Necessity of Certification

Having disposed of all affirmative obstacles to certification under (b)(2), the final question the Court must address is whether such certification is necessary. Under Second Circuit law, there is no need for (b)(2) certification when a defendant is willing to “represent[]” that it “ha[s] no intention of reinstating” a challenged policy, even if the policy has only been challenged on an individual basis. In other words, if the right in question can be secured on a class-wide basis through individual adjudication — if all class members’ interests will be protected whether or not the class is certified — certification should be denied.

Assuming, arguendo, that this principle generally applies in cases where defendants are private corporations rather than state officials, it is

112 Daniels, 198 F.R.D. at 420. Accord Davis v. Smith, 607 F.2d 535, 540 (2d Cir. 1978) (“[When] the prospective benefits of declaratory and injunctive relief will benefit all members of a proposed class to such an extent that [] certification . . . would not further the implementation of the judgment, a district court may decline certification.”); Galvan v. Levine, 490 F.2d 1255, 1261 (2d Cir. 1973) (holding that (b)(2) certification would be “largely a formality” when defendant “has made clear that it understands the judgment [as to one claimant] to bind it with respect to all claimants [and that] even before entry of the judgment, [defendant] withdrew the challenged policy . . . and stated it did not intend to reinstate the policy”).

113 The Second Circuit has indicated that the reasoning of Galvan might be exclusive to civil rights actions, due to the “ assum[ption],” in those cases, that it would be “unthinkable” for “public officials, mindful of their responsibilities,” not
inapposite here. Defendants have made no representation that if the territorial restraints are declared unlawful as applied to the named plaintiffs, defendants will implement that holding across the board. In practice, of course, it is probable that defendants would do so; that their response to a merits verdict in plaintiffs’ favor will be to abolish territorial restraints universally, across the United States. But taking the momentous step of concluding that certification is unnecessary requires more than probability. The case law makes clear that a defendant’s representations must be “express,”\textsuperscript{114} or otherwise “explicit,”\textsuperscript{115} before it is appropriate to forgo certification. Here, no such representation has been made. And although it may not be likely, it is nonetheless possible that defendants could respond to an adverse merits verdict by lifting some, but not all, territorial restraints — in a manner that

\begin{quotation}

\textit{to “apply [an adverse] determination . . . equally to all persons similarly situated.” Berger v. Heckler, 771 F.2d 1556, 1566-67 (2d Cir. 1985). Accord Hurley v. Ward, 584 F.2d 609, 611-12 (2d Cir. 1978) (“Since it is ordinarily assumed that state officials will abide by the court’s judgment, where the State has admitted the identity of issues as to all potential class litigants class certification is indeed unnecessary.”). Because it is unclear from these precedents how widely Galvan applies, I assume for present purposes that it applies here.}

\end{quotation}

\textsuperscript{114} Cutler v. Perales, 128 F.R.D. 39, 46-47 (S.D.N.Y. 1989) (expounding on the importance of a defendant’s “express [ ] commitment to apply the judgment of the court in the single action to all similarly situated persons,” and noting that in Galvan, “the defendant had withdrawn the challenged policy prior to class certification”) (emphasis added).

resolves the named plaintiffs' injuries but does not reconfigure the market for
baseball and hockey broadcasting. However slight that risk may be, it is one I
decline to take.\textsuperscript{116} The legality of the territorial restraints should be adjudicated on
a class-wide basis pursuant to Rule 23(b)(2).

VI. CONCLUSION

For the reasons set forth above, plaintiffs' motion is GRANTED in
part and DENIED in part. The Clerk of the Court is directed to close this motion,
Dkt. No. 266 in 12 Civ. 1817, and Dkt. No. 339 in 12 Civ. 3704.

\textit{SO ORDERED:}

\begin{center}
\textit{Shira A. Scheindlin}
U.S.D.J.
\end{center}

\begin{flushleft}
Dated: New York, New York
May 14, 2015
\end{flushleft}

\textsuperscript{116} Moreover, even if defendants \textit{did} explicitly represent that the
territorial restraints would be lifted across the entire market in the event that
plaintiffs prevail, this would still leave unaddressed the interests of absent class
members who potentially stand to “lose” in the BFW — and who might, on that
basis, prefer to exercise some voice in the litigation. Because (b)(2) certification
\textit{“helps”} absent parties,” concern for unnamed class members is an independent
reason for certification. Newberg on Class Actions § 4:34 (emphasis in original).
Even if defendants were — hypothetically — to assure the Court that certification
is unnecessary to secure class-wide relief, it would still be necessary to ensure
optimal representation.
- Appearances -

For Plaintiffs:

Edward A. Diver, Esq.
Howard I. Langer, Esq.
Peter E. Leckman, Esq.
Langer Grogan & Diver, P.C.
Three Logan Square, Suite 4130
1717 Arch Street
Philadelphia, Pennsylvania 19103
(215) 320-5663

Kevin M. Costello, Esq.
Gary E. Klein, Esq.
Klein Kavanagh Costello, LLP
85 Merrimac St., 4th Floor
Boston, Massachusetts 02114
(617) 357-5034

Michael Morris Buchman, Esq.
John A. Ioannou, Esq.
Motley Rice, LLC
600 Third Avenue
New York, New York 10016
(212) 577-0040

Marc I. Gross, Esq.
Adam G. Kurtz, Esq.
Pomerantz, LLP
600 Third Avenue
New York, New York 10016
(212) 661-1100

Robert LaRocca, Esq.
Kohn, Swift & Graf, P.C.
One South Broad Street
Suite 2100
Philadelphia, Pennsylvania 19107  
(215) 238-1700

J. Douglas Richards, Esq.  
Jeffrey Dubner, Esq.  
Cohen, Milstein, Sellers & Toll, PLLC  
88 Pine Street  
New York, New York 10005  
(212) 838-7797

Michael J. Boni, Esq.  
Joshua D. Snyder, Esq.  
Boni & Zack, LLC  
15 St. Asaphs Road  
Bala Cynwyd, Pennsylvania 19004  
(610) 822-0200


Beth A. Wilkinson, Esq.  
Samantha P. Bateman, Esq.  
Paul, Weiss, Rifkind Wharton & Garrison LLP  
2001 K St. NW  
Washington, D.C. 20006  
(202) 223-7300

Bradley I. Ruskin, Esq.  
Helene Debra Jaffe, Esq.  
Jennifer R. Scullion, Esq.  
Colin Kass, Esq.  
Proskauer Rose LLP  
11 Times Square  
New York, New York 10036
(212) 969-3465

Thomas J. Ostertag, Esq.
Senior Vice President and General Counsel
Office of the Commissioner of Baseball
245 Park Avenue
New York, New York 10167
(212) 931-7855


Shepard Goldfein, Esq.
James A. Keyte, Esq.
Paul M. Eckles, Esq.
Matthew M. Martino, Esq.
Skadden, Arps, Slate, Meagher & Flom LLP
Four Times Square
New York, New York 10036
(212) 735-3000


Arthur J. Burke, Esq.
James W. Haldin, Esq.
Davis Polk & Wardwell
450 Lexington Avenue
New York, New York 10017
(212) 450-4000

For Defendants DIRECTV, LLC, DIRECTV Sports Networks, LLC, DIRECTV Sports Net Pittsburgh, LLC a/k/a Root Sports Pittsburgh, DIRECTV Sports Net Rocky Mountain, LLC a/k/a Root Sports Rocky
Mountain, and DIRECTV Sports Net Northwest, LLC a/ka/a Root Sports Northwest:

Louis A. Karasik, Esq.
Andrew E. Paris, Esq.
Stephanie A. Jones, Esq.
Alston & Bird LLP
333 South Hope Street, 16th Floor
Los Angeles, California 90071
(213) 576-1000

For Defendant New York Yankees Partnership:

Jonathan Schiller, Esq.
Alan Vickery, Esq.
Christopher Duffy, Esq.
Boies, Schiller & Flexner LLP
575 Lexington Avenue
New York, New York 10022
(212) 849-2300

For Defendants The Madison Square Garden Company and New York Rangers Hockey Club:

Stephen R. Neuwirth, Esq.
Deborah Brown, Esq.
Richard I. Werder, Jr., Esq.
Quinn Emanuel Urquhart & Sullivan, LLP
51 Madison Avenue, 22nd Floor
New York, New York 10010
(212) 849-7000

For Defendant Yankees Entertainment Sports Network, LLC:

John E. Schmidtlein, Esq.
Kenneth Charles Smurzynski, Esq.
James Harris Weingarten, Esq.
William Jefferson Vigen, Esq.
I. INTRODUCTION AND BACKGROUND

The Federal Trade Commission (“Commission”) has accepted for public comment, subject to final approval, an Agreement Containing Consent Order (“Consent Order”) from Cerberus Institutional Partners V, L.P. (“Cerberus”), its wholly owned subsidiary, AB Acquisition, LLC (“Albertson’s”), and Safeway Inc. (“Safeway”) (collectively, the “Respondents”). On March 6, 2014, Albertson’s and Safeway entered into a merger agreement whereby Albertson’s agreed to purchase 100% of the equity of Safeway for approximately $9.2 billion (the “Acquisition”). The purpose of the proposed Consent Order is to remedy the anticompetitive effects that otherwise would result from the Acquisition. Under the terms of the proposed Consent Order, Respondents are required to divest 168 stores and related assets in 130 local supermarket geographic markets (collectively, the “relevant markets”) in eight states to four Commission-approved buyers. The divestitures must be completed within a time-period ranging from 60 to 150 days following the date of the Acquisition. Finally, the Commission and Respondents have agreed to an Order to Maintain Assets that requires Respondents to operate and maintain each divestiture store in the normal course of business, through the date the store is ultimately divested to a buyer.

The proposed Consent Order has been placed on the public record for 30 days to solicit comments from interested persons. Comments received during this period will become part of the public record. After 30 days, the Commission again will review the proposed Consent Order and any comments received, and decide whether it should withdraw the Consent Order, modify the Consent Order, or make it final.

The Commission’s Complaint alleges that the Acquisition, if consummated, would violate Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45, by removing an actual, direct, and substantial supermarket competitor in the 130 local supermarket geographic markets. The elimination of this competition would result in significant competitive harm; specifically the Acquisition will allow the combined entity to increase prices above competitive levels, unilaterally or by coordinating with remaining market participants. Similarly, absent a remedy, there is significant risk that the merged firm may decrease quality and service aspects of their stores below competitive levels. The proposed Consent Order would remedy the alleged violations by requiring divestitures to replace competition that otherwise would be lost in the relevant markets because of the Acquisition.
II. THE RESPONDENTS

AB Acquisition, LLC, owned by New York-based private equity firm Cerberus Capital Management, L.P., is the parent company of Albertson’s LLC and New Albertson’s, Inc. (together “Albertson’s”). As of March 19, 2014, Albertson’s LLC operated 630 supermarkets, primarily under its Albertson’s banner. Presently, Albertson’s stores are located in Arkansas, Arizona, California, Colorado, Florida, Idaho, Louisiana, Montana, Nevada, New Mexico, North Dakota, Oregon, Texas, Utah, Washington, and Wyoming. Albertson’s LLC also operates supermarkets in Texas under the Market Street, Amigos, and United Supermarkets banners. United Supermarkets is a traditional grocery store, while Market Street offers specialty and “whole-health” products, and Amigos has an international and Hispanic format. As of March 19, 2014, New Albertson’s, Inc., owned and operated 445 supermarkets under the Jewel-Osco, ACME, Shaw’s, and Star Market banners, dispersed throughout Iowa, Illinois, Indiana, Delaware, Maryland, Pennsylvania, New Jersey, Massachusetts, Maine, New Hampshire, Rhode Island, and Vermont.

As of December 2013, Safeway owned 1,332 supermarkets, making it one of the largest food and drug retailers in the United States. Stores are operated under the Safeway banner in Alaska, Arizona, California, Colorado, District of Columbia, Delaware, Hawaii, Idaho, Maryland, Montana, Nebraska, Nevada, New Mexico, Oregon, South Dakota, Virginia, Washington, and Wyoming. Safeway also operates stores under the following banners: Pavilions, Pak ’n Save, and The Market in California; Randall’s and Tom Thumb in Texas; Genuardi’s in Pennsylvania; Vons in California and Nevada; and Carr’s in Alaska.

III. RETAIL SALE OF FOOD AND OTHER GROCERY PRODUCTS IN SUPERMARKETS

The Acquisition presents substantial antitrust concerns for the retail sale of food and other grocery products in supermarkets. Supermarkets are defined as traditional full-line retail grocery stores that sell, on a large-scale basis, food and non-food products that customers regularly consume at home – including, but not limited to, fresh meat, dairy products, frozen foods, beverages, bakery goods, dry groceries, detergents, and health and beauty products. This broad set of products and services provides a “one-stop shopping” experience for consumers by enabling them to shop in a single store for all of their food and grocery needs. The ability to offer consumers one-stop shopping is a critical differentiating factor between supermarkets and other food retailers.

The relevant product market includes supermarkets within “hypermarkets,” such as Wal-Mart Supercenters. Hypermarkets also sell an array of products that would not be found in traditional supermarkets. However, hypermarkets, like conventional supermarkets, contain bakeries, delis, dairy, produce, fresh meat, and sufficient product offerings to enable customers to
purchase all of their weekly grocery requirements in a single shopping visit.

Other types of retailers – such as hard discounters, limited assortment stores, natural and organic markets, ethnic specialty stores, and club stores – also sell food and grocery items. These types of retailers, however, are not in the relevant product market because they offer a more limited range of products and services than supermarkets and because they appeal to a distinct customer type. Shoppers typically do not view these other food and grocery retailers as adequate substitutes for supermarkets.  

Further, although these other types of retailers offer some competition, supermarkets do not view them as providing as significant or close competition as traditional supermarkets. Thus, consistent with prior Commission precedent, these other types of retailers are excluded from the relevant product market.

The relevant geographic markets in which to analyze the effects of the Acquisition are areas that range from a two- to ten-mile radius around each of the Respondents’ supermarkets, depending on factors such as population density, traffic patterns, and unique characteristics of each market. Where the Respondents’ supermarkets are located in rural, isolated areas, the relevant geographic areas are larger than areas where the Respondents’ supermarkets are located in more densely populated suburban areas. A hypothetical monopolist of the retail sale of food and grocery products in supermarkets in each relevant area could profitably impose a small but significant non-transitory increase in price.

The 130 geographic markets in which to analyze the effects of the Acquisition are local areas in and around:  
(1) Anthem, Arizona; (2) Carefree, Arizona; (3) Flagstaff, Arizona; (4) Lake Havasu, Arizona; (5) Prescott, Arizona; (6) Prescott Valley, Arizona; (7) Scottsdale, Arizona; (8) Tucson (Eastern), Arizona; (9) Tucson (Southwest), Arizona; (10) Alpine, California; (11) Arroyo Grande/Grover Beach, California; (12) Atascadero, California; (13) Bakersfield, California; (14) Burbank, California; (15) Calabasas, California; (16) Camarillo, California; (17) Carlsbad (North), California; (18) Carlsbad (South), California; (19) Carpinteria, California; (20) Cheviot Hills/Culver City, California; (21) Chino Hills, California; (22) Coronado, California; (23) Diamond Bar, California; (24) El Cajon, California; (25) Hermosa Beach, California; (26) Imperial Beach, California; (27) La Jolla, California; (28) La Mesa, California; (29) Ladera Ranch, California; (30) Laguna Beach, California; (31) Laguna Niguel, California; (32) Lakewood, California; (33) Lemon Grove, California; (34) Lomita, California; (35) Lompoc, California; (36) Mira Mesa (North), California; (37) Mira Mesa (South), California.

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1 Supermarket shoppers would be unlikely to switch to one of these other types of retailers in response to a small but significant increase in price or “SSNIP” by a hypothetical supermarket monopolist. See U.S. DOJ and FTC Horizontal Merger Guidelines § 4.1.1 (2010).

2 See, e.g., Bi-Lo Holdings, LLC/Delhaize America, LLC, Docket C-4440 (February 25, 2014); AB Acquisition, LLC, Docket C-4424 (December 23, 2013); Koninklijke Ahold N.V./Safeway Inc., Docket C-4367 (August 17, 2012); Shaw’s/Star Markets, Docket C-3934 (June 28, 1999); Kroger/Fred Meyer, Docket C-3917 (January 10, 2000); Albertsons/s/American Stores, Docket C–3986 (June 22, 1999); Ahold/Giant, Docket C-3861 (April 5, 1999); Albertson’s/Buttrey, Docket C-3838 (December 8, 1998); Jitney-Jungle Stores of America, Inc., Docket C-3784 (January 30, 1998). But see Wal-Mart/Supermercados Amigo, Docket C-4066 (November 21, 2002) (the Commission’s complaint alleged that in Puerto Rico, club stores should be included in a product market that included supermarkets because club stores in Puerto Rico enabled consumers to purchase substantially all of their weekly food and grocery requirements in a single shopping visit).
California; (38) Mission Viejo/Laguna Hills, California; (39) Mission Viejo (North), California; (40) Morro Bay, California; (41) National City, California; (42) Newbury, California; (43) Newport, California; (44) Oxnard, California; (45) Palm Desert/Rancho Mirage, California; (46) Palmdale, California; (47) Paso Robles, California; (48) Poway, California; (49) Rancho Cucamonga/Upland, California; (50) Rancho Santa Margarita, California; (51) San Diego (Clairemont), California; (52) San Diego (Hillcrest/University Heights), California; (53) San Diego (Tierrasanta), California; (54) San Luis Obispo, California; (55) San Marcos, California; (56) San Pedro, California; (57) Santa Barbara, California; (58) Santa Barbara/Goleta, California; (59) Santa Clarita, California; (60) Santa Monica, California; (61) Santee, California; (62) Simi Valley, California; (63) Solana Beach, California; (64) Thousand Oaks, California; (65) Tujunga, California; (66) Tustin (Central), California; (67) Tustin/Irvine, California; (68) Ventura, California; (69) Westlake Village, California; (70) Yorba Linda, California; (71) Butte, Montana; (72) Deer Lodge, Montana; (73) Missoula, Montana; (74) Boulder City, Nevada; (75) Henderson, (East), Nevada; (76) Henderson (Southwest), Nevada; (77) Summerlin, Nevada; (78) Ashland, Oregon; (79) Baker County, Oregon; (80) Bend, Oregon; (81) Eugene, Oregon; (82) Grants Pass, Oregon; (83) Happy Valley/Clackamas, Oregon; (84) Keizer, Oregon; (85) Klamath Falls, Oregon; (86) Lake Oswego, Oregon; (87) Milwaukie, Oregon; (88) Sherwood, Oregon; (89) Springfield, Oregon; (90) Tigard, Oregon; (91) West Linn, Oregon; (92) Colleyville, Texas; (93) Dallas (Far North), Texas; (94) Dallas (Farmers/Branch/North Dallas), Texas; (95) Dallas (University Park/Highland Park), Texas; (96) Dallas (University Park/Northeast), Texas; (97) McKinney, Texas; (98) Plano, Texas; (99) Roanoke, Texas; (100) Rowlett, Texas; (101) Bremerton, Washington; (102) Burien, Washington; (103) Everett, Washington; (104) Federal Way, Washington; (105) Gig Harbor, Washington; (106) Lake Forest Park, Washington; (107) Lake Stevens, Washington; (108) Lakewood, Washington; (109) Liberty Lake, Washington; (110) Milton, Washington; (111) Monroe, Washington; (112) Oak Harbor, Washington; (113) Olympia (East), Washington; (114) Port Angeles, Washington; (115) Port Orchard, Washington; (116) Puyallup, Washington; (117) Renton (East Hill-Meridian), Washington; (118) Renton (New Castle), Washington; (119) Sammamish, Washington; (120) Shoreline, Washington; (121) Silverdale, Washington; (122) Snohomish, Washington; (123) Tacoma (Eastside), Washington; (124) Tacoma (Spanaway), Washington; (125) Walla Walla, Washington; (126) Wenatchee, Washington; (127) Woodinville, Washington; (128) Casper, Wyoming; (129) Laramie, Wyoming; and (130) Sheridan, Wyoming.

Each of the relevant geographic markets is highly concentrated and the Acquisition would significantly increase market concentration and eliminate substantial direct competition between two significant supermarket operators. The post-Acquisition HHI levels in the relevant markets vary from 2,562 to 10,000 points, and the HHI deltas vary from 225 to 5,000 points. Under the 2010 Department of Justice and Federal Trade Commission Horizontal Merger Guidelines (“Merger Guidelines”), an acquisition that results in an HHI in excess of 2,500 points and increases the HHI by more than 200 points is presumed anticompetitive. Thus, the presumptions of illegality and anticompetitive effects are easily met, and often far exceeded, in the relevant geographic markets at issue.

The relevant markets are also highly concentrated in terms of the number of remaining market participants post-Acquisition. Of the 130 geographic markets, the acquisition will result
in a merger-to-monopoly in 13 markets and a merger-to-duopoly in 42 markets. In the remaining markets, the Acquisition will reduce the number of market participants from four to three in 43 markets, five to four in 27 markets, and six to five in five markets.\textsuperscript{3}

The anticompetitive implications of such significant increases in market concentration are reinforced by substantial evidence demonstrating that Albertson’s and Safeway are close and vigorous competitors in terms of price, format, service, product offerings, promotional activity, and location in each of the relevant geographic markets. Absent relief, the Acquisition would eliminate significant head-to-head competition between Albertson’s and Safeway and would increase the ability and incentive of Albertson’s to raise prices unilaterally post-Acquisition. The Acquisition would also decrease incentives to compete on non-price factors, such as service levels, convenience, and quality. Lastly, the high levels of concentration also increase the likelihood of competitive harm through coordinated interaction in markets in which Albertson’s will face only one other traditional supermarket competitor post-Acquisition. Given the transparency of pricing and promotional practices among supermarkets and that supermarkets “price check” competitors in the ordinary course of business, the Acquisition increases the possibility that Albertson’s and its remaining competitor could simply follow each other’s price increases post-Acquisition.

New entry or expansion in the relevant markets is unlikely to deter or counteract the anticompetitive effects of the Acquisition. Moreover, even if a prospective entrant existed, the entrant must secure a viable location, obtain the necessary permits and governmental approvals, build its retail establishment or renovate an existing building, and open to customers before it could begin operating and serve as a relevant competitive constraint. As a result, new entry sufficient to achieve a significant market impact and act as a competitive constraint is unlikely to occur in a timely manner.

IV. THE PROPOSED CONSENT ORDER

The proposed remedy, which requires the divestiture of Albertson’s or Safeway supermarkets in the relevant markets to four Commission-approved up-front buyers (the “proposed buyers”) will restore fully the competition that otherwise would be eliminated in these markets as a result of the Acquisition. Specifically, Respondents have agreed to divest:

- 146 stores and related assets in Arizona, California, Nevada, Oregon, and Washington to Haggen, Inc. (“Haggen”);
- Two stores in Washington to Supervalu, Inc. (“Supervalu”);
- 12 stores and related assets in Texas to Associated Wholesale Grocers (“AWG”); and
- Eight stores and related assets in Montana and Wyoming to Associated Food Stores (“Associated”).

The proposed buyers appear to be highly suitable purchasers and are well positioned to enter the relevant geographic markets and prevent the increase in market concentration and likely

\textsuperscript{3} See Exhibit A.
competitive harm that otherwise would have resulted from the Acquisition. The supermarkets currently owned by any of the proposed buyers are all located outside the relevant geographic markets in which they are purchasing divested stores.

Haggen is a regional supermarket chain with 18 supermarkets in Washington and Oregon. Haggen will purchase all but two of the divested stores in Washington, because Haggen already operates stores in those two geographic markets. Supervalu will purchase the two stores in Washington that Haggen is not purchasing. Supervalu is a wholesale distributor that also operates 190 corporate-owned supermarkets and previously owned these two Washington stores. AWG is a member-owned cooperative grocery wholesaler supplying nearly 3,000 supermarkets in 33 states. Although AWG does not currently own or operate any supermarkets, AWG has owned and operated corporate-owned supermarkets in the past. Finally, Associated is a member-owned cooperative grocery wholesaler that supplies and operates retail supermarkets. Associated’s members operate approximately 424 grocery stores in ten states, and the cooperative, through a subsidiary, owns and operates 43 corporate-owned supermarkets located in Utah and Nevada. It is expected that AWG will assign its operating rights in the 12 Texas stores it is acquiring to RLS Supermarkets, LLC (d/b/a Minyard Food Stores) and that Associated will assign its rights in the eight Montana and Wyoming stores it is acquiring to Missoula Fresh Market LLC, Ridley’s Family Markets, Inc., and Stokes Inc.

The Proposed Consent Order requires Respondents to divest: (a) the Arizona, California, Nevada, Oregon, and Washington assets to Haggen within 150 days from the date of the Acquisition; (b) the two stores in Washington to Supervalu within 100 days of the date of the Acquisition; (c) the Texas assets to AWG within 60 days of the date of the Acquisition; and (d) the Montana and Wyoming assets to Associated within 60 days of the date of the Acquisition. If, at the time before the Proposed Consent Order is made final, the Commission determines that any of the proposed buyers are not acceptable buyers, Respondents must immediately rescind the divestiture(s) and divest the assets to a different buyer that receives the Commission’s prior approval.

The proposed Consent Order contains additional provisions designed to ensure the adequacy of the proposed relief. For example, Respondents have agreed to an Order to Maintain Assets that will be issued at the time the Proposed Consent Order is accepted for public comment. The Order to Maintain Assets requires Albertson’s and Safeway to operate and maintain each divestiture store in the normal course of business, through the date the store is ultimately divested to a buyer. Since the divestiture schedule runs for an extended period of time (potentially up to 150 days following the Acquisition date), the Proposed Consent Order appoints Richard King as a Monitor to oversee the Respondents’ compliance with the requirements of the Proposed Consent Order and Order to Maintain Assets. Mr. King has the experience and skill-set to be an effective Monitor, no identifiable conflicts, and sufficient time to dedicate to this matter through its conclusion. Lastly, for a period of ten years, Albertson’s is required to give the Commission prior notice of plans to acquire any interest in a supermarket that has operated or is operating in the counties included in the relevant markets.

* * *
The sole purpose of this Analysis is to facilitate public comment on the proposed Consent Order. This Analysis does not constitute an official interpretation of the proposed Consent Order, nor does it modify its terms in any way.
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FEDERAL TRADE COMMISSION

(File No. 141 0207)

Dollar Tree, Inc. and Family Dollar Stores, Inc.—Analysis of Proposed Consent Orders To Aid Public Comment

AGENCY: Federal Trade Commission.

ACTION: Proposed consent agreement.

SUMMARY: The consent agreement in this matter settles alleged violations of federal law prohibiting unfair methods of competition. The attached Analysis to Aid Public Comment describes both the allegations in the draft complaint and the terms of the consent orders—embodied in the consent agreement—that would settle these allegations.

DATES: Comments must be received on or before August 3, 2015.

ADRESSES: Interested parties may file a comment at https://ftcpublic.commentworks.com/ftc/dollartreeconsent online or on paper, by following the instructions in the Request for Comment part of the SUPPLEMENTARY INFORMATION section below. Write “Dollar Tree, Inc. and Family Dollar Stores, Inc.—Consent Agreement; File No. 141–0207” on your comment and file your comment online at https://ftcpublic.commentworks.com/ftc/dollartreeconsent by following the instructions on the web-based form. If you prefer to file your comment on paper, write “Dollar Tree, Inc. and Family Dollar Stores, Inc.—Consent Agreement; File No. 141–0207” on your comment and mail or deliver it to the following address: Federal Trade Commission, Office of the Secretary, Constitution Center, 400 7th Street SW., 5th Floor, Suite CC–5610 (Annex J), Washington, DC 20024. If possible, submit your paper comment to the Commission by courier or overnight service.

The FTC Act and other laws that the Commission administers permit the collection of public comments to consider and use in this proceeding as appropriate. The Commission will consider all timely and responsive public comments that it receives on or before September 18, 2015. For information on the Commission’s privacy policy, including routine uses by the Privacy Act, see http://www.ftc.gov/ftc/privacy.htm. You can file a comment online or on paper. For the Commission to consider your comment, we must receive it on or before August 3, 2015. Write “Dollar Tree, Inc. and Family Dollar Stores, Inc.—Consent Agreement; File No. 141–0207” on your comment and on the envelope, and mail your comment to the following address: Federal Trade Commission, Office of the Secretary, Constitution Center, 400 7th Street SW., 5th Floor, Suite 5610 (Annex D), Washington, DC 20024.

FOR FURTHER INFORMATION CONTACT: Sean Pugh, Bureau of Competition, (202)–326–3201, 600 Pennsylvania Avenue NW., Washington, DC 20580.

SUPPLEMENTARY INFORMATION: Pursuant to Section 6(f) of the Federal Trade Commission Act, 15 U.S.C. 46(f), and FTC Rule 2.34, 16 CFR 2.34, notice is hereby given that the above-captioned consent agreement containing consent orders to cease and desist, having been filed with and accepted, subject to final approval, by the Commission, has been placed on the public record for a period of thirty (30) days. The following Analysis to Aid Public Comment describes the terms of the consent agreement, and the allegations in the complaint. An electronic copy of the full text of the consent agreement package can be obtained from the FTC Home Page (for July 2, 2015), on the World Wide Web, at http://www.ftc.gov/os/actions.shtm.

You can file a comment online or on paper. For the Commission to consider your comment, we must receive it on or before August 3, 2015. Write “Dollar Tree, Inc. and Family Dollar Stores, Inc.—Consent Agreement; File No. 141–0207” on your comment and on the envelope, and mail your comment to the following address: Federal Trade Commission, Office of the Secretary, Constitution Center, 400 7th Street SW., Suite CC–5610 (Annex D), Washington, DC 20580, or deliver your comment to the following address: Federal Trade Commission, Office of the Secretary, Constitution Center, 400 7th Street SW., 5th Floor, Suite 5610 (Annex D), Washington, DC 20024.

As a matter of discretion, the Commission tries to remove individuals’ name and other personally identifiable health information. In addition, do not include any “[t]rade secret or any commercial or financial information which . . . is privileged or confidential,” as discussed in Section 6(f) of the FTC Act, 15 U.S.C. § 46(f), and FTC Rule 4.10(a)(2), 16 CFR § 4.10(a)(2). In particular, do not include competitively sensitive information such as costs, sales statistics, inventories, formulas, patterns, devices, manufacturing processes, or customer names.

If you want the Commission to give your comment confidential treatment, you must file it in paper form, with a request for confidential treatment, and you must follow the procedure explained in FTC Rule 4.9(c), 16 CFR § 4.9(c). Your comment will be kept confidential only if the FTC General Counsel, in his or her sole discretion, grants your request in accordance with the law and the public interest.

Visit the Commission Web site at http://www.ftc.gov to read this Notice and the news release describing it. The FTC Act and other laws that the
Commission administers permit the collection of public comments to consider and use in this proceeding as appropriate. The Commission will consider all timely and responsive public comments that it receives on or before August 3, 2015. For information on the Commission’s privacy policy, including routine uses permitted by the Privacy Act, see http://www.ftc.gov/ftc/privacy.htm.

Analysis of Agreement Containing Consent Orders To Aid Public Comment

I. Introduction and Background

The Federal Trade Commission (“Commission”) has accepted for public comment, subject to final approval, an Agreement Containing Consent Orders (“Consent Order”) from Dollar Tree, Inc. (“Dollar Tree”) and Family Dollar Stores, Inc. (“Family Dollar”), (collectively, the “Respondents”). On July 27, 2014, Dollar Tree and Family Dollar entered into an agreement whereby Dollar Tree would acquire Family Dollar for approximately $9.2 billion (the “Acquisition”). The purpose of the proposed Consent Order is to remedy the anticompetitive effects that otherwise would result from Dollar Tree’s acquisition of Family Dollar. Under the terms of the proposed Consent Order, Respondents are required to divest 330 stores in local geographic markets (collectively, the “relevant markets”) in 35 states to the Commission-approved buyer. The divestitures must be completed within 150 days from the date of the Acquisition. The Commission and Respondents have agreed to an Order to Maintain Assets to maintain the viability of Respondents’ assets until they are transferred to the Commission-approved buyer.

The proposed Consent Order has been placed on the public record for 30 days to solicit comments from interested persons. Comments received during this period will become part of the public record. After 30 days, the Commission will review the proposed Consent Order and any comments received, and decide whether the Consent Order should be withdrawn, modified, or made final.

The Commission’s Complaint alleges that the Acquisition, if consummated, would violate Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45, by removing an actual, direct, and substantial competitor in localized geographic markets in 222 cities nationwide. The elimination of this competition would result in significant competitive harm; specifically the Acquisition will allow the combined entity to increase prices unilaterally above competitive levels. Similarly, absent a remedy, there is significant risk that the merged firm may decrease the quality and service aspects of its stores. The proposed Consent Order would remedy the alleged violations by requiring divestitures to replace competition that otherwise would be lost in these markets because of the Acquisition.

II. The Respondents

As of January 31, 2015, Dollar Tree operated 5,157 discount general merchandise retail stores across the United States under the Dollar Tree and Deals banners. Presently, Dollar Tree banner stores are located in 48 states and the District of Columbia, while Deals banner stores are currently located in 18 states and the District of Columbia. In the Dollar Tree banner stores, Dollar Tree sells a wide selection of everyday basic, seasonal, closeout, and promotional merchandise for $1 or less. At its Deals banner stores, Dollar Tree offers an expanded assortment of this merchandise at prices generally less than $10. Dollar Tree and Deals banner stores range in size from 8,000 to 12,000 square feet of selling space and typically carry between 6,600 to 7,000 stock keeping units (“SKUs”).

As of February 28, 2015, Family Dollar operated approximately 8,184 discount general merchandise retail stores nationwide. Family Dollar sells an assortment of consumables, home products, apparel and accessories, seasonal items, and electronic merchandise at prices generally less than $10. Currently, Family Dollar stores are located in 46 states and the District of Columbia. Stores typically have 7,150 square feet of selling space and carry approximately 6,500 to 7,000 SKUs.

III. Competition in the Relevant Markets

Dollar stores are small-format, deep-discount retailers that sell an assortment of consumables and non-consumables, including food, home products, apparel and accessories, and seasonal items, at prices typically under $10. Dollar stores differentiate themselves from other retailers on the basis of both convenience and value by offering a broad assortment but limited variety of general merchandise items at discounted prices in stores with small footprints (i.e., approximately 7,000 to 10,000 square feet of selling space), located relatively close to consumers’ homes or places of work. Customers often shop at dollar stores as part of a “fill-in” shopping trip. Dollar stores typically compete most closely with other dollar stores that provide the same kind of convenient shopping trip for discounted general merchandise.

Walmart competes closely with dollar stores and offers a wide assortment of products at deeply-discounted prices. Although Walmart does not provide the same kind of convenience as that of dollar stores given its less-accessible locations, larger store footprints, and greater assortment of products, Walmart nevertheless competes closely with dollar stores by offering a comparable or better value to consumers in terms of pricing. For purposes of this matter, “discount general merchandise retail stores” refers to dollar stores and the retailer Walmart.

Although other retail stores (i.e., supermarkets, pharmacies, mass merchandisers, and discount specialty merchandise retail stores) often sell discounted merchandise similar to that offered by dollar stores and Walmart, these other retailers generally are not as effective as constraining Respondents as are other discount general merchandise retail stores. These other retailers do not offer the same value as Walmart or the same combination of convenience and value offered by dollar stores, which tends to make them less effective substitutes for discount general merchandise retail stores. As a result, consumers shopping at discount general merchandise retail stores are unlikely to significantly increase purchases of discounted merchandise at other retailers in response to a small but significant price increase at discount general merchandise retail stores. However, in certain geographic markets, typically characterized by high population density, where the number and geographic proximity of these other retailers is substantial relative to the...
competing discount general merchandise retail stores, the collective presence of these other retailers acts as a more significant price constraint on the discount general merchandise retail stores operating in the area.5

Thus, the relevant line of commerce in which to analyze the Acquisition is no narrower than discount general merchandise retail stores. In certain geographic markets, the relevant line of commerce may be as broad as the sale of discounted general merchandise in retail stores (i.e., discount general merchandise retail stores as well as supermarkets, pharmacies, mass merchandisers, and discount specialty merchandise retail stores). Whether the relevant line of commerce is discount general merchandise retail stores or discounted general merchandise in retail stores depends on the specifics of the geographic market at issue, such as population density and the density and proximity of the Respondents’ stores and competing retailers.

The relevant geographic market varies depending on the unique characteristics of each market, including the local road network, physical boundaries, and population density. A strong motivation of consumers shopping at discount general merchandise retail stores is convenience. As with grocery shopping, the vast majority of consumers who shop for discounted general merchandise do so at stores located very close to where they live or work. The draw area of a dollar store, which varies depending on whether it is located in an urban, suburban, or rural area, may range from a couple of city blocks to several miles. Other market participants, such as supermarkets and retail pharmacies, may have similar, although somewhat broader draw areas.

Walmart’s stores, particularly Walmart Supercenters, tend to have a considerably broader draw area. In highly urban areas, the geographic markets are generally no broader than a half-mile radius around a given store. In highly rural areas, the geographic market is generally no narrower than a three-mile radius around a given store. In areas neither highly urban nor highly rural, the geographic market is generally within a half-mile to three-mile radius around a given store.

Respondents are close competitors in terms of format, customer service, product offerings, and location in the relevant geographic markets. With regard to pricing, product assortment, and a host of other competitive issues, Respondents typically focus most directly on the actions and responses of each other and other dollar stores, while also paying close attention to Walmart. In many of the relevant geographic markets, Dollar Tree and Family Dollar operate the only dollar stores in the area or the vast majority of conveniently-located discount general merchandise retail stores. Absent relief, the Acquisition would increase the incentive and ability of Dollar Tree to raise prices unilaterally post-Acquisition in the relevant geographic markets. The Acquisition would also decrease incentives to compete on non-price factors, including product selection, quality, and service.

Entry into the relevant geographic markets that is timely and sufficient to prevent or counteract the expected anticompetitive effects of the Acquisition is unlikely. Entry barriers include the time, costs, and feasibility associated with identifying and potentially constructing an appropriate and available location for a discount general merchandise retail store, the resources required to support one or more new stores over a prolonged ramp-up period, and the sufficient scale to compete effectively. An entrant’s ability to secure a viable competitive location may be hindered by restrictive-use commercial lease covenants, which can limit the products sold, or even the type of retailer that can be located, at a particular location.

IV. The Proposed Consent Order

The proposed remedy, which requires the divestiture of 330 Family Dollar stores in the relevant markets to Sycamore Partners (“Sycamore”), will restore fully the competition that otherwise would be eliminated in these markets as a result of the Acquisition. Sycamore is a private equity firm specializing in consumer and retail investments. The proposed buyer appears to be a highly suitable purchaser and is well positioned to enter the relevant geographic markets and prevent the likely competitive harm that otherwise would result from the Acquisition. Sycamore’s proposed executive team has extensive experience operating discount general merchandise retail stores.

The proposed Consent Order requires Respondents to divest 330 stores to Sycamore within 150 days from the date of the Acquisition. If, at any time before the proposed Consent Order is made final, the Commission determines that Sycamore is not an acceptable buyer, Respondents must immediately rescind the divestitures and divest the assets to a different buyer that receives the Commission’s prior approval.

The proposed Consent Order contains additional provisions to ensure the adequacy of the proposed relief. For example, Respondents have agreed to an Order to Maintain Assets that will be issued at the time the proposed Consent Order is accepted for public comment. The Order to Maintain Assets requires Family Dollar to operate and maintain each divestiture store for the normal course of business through the date the store is ultimately divested to Sycamore. Because the divestiture schedule runs for an extended period of time, the proposed Consent Order appoints Gary Smith as a Monitor to oversee Respondents’ compliance with the requirements of the proposed Consent Order and Order to Maintain Assets. Mr. Smith has the experience and skills to be an effective Monitor, no identifiable conflicts, and sufficient time to dedicate to this matter through its conclusion.

* * *

The sole purpose of this Analysis is to facilitate public comment on the proposed Consent Order. This Analysis does not constitute an official interpretation of the proposed Consent Order, nor does it modify its terms in any way.

Appendix A

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5 Online retailers are not participants in the relevant product market. The primary appeal of dollar stores is the combination of value and convenience they offer consumers. Given the time required to process and ship items ordered online, Internet retailers are less convenient shopping options for consumers looking to make an immediate purchase on a fill-in trip.
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By direction of the Commission, Commissioner Wright dissenting. Donald S. Clark.

Secretary.
the local markets where it may likely harm competition, the Commission considered multiple sources of quantitative and qualitative evidence. One component of the investigation involved a Gross Upward Pricing Pressure Index ("GUPPI") analysis. As described in the 2010 Horizontal Merger Guidelines, this mode of analysis can serve as a useful indicator of whether a merger involving differentiated products is likely to result in unilateral anticompetitive effects. Such effects can arise "when the merger gives the merged entity an incentive to raise the price of a product previously sold by one merging firm" because the merged entity stands to profit from any sales that are then diverted to products that would have been "previously sold by the other merging firm."3 Using the value of diverted sales as an indicator of the upward pricing pressure resulting from the merger, a GUPPI is defined as the value of diverted sales that would be gained by the second firm measured in proportion to the revenues that would be lost by the first firm. If the "value of diverted sales is proportionately small, significant unilateral price effects are unlikely."4

The Commission’s investigation involved thousands of Dollar Tree and Family Dollar stores with overlapping geographic markets. A GUPPI analysis served as a useful initial screen to flag those markets where the transaction might likely harm competition and those where it might pose little or no risk to competition. As a general matter, Dollar Tree and Family Dollar stores with relatively low GUPPIs suggested that the transaction was unlikely to harm competition, unless the investigation uncovered specific reasons why the GUPPIs may have understated the potential for anticompetitive effects. Conversely, Dollar Tree and Family Dollar stores with relatively high GUPPIs suggested that the transaction was likely to harm competition, subject to evidence or analysis indicating that the GUPPIs may have overstated the potential for anticompetitive effects. While the GUPPI analysis was an important screen for the Commission’s inquiry, it was only a starting point. The Commission considered several other sources of evidence in assessing the transaction’s likely competitive effects, including additional detail regarding the geographic proximity of the merging parties’ stores relative to each other and to other retail stores, ordinary course of business documents and data supplied by Dollar Tree and Family Dollar, information from other market participants, and analyses conducted by various state attorneys general who were also investigating the transaction. After considering all of this evidence, the Commission identified specific local markets where the acquisition would be likely to harm competition and arrived at the list of 330 stores slated for divestiture.

In his statement, Commissioner Wright criticizes the way that the Commission used the GUPPI analysis in this case and argues that GUPPIs below a certain threshold should be treated as a "safe harbor."5 We respectfully disagree. As an initial matter, Commissioner Wright mischaracterizes the way that the GUPPI analysis was used in this case. Contrary to his suggestion, GUPPIs were not used as a rigid presumption of harm. As explained above, they were used only as an initial screen to identify those markets where further investigation was warranted. The Commission then proceeded to consider the results of the GUPPI analysis in conjunction with numerous other sources of information.6 Based on this complete body of evidence, we have reason to believe that, without the proposed divestitures, the acquisition would substantially lessen competition in each of the relevant local markets.

Our market-by-market review showed that the model of competition underlying the GUPPI analysis was largely consistent with other available evidence regarding the closeness of competition between the parties’ stores in each local market. For example, stores with high GUPPIs were generally found in markets in which there were few or no other conveniently located discount general merchandise retail stores. The GUPPI analysis did have some limitations, however. For example, there were Family Dollar stores with relatively low GUPPIs in markets that were nevertheless price-zoned to Dollar Tree stores, which meant that if Dollar Tree stores were

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1 This statement reflects the views of Chairwoman Ramirez and Commissioners Brill, Ohlhausen, and McSweeney.


3 Id.

4 Id.


6 As Joseph Farrell and Carl Shapiro have noted, "[r]eal-world mergers are complex, and our proposed test, like the concentration-based test, is consciously oversimplified. . . . In the end, the evaluation of any merger that is thoroughly investigated or litigated may come down to the fullest feasible analysis of effects." Joseph Farrell & Carl Shapiro, Antitrust Evaluation of Horizontal Mergers: An Economic Alternative to Market Definition, 10 B.E. J. Theoretical Econ. 1, 20 (2010).
removed as competition, then the prices of certain items at those Family Dollar stores would likely go up. The GUPPI analysis also was not sufficiently sensitive to differentiate between Dollar Tree and Family Dollar stores that were in the same shopping plaza from those that were almost a mile away from each other. For these situations, we appropriately relied on other evidence to reach a judgment about the closeness of competition.7

More broadly, Commissioner Wright’s view that the Commission should identify and treat GUPPIs below a certain threshold as a “safe harbor” ignores the reality that merger analysis is inherently fact-specific. The manner in which GUPPI analysis is used will vary depending on the factual circumstances, the available data, and the other evidence gathered during an investigation. Moreover, whether the value of diverted sales is considered “proportionately small” compared to lost revenues will vary from industry to industry and firm to firm.8 For example, internal friction between merging firms may cause margins to be very low, which could produce a low GUPPI even in the presence of very high divergence ratios. Such conditions could produce a false negative implying that the merger is not likely to harm competition when in fact it is.9

Indeed, we agree with Commissioner Wright that “a GUPPI-based presumption of competitive harm is inappropriate at this stage of economic learning.”10 We think that a GUPPI-based safe harbor is equally inappropriate. In antitrust law, bright-line rules and presumptions rest on accumulated experience and economic learning that the transaction or conduct in question is likely or unlikely to harm competition.11 We do not believe there is a basis for the recognition of a GUPPI safe harbor.

Accordingly, in any case where a GUPPI analysis is used, the Commission will consider the particular factual circumstances and evaluate other sources of quantitative and qualitative evidence.12 As with other quantitative evidence such as market shares and HHIs, we believe that GUPPIs should be considered in the context of all other reasonably available evidence. The 2010 Horizontal Merger Guidelines do not instruct otherwise.13 For all of these reasons, we believe it is appropriate to use GUPPIs flexibly and as merely one tool of analysis in the Commission’s assessment of unilateral anticompetitive effects.

By direction of the Commission, Commissioner Wright not participating, the per se rule is appropriate only after courts have had considerable experience with the type of restraint at issue. . . . and only if courts can predict with confidence that it would be invalidated in all or almost all instances under the rule of reason. . . .”); Cal. Dental Ass’n v. FTC, 528 U.S. 756, 781 (1999) (“The object is to see whether the experience of the market has been so clear, or necessarily will be, that a confident conclusion about the principal tendency of a restriction will follow from a quick (or at least quicker) look, in place of a more laborious one.”); ProMedica Health Sys., Inc. v. FTC, 749 F.3d 559, 570, 571 (6th Cir. 2014) (noting that “the strong correlation between market share and price, and the degree to which this merger would further concentrate markets that are already highly concentrated—converge in a manner that fully supports the Commission’s application of a presumption of illegality” but also noting that “the Commission did not merely rest upon the presumption, but instead discussed a wide range of evidence.14

We dissent in part because in 27 markets the proposed transaction will harm competition in real-world industries. Indeed, as stressed above, all of the quantitative methods discussed here must be used in conjunction with the broader set of qualitative evidence that the Agencies assemble during a merger investigation.”); Farrell & Shapiro, Upward Pricing Pressure, supra note 8, at 6 (“Whatever measure is used for screening purposes, it is important that the full analysis give proper weight to all the available evidence.”). Notwithstanding Commissioner Wright’s suggestion to the contrary, we do not believe that the Commission’s use of GUPPIs as a tool for assessing unilateral effects differs materially from their use by the Department of Justice.

Recognizing in the 2010 Horizontal Merger Guidelines that when the “value of diverted sales is proportionately small, significant unilateral price effects are unlikely” does not necessarily mean that “proportionately small” should be reduced to some numerical value that applies in all cases. See Merger Guidelines, supra note 2, § 1 (“These Guidelines should be read with the awareness that merger analysis does not consist of uniform application of a single methodology.”).

Statement of Commissioner Joshua D. Wright Dissenting in Part and Concurring in Part

The Commission has voted to issue a Complaint and a Decision & Order against Dollar Tree, Inc. (“Dollar Tree”) and Family Dollar Stores, Inc. (“Family Dollar”) to remedy the allegedly anticompetitive effects of the proposed acquisition by Dollar Tree of Family Dollar. I dissent in part from and concur in part with the Commission’s decision. I dissent in part because in 27 markets I disagree with the Commission’s conclusion that there is reason to believe the proposed transaction violates the Clayton Act.

The record evidence includes a quantitative measure of the value of diverted sales as well as various forms of qualitative evidence. The value of diverted sales is typically measured as the product of the diversion ratio between the merging parties’ products—the diversion ratio is that between two products is the percentage of unit sales lost by one product when its price rises, that are captured by the second product—and the profit margin of the second product. When the value of diverted sales is measured in proportion to “the lost revenues attributable to the reduction in unit sales resulting from the price increase,” it is the “gross upward pricing pressure index,” or “GUPPI.” The GUPPI is an economic tool used to score or rank the incentives for potential unilateral price effects. In the markets where I depart from the Commission’s decision the GUPPI is below 5 percent, indicating insignificant upward pricing pressure even before efficiencies or entry are taken into account, and weak incentives for unilateral price increases. In my view, the available quantitative and qualitative evidence are insufficient to support a reason to believe the proposed transaction will harm competition in these markets. I write separately to explain more fully the basis for my dissent in these markets.

I also write to address an important merger policy issue implicated by today’s decision—that is, whether the FTC should adopt a safe harbor in unilateral effects merger investigations by defining a GUPPI threshold below which it is presumed competitive harm is unlikely. The Merger Guidelines clearly contemplate such a safe harbor. The Merger Guidelines explain that “[i]f the value of diverted sales is proportionately small, significant

7 Commissioner Wright cites the Albertson’s/Safeway transaction as another recent case in which a GUPPI analysis was used. See Wright Statement at 2 n.6. To be precise, the Commission analyzed that transaction using diversion ratios, not GUPPI scores, but in any event, Commissioner Wright himself voted to accept the consent order in that case.
8 Marginal cost efficiencies, as well as pass-through rates, also will vary from industry to industry and firm to firm. The pass-through rate will determine the magnitude of the post-merger unilateral price effects.
9 See, e.g., Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 553 U.S. 877, 886–87 (2007) (“As a result, the price increase,” it is the “gross upward pricing pressure index,” or “GUPPI.” The GUPPI is an economic tool used to score or rank the incentives for potential unilateral price effects. In the markets where I depart from the Commission’s decision the GUPPI is below 5 percent, indicating insignificant upward pricing pressure even before efficiencies or entry are taken into account, and weak incentives for unilateral price increases. In my view, the available quantitative and qualitative evidence are insufficient to support a reason to believe the proposed transaction will harm competition in these markets. I write separately to explain more fully the basis for my dissent in these markets.
10 Wright Statement, supra note 5, at 8 & nn.23 & 24 (citing commentators’ concerns and criticisms regarding the use of GUPPI analysis generally). Such concerns and criticisms, if valid, would apply equally to the wisdom of using GUPPIs to recognize a safe harbor.
11 See, e.g., Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 553 U.S. 877, 886–87 (2007) (“As a result, the price increase,” it is the “gross upward pricing pressure index,” or “GUPPI.” The GUPPI is an economic tool used to score or rank the incentives for potential unilateral price effects. In the markets where I depart from the Commission’s decision the GUPPI is below 5 percent, indicating insignificant upward pricing pressure even before efficiencies or entry are taken into account, and weak incentives for unilateral price increases. In my view, the available quantitative and qualitative evidence are insufficient to support a reason to believe the proposed transaction will harm competition in these markets. I write separately to explain more fully the basis for my dissent in these markets.
unilateral price effects are unlikely." In other words, the Merger Guidelines recognize that if the GUPPI is small, significant unilateral price effects are unlikely. Without more, one might reasonably conclude it is unclear whether the Merger Guidelines merely offer a truism about the relationship between the GUPPI and likely unilateral price effects or invite the agencies to take on the task of identifying a safe harbor of general applicability across cases. But there is more. A principal drafter of the Merger Guidelines, Steven C. Salop, in his Merger Guidelines’ reference to a “proportionately small” value of diverted sales was intended to establish a GUPPI safe harbor. The Department of Justice’s Antitrust Division (“Division”), consistent with this interpretation of the Merger Guidelines, publicly announced precisely such a safe harbor when the GUPPI is less than 5 percent.3 Further, there is significant intellectual support for a GUPPI-based safe harbor among economists, once again including the principal drafter of the Merger Guidelines. The Commission, however, has rejected the safe harbor approach both in practice—indeed, the Commission has recently entered into another consent involving divestitures in markets with GUPPI scores below 5 percent—and as a matter of the policy announced in the Commission’s statement today.7

This is unfortunate. The legal, economic, and policy case for the GUPPI-based safe harbor contemplated by the Merger Guidelines is strong.8 There are a number of reasons why such a safe harbor might be desirable as a matter of antitrust policy if sufficiently supported by economic theory and evidence. Efficient resource allocation—expenditing agency resources on the transactions most likely to raise serious competitive concerns and quickly dispensing with those that do not—is one such goal.

A second reason a safe harbor for proportionately small diversion might be desirable antitrust policy is to compensate for the sources of downward pricing pressure not measured by the GUPPI but expected with most transactions, including efficiencies, entry, or repositioning. Some have argued that—as a GUPPI diversion or GUPPI-based analysis was a step forward relative to relying exclusively upon structural analysis. The fact that there were stores identified for divestiture with implied GUPPIs less than 5 percent was unique. It is now a trend reinforced by a Commission decision to reject a GUPPI-based safe harbor—a decision I do not believe is in the public interest. Regarding Cerberus, it is worth pointing out further that even a careful reader of the public documents in that case would come away with the impression that the Commission’s analysis was largely structural, and concluded a number of six-to-five mergers were presumptively anticompetitive. See Analysis of Agreement Containing Consent Order to Aid Public Comment Exhibit A, id. An ancillary benefit of the transparency reluctantly generated today by the Commission statement is that the antitrust community is now on notice that more sophisticated economic tools were used in that matter, how they were used, and that the potential structural policy change signaled by those public documents should appear transparent to the accurately the Commission’s complete analysis in that case.


A second question is whether a presumption of competitive harm should follow, as a matter of economic theory and empirical evidence, from a demonstration of a GUPPI above a certain threshold value. There appears to be a consensus that the value of diverted sales is proportionately small and hence that the proposed merger is unlikely to raise unilateral effects concerns”.


6 See Cerberus Institutional Partners V, L.P., FTC File No. 141–0108 (July 2, 2015). There, though one could not possibly infer this from the public-facing documents in the case, the Commission applied a diversion ratio threshold to identify stores for divestiture. To be accurate, a GUPPI threshold could be implied from the Commission’s analysis and, as algebraically mindful readers will note, setting a diversion ratio threshold given profit margin data and a predicted price increase is not analytically distinguishable from the analysis in this matter. The Commission rightly points out that I voted in favor of the consent in Cerberus. As to whether I am merely being inconsistent in my views on the appropriate role of GUPPIs in merger analysis and, or alternatively, there is some other more reasonable explanation for my votes, I can provide the explanation and let readers decide. In Cerberus, I voted for the consent on the basis that the use of

7 Antitrust L.J. 587, 628 (2010) (“an uncalibrated tool cannot have predictive value as a screen if it always indicates postmerger price increase”).

8 Farrell & Shapiro, supra note 5, at 10–12.

9 See id. at 12.

10 James A. Keyte & Kenneth B. Schwartz, “Tally-Ho!” UPP and the 2010 Horizontal Merger Guidelines, 7 Antitrust L.J. 587, 628 (2010) (“an uncalibrated tool cannot have predictive value as a screen if it always indicates postmerger price increase”)

11 Shapiro, supra note 3, at 24. Shapiro further cautioned that, although a GUPPI analysis “can be highly informative, the Agencies understand full well that measuring upward pricing pressure . . . typically is not the end of the story . . . Repositioning, entry, innovation, and efficiencies must also be considered.” Id. at 26.

12 Id. at 24. Others have interpreted this speech as clearly announcing a Division policy. See Salop, supra note 8, at 43 & n.105 (“In a speech while he was Deputy AAG, Carl Shapiro also specified a GUPPI safe harbor of 5%. As a speech by the Deputy AAG, this statement appeared to reflect DOJ policy.” (citing Shapiro, supra note 3)). Other economists agree that a GUPPI safe harbor should apply. E.g., Farrell & Shapiro, supra note 5, at 10; Salop, Moresi & Woodbury, supra note 2, at 2.
the Merger Guidelines were adopted other than the two already mentioned that meet these criteria. The domain in which flexibility would be reduced with adoption of a reasonable safe harbor is small and the costs of doing so correspondingly low.

The Commission rejects a GUPPI safe harbor on the grounds that such an approach “ignores the reality that merger analysis is inherently fact-specific.” 14 The Commission appears especially concerned that a GUPPI-based safe harbor might result in a false negative—that is, it is possible that a merger with a GUPPI less than 5 percent harms competition. This objection to safe harbors and bright-line rules and presumptions is both conceptually misguided and is in significant tension with antitrust doctrine and agency practice. Merger analysis is, of course, inherently fact specific. One can accept that reality, as well as the reality that evidence is both imperfect and can be costly to obtain, and yet still conclude that the optimal legal test from a consumer perspective is a rule rather than a standard. This is a basic insight of decision theory, which provides a lens through which economists and legal scholars have long evaluated antitrust legal rules, burdens, and presumptions. 15 The Commission’s assertion that the mere possibility of false negatives undermines in the slightest the case for a safe harbor reveals a misunderstanding of the economic analysis of legal rules. The relevant question is not which legal rule drives false positives or false negatives to zero but rather which legal rule minimizes the sum of the welfare costs associated with false negatives, false positives, and the costs of obtaining evidence and otherwise administering the law.

Existing antitrust law regularly embraces bright-line rules and presumptions—rejecting the flexibility of a case-by-case standard taking full account of facts that vary across industries and firms. A simple example is the application of per se rules in price-fixing cases. 16 This presumption of illegality is not based upon a belief that it is impossible for a horizontal restraint among competitors to increase welfare. Rather, the per se prohibition on naked price fixing “reflects a judgment that the costs of identifying exceptions to the general rule so far outweigh the costs of occasionally condemning conduct that might upon further inspection prove to be acceptable, that it is preferable not to entertain defenses to the conduct at all.” 17 Similar decision-theoretic logic explains, for example, the presumption that above-cost prices are lawful. 18 A GUPPI-based presumption would be based upon the same economic logic—not that small-GUPPI mergers can never result in anticompetitive effects, but rather that mergers involving small GUPPIs are sufficiently unlikely to result in unilateral price increases such that incurring the costs of identifying exceptions to the safe harbor is less efficient than simply allowing mergers within the safe harbor to move forward. 19

Whether the Commission should adopt a GUPPI-based safe harbor is particularly relevant in the instant matter, as the FTC had data sufficient to calculate GUPPIs for Dollar Tree, Deals, 20 and Family Dollar stores. The sheer number of stores owned and operated by the parties rendered individualized, in-depth analysis of the competitive nuances of each and every market difficult, if not impossible, to conduct. GUPPI calculations provided an efficient and workable alternative to identifying the small fraction of markets in which the transaction may be anticompetitive. This was a tremendous amount of work and I want to commend staff on taking this approach. Staff identified a GUPPI threshold such that stores with GUPPIs greater than the threshold were identified for divestiture. About half of the 330 stores divested as part of the Commission’s Order were identified through this process.

What about the other stores? The Commission asserts I “miscal...characterize[]” its use of GUPPIs and that “GUPPIs were not used as a rigid presumption of harm.” 21 It claims that GUPPIs were used only as “an initial screen” to identify markets for further analysis, and that the Commission “proceeded to consider the results of the GUPPI analysis in conjunction with numerous other sources of information.” 22 The evidence suggests otherwise. One might reasonably hypothesize that further consideration and analysis of

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14 Majority Statement, supra note 7, at 3.
16 See Broad, Music, Inc. v. Columbia Broad. Sys., Inc., 441 U.S. 1, 19–20 (1979) (“More generally, in characterizing this conduct under the per se rule, our inquiry must focus on . . . whether the practice facially appears to be one that would always or almost always tend to restrict competition and decrease output.”).
17 Andrew I. Gavil, William E. Kovacic & Jonathan B. Baker, Antitrust Law in Perspective: Cases, Concepts and Problems in Competition Policy 104–05 (2d ed. 2008); see Barry Wright Corp. v.ITT Grinnell Corp., 724 F.2d 227, 234 (1st Cir. 1983) (“Rules that seek to embody every economic complexity and qualification may well, through the vagaries of administration, prove counterproductive, undercutting the very economic ends they seek to serve. Thus, despite the theoretical possibility of finding a market in which horizontal price fixing, or vertical price fixing, are economically justified, the courts have held them unlawful per se, concluding the administrative virtues of simplicity outweigh the occasional ‘economic’ loss.”); Herbert Hovenkamp, The Antitrust Enterprise: Principle and Execution 50 (2005) (“Not every anticompetitive practice can be condemned.”); Thomas A. Lambert, Book Review, Tweaking Antitrust’s Business Model, 85 Tex. L. Rev. 153, 172 (2006) (“Hovenkamp’s discussion of predatory and limit pricing reflects a key theme that runs throughout The Antitrust Enterprise: That antitrust rules should be easily administrable, even if that means they must permit some anticompetitive practices to go unpunished.”).
18 See Brooke & Williamson Tobacco Corp., 509 U.S. 209, 226 (1993); see also Barry Wright Corp., 724 F.2d at 234 (“Conversely, we must be concerned lest a rule or precedent that authorizes a search for a particular type of undesirable pricing behavior end up by discouraging legitimate price competition. . . . [A] price cut that ends up with a price exceeding total cost—in this case, a price paid by a firm with market power—is almost certainly moving price in the ‘right’ direction (towards the level that would be set in a competitive marketplace). The antitrust laws evaluate such a move as ‘good’ on the grounds that if the transaction can be justified as a search for the sake of more speculative (future low-price) ‘hedge in the bush’. To do so opens the door to similar speculative claims that might seek to legitimate even the most settled unlawful practices.”).
19 The Commission asserts that a GUPPI safe harbor cannot be justified by economic theory and evidence unless a presumption of liability can also be supported. I appreciate the Commission clarifying its view, but I believe it to be based upon a false equivalence. The Commission appears to misunderstand the difference between evidence sufficient to conclude harm is likely and evidence sufficient to conclude harm is unlikely. These are two very different economic propositions and it should not be surprising that one might be substantiated while the other is not. For example, one might rationally be uncomfortable pointing to the economic literature for support that mergers above a certain level of concentration are sufficiently likely to harm competition to support a presumption of antitrust liability, but also recognize the same body of economic theory and evidence would indeed support a safe harbor for mergers involving markets with thousands of competitors. To the extent the Commission appeals to academics who have raised concerns with GUPPI-based merger screens, my view clearly differs from the Commission. The Commission’s more important dispute, in my view, is with the Merger Guidelines and its principal drafters, who clearly contemplated such a safe harbor.
20 Deals is a separate banner under which Dollar Tree operates. See Majority Statement, supra note 7, at 1.
21 Id. at 2.
22 Id.
“numerous sources of information” should result in both the identification of some stores above the GUPPI threshold that were ultimately determined unlikely to harm competition as well as some stores with GUPPIs below the threshold that nonetheless did create competitive problems—that is, further scrutiny might reveal both false negatives and false positives.

The number of stores with GUPPIs exceeding the identified threshold that, after evaluation in conjunction with the qualitative and other evidence described by the Commission, were not slated for divestiture is nearly zero. This outcome is indistinguishable from the application of a presumption of competitive harm.28 The additional stores with GUPPIs below the threshold that were then identified for divestiture based upon additional qualitative factors included a significant number of stores with GUPPIs below 5 percent. The ratio of stores falling below the GUPPI threshold but deemed problematic after further qualitative evidence is taken into account to stores with GUPPIs above the threshold but deemed not to raise competitive problems after qualitative evidence is accounted for is unusual and remarkably high. It is difficult to conceive of a distribution of qualitative and other evidence occurring in real-world markets that would result in this ratio. Qualitative evidence should not be a one-way ratchet confirming the Commission’s conclusion of likely anticompetitive effects when GUPPIs are high and providing an independent basis for the same conclusion when GUPPIs are low.

I applaud the FTC for taking important initial steps in applying more sophisticated economic tools in conducting merger analysis where the data are available to do so. Scoring metrics for evaluating incentives for unilateral price increases are no doubt a significant improvement over simply counting the number of firms in markets pre- and post-transaction. To be clear, it bears repeating that I agree that a GUPPI-based presumption of competitive harm is inappropriate at this stage of economic learning.29 There is no empirical evidence to support the use of GUPPI calculations in merger analysis on a standalone basis, let alone the use of a particular GUPPI threshold to predict whether a transaction is likely to substantially harm competition.24 I also agree that in the context of a full-scale evaluation of whether a proposed transaction is likely to harm competition, GUPPI-based analysis can and should be interpreted in conjunction with all other available quantitative and qualitative evidence. The relevant policy question is a narrow one: Whether there exists a GUPPI threshold below which the Commission should presumptively conclude a proposed transaction is unlikely to violate the antitrust laws. The FTC has not publicly endorsed a GUPPI-based safe harbor of 5 percent and disappointingly, has rejected the concept in its statement today. The Commission’s interpretation is that what is a “proportionately small” value of diverted sales should vary according to the industry—and even the individual firms—in a given investigation.28 As discussed, I believe this interpretation contradicts the letter and spirit of the Merger Guidelines.26 Moreover, the Commission’s apparent discomfort with safe harbors on the grounds that they are not sufficiently flexible to take into account the fact-intensive nature of antitrust analysis in any specific matter is difficult to reconcile with its ready acceptance of presumptions and bright-line rules that trigger liability.27

Once it is understood that a safe harbor should apply, it becomes obvious that for the safe harbor to be effective, the threshold should not move. As the plane crash survivors in LOST can attest, a harbor on an island that cannot be found and that can be moved at will is hardly “safe.”28

In my view, the Commission should adopt a GUPPI-based safe harbor in unilateral effects investigations where data are available. While reasonable minds can and should conceive of a distribution of qualitative and other evidence occurring in real-world markets that would result in this ratio, Qualitative evidence should not be a one-way ratchet confirming the Commission’s conclusion of likely anticompetitive effects when GUPPIs are high and providing an independent basis for the same conclusion when GUPPIs are low.

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23 Joseph J. Simons & Malcolm B. Coate, Upward Pressure on Price Analysis: Issues and Implications for Merger Policy, 6 Eur. Competition J. 377, 389 (2010) (the upward pricing pressure screen “identifies as potentially problematic far more mergers than would be challenged or even investigated under the enforcement standards that have existed for more than twenty years”); Lambert, supra note 8, at 13 (“In the end, the agencies’ reliance on the difficult-to-administer, empirically unverified, and inherently biased GUPPI is likely to generate many false condemnations of mergers that are, on the whole, beneficial.”).

24 See Dennis W. Carlton, Revising the Horizontal Merger Guidelines, 10 J. Competition L. & Econ. 1, 7 (2014) (“Proponents of theoretical treatment in an intermediate regime (as described in the 2010 Merger Guidelines) is new and little empirical analysis has been performed to validate its predictive value in assessing the competitive effects of mergers.”); Keyte & Schwartz, supra note 11, at 590 (discussing the 2010 Merger Guidelines’ inclusion of the GUPPI and opining that “in light of the [the] extremely light judicial record, as well as the absence of demonstrated reliability in predicting real-world competitive effects, we think it is premature, at best, to embrace [it] as a screening tool for merger review”); Simons & Coate, supra note 23 (“[SYN]metrical UPP [as such as the GUPPI] purport to highlight general results, they need empirical support to show the methodology actually predicts concerns relatively well. This empirical support is not available at this time.”); Lambert, supra note 8, at 13 (the GUPPI “has not been empirically verified as a means of identifying anticompetitive mergers”).

25 Majority Statement, supra note 7, at 3.

26 See supra text accompanying note 12.

27 For example, the Commission regularly applies such presumptions of liability involving the number of firms in a market, or presumptions based on inter-firm market concentration as articulated by the Merger Guidelines or the courts. See, e.g., Statement of the Federal Trade Commission, Hokim Ltd., FTC File No. 141–0129 (May 8, 2015) (finding liability based upon, alternatively, changes in concentration and number of firms pre- and post-merger); Statement of the Federal Trade Commission, ZF Friedrichshafen AG, FTC File No. 141–0235 (May 8, 2015) (finding liability based upon number of firms pre- and post-merger); Mem. in Supp. of PI, Federal Trade Commission’s Mot. for T.R.O. and Prelim. Inj. at 23, FTC, v. Sysco Corp., 2015 WL 1501608, No. 1:15–cv–00256 (D.D.C. 2015) (arguing that the proposed merger was presumptively unlawful based upon the holding of United States v. Philip, Nat’l Bank, 374 U.S. 321 (1963)). That the Commission’s tolerance of presumptions that that satisfy its own prima facie burden does not extend to safe harbors raises basic questions about the symmetry of the burdens applied in its antitrust analysis. See Dissenting Statement of Commissioner Joshua D. Wright 6, Ardagh Group S.A., FTC File No. 131–0087 (June 18, 2015) (“[SYN]metrical theory and practice of evidence proffered to discharge the respective burdens of proof facing the agencies and merging parties is necessary for consumer-welfare based merger policy.”).


29 I do not take a position as to how the Division currently uses the GUPPI analysis. But see Majority Statement, supra note 7, at 4 n.12. However, public statements by the Division and the Commission—the only sources upon which business firms and the antitrust bar can rely—suggest there are material differences. Compare id. at 3 (“Whether the value of diverted sales is considered ‘proportionately small’ compared to lost revenues will vary from industry to industry and firm to firm.”) with Shapiro, supra note 3, at 24 (“Current Division practice is to treat the value of diverted sales as proportionately small if it is no more than 5% of the lost revenues.”).

30 A GUPPI-based safe harbor of the type endorsed by the Merger Guidelines implies a GUPPI above the threshold is necessary but not sufficient for liability. A GUPPI-based safe harbor implies a GUPPI above the threshold is sufficient but not necessary for liability. Unfortunately, the use of GUPPIs here is more consistent with the latter than the former.
DEPARTMENT OF DEFENSE

GENERAL SERVICES ADMINISTRATION

NATIONAL AERONAUTICS AND SPACE ADMINISTRATION

[OMB Control No. 9000–0054]; [Docket 2015–0053; Sequence 3]

Submission to OMB for Review; Federal Acquisition Regulation; U.S.-Flag Air Carriers Statement

AGENCY: Department of Defense (DOD), General Services Administration (GSA), and National Aeronautics and Space Administration (NASA).

ACTION: Notice of request for public comments regarding an extension to an existing OMB clearance.

SUMMARY: Under the provisions of the Paperwork Reduction Act, the Regulatory Secretariat will be submitting to the Office of Management and Budget (OMB) a request to review and approve a previously approved information collection requirement concerning U.S. Flag Air Carriers Statement. A notice was published in the Federal Register at 80 FR 15789 on March 25, 2015. No comments were received.

DATES: Submit comments on or before August 19, 2015.

ADDRESSES: Submit comments identified by Information Collection 9000–0054, U.S. Flag Air Carriers Statement by any of the following methods:

- Regulations.gov: http://www.regulations.gov. Submit comments via the Federal eRulemaking portal by searching the OMB control number 9000–0054. Select the link “Comment Now” that corresponds with “Information Collection “Information Collection 9000–0054, U.S. Flag Air Carriers Statement””. Follow the instructions provided on the screen. Please include your name, company name (if any), and “Information Collection 9000–0054, U.S. Flag Air Carriers Statement” on your attached document.

Instructions: Please submit comments only and cite Information Collection 9000–0054, U.S. Flag Air Carriers Statement, in all correspondence related to this collection. All comments received will be posted without change to http://www.regulations.gov, including any personal and/or business confidential information provided.

FOR FURTHER INFORMATION CONTACT: Mr. Curtis E. Glover, Sr. Procurement Analyst, Contract Policy Division, GSA 202–501–1448 or via email at curtis.glover@gsa.gov.

SUPPLEMENTARY INFORMATION:

A. Purpose
Section 5 of the International Air Transportation Fair Competitive Practices Act of 1974 (49 U.S.C. 1517) (Fly America Act) requires that all Federal agencies and Government contractors and subcontractors at FAR 47.402, use U.S.-flag air carriers for U.S. Government-financed international air transportation of personnel (and their personal effects) or property, to the extent that service by those carriers is available. It requires the Comptroller General of the United States, in the absence of satisfactory proof of the necessity for foreign-flag air transportation, to disallow expenditures from funds, appropriated or otherwise established for the account of the United States, for international air transportation secured aboard a foreign-flag air carrier if a U.S.-flag air carrier is available to provide such services. In the event that the contractor selects a carrier other than a U.S.-flag air carrier for international air transportation during performance of the contract, the contractor shall include per FAR clause 52.247–64 a statement on vouchers involving such transportation. The contracting officer uses the information furnished in the statement to determine whether adequate justification exists for the contractor’s use of other than a U.S.-flag air carrier.

B. Annual Reporting Burden

Respondents: 150.
Responses per Respondent: 2.
Annual Responses: 300.
Hours per Response: .25.
Total Burden Hours: 75.

C. Public Comments

Public comments are particularly invited on: Whether this collection of information is necessary for the proper performance of functions of the FAR, and whether it will have practical utility; whether our estimate of the public burden of this collection of information is accurate, and based on valid assumptions and methodology; ways to enhance the quality, utility, and clarity of the information to be collected; and ways in which we can minimize the burden of the collection of information on those who are to respond, through the use of appropriate technological collection techniques or other forms of information technology.

Obtaining Copies of Proposals:
Requesters may obtain a copy of the information collection documents from the General Services Administration, Regulatory Secretariat Division (MVCB), 1800 F Street NW., Washington, DC 20405, telephone 202–501–4755. Please cite OMB Control No. 9000–0054 Submission for OMB Review; U.S.-Flag Air Carriers Statement, in all correspondence.

Dated: July 15, 2015.

Edward Loeb,
Director, Office of Government-wide Acquisition Policy, Office of Acquisition Policy, Office of Government-wide Policy.

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Centers for Disease Control and Prevention

Multi-Agency Informational Meeting Concerning Compliance With the Federal Select Agent Program; Public Webcast

AGENCY: Centers for Disease Control and Prevention (CDC), Department of Health and Human Services (HHS).

ACTION: Notice of public webcast.

SUMMARY: The HHS Centers for Disease Control and Prevention’s Division of Select Agents and Toxins (DSAT) and the USDA Animal and Plant Health Inspection Service (APHIS), Agriculture Select Agent Services (AgSAS) are jointly charged with the oversight of the possession, use and transfer of biological agents and toxins that have the potential to pose a severe threat to public, animal or plant health or to animal or plant products (select agents and toxins). This joint effort constitutes the Federal Select Agent Program. The purpose of the webcast is to provide guidance related to the Federal Select Agent Program for interested individuals.

DATES: The webcast will be held on Thursday, November 19, 2015 from 12 p.m. to 4 p.m. EST. All who wish to join the webcast must register by October 23,
lawczyk to speak or present any information to mitigate his sentence.

CONCLUSION
For the foregoing reasons, we AFFIRM Wrobel and Stanislawczyk’s convictions, and AFFIRM Stanislawczyk’s sentence.

FEDERAL TRADE COMMISSION and State of Illinois, Plaintiffs–Appellants,
v. ADVOCATE HEALTH CARE NETWORK, et al., Defendants–Appellees.

No. 16-2492
United States Court of Appeals, Seventh Circuit.
Argued August 19, 2016
Decided October 31, 2016

Background: Federal Trade Commission (FTC) and State of Illinois brought action against hospitals to enjoin proposed merger of hospitals pending FTC’s administrative trial on merits of antitrust claim. The United States District Court for the Northern District of Illinois, Jorge L. Alonso, J., 2016 WL 3387163, denied motion for preliminary injunction. FTC and state appealed.

Holdings: The Court of Appeals, Hamilton, Circuit Judge, held that:

(1) district court erred in rejecting FTC’s expert’s candidate market as too narrow due to circularity of assuming the answer to the market definition question;

(2) district court erred in rejecting FTC’s expert’s proposed geographical market due to exclusion from market of what expert called “destination hospitals” for having no economic basis;

(3) district court erred in rejecting FTC’s expert’s proposed geographical market due to expert’s determination that patients generally choose hospitals close to their homes, which court determined was based on equivocal evidence; and

(4) district court erred in assuming that measures of patient substitution, such as diversion ratios, which looked at where a patient would go for care if their first-choice hospital was unavailable, translated into options for insurers’ networks.

Reversed and remanded.

1. Federal Courts ⇨3616(2)

The Court of Appeals reviews the district court’s legal determinations regarding preliminary injunction de novo, its factual findings for clear error, and its ultimate decision for abuse of discretion.

2. Antitrust and Trade Regulation ⇨757

All that is necessary for a violation of the Clayton Act is that a merger create an appreciable danger of substantially lessening competition in the future. Clayton Act § 7, 15 U.S.C.A. § 18.

3. Antitrust and Trade Regulation ⇨757

4. Antitrust and Trade Regulation
\(\Rightarrow 766, 767\)


5. Antitrust and Trade Regulation
\(\Rightarrow 767\)

For purposes of Clayton Act section regarding mergers, product markets usually include the product at issue and its substitutes, the other products that are reasonably interchangeable with it; however, products can also be clustered together if the cluster is itself an object of consumer demand. Clayton Act § 7, 15 U.S.C.A. § 18.

6. Antitrust and Trade Regulation
\(\Rightarrow 766\)

The relevant geographic market for purposes of Clayton Act section regarding mergers is where the effect of the merger on competition will be direct and immediate. Clayton Act § 7, 15 U.S.C.A. § 18.

7. Antitrust and Trade Regulation
\(\Rightarrow 766\)

The relevant geographic marker for purposes of Clayton Act section on mergers must include the sellers or producers who have the ability to deprive each other of significant levels of business. Clayton Act § 7, 15 U.S.C.A. § 18.

8. Antitrust and Trade Regulation
\(\Rightarrow 766\)


9. Antitrust and Trade Regulation
\(\Rightarrow 766\)

The “hypothetical monopolist test” for identifying the relevant geographic market in a Clayton Act merger case asks what would happen if a single firm became the only seller in a candidate geographic region: if that hypothetical monopolist could profitably raise prices above competitive levels, the region is a relevant geographic market, but if customers would defeat the attempted price increase by buying from outside the region, it is not a relevant market and the test should be rerun using a larger candidate region. Clayton Act § 7, 15 U.S.C.A. § 18.

10. Antitrust and Trade Regulation
\(\Rightarrow 766\)

The process of determining the relevant geographic market in a Clayton Act merger case under the “hypothetical monopolist test” is iterative, meaning it should be repeated with ever-larger candidates until it identifies a relevant geographic market. Clayton Act § 7, 15 U.S.C.A. § 18.

11. Antitrust and Trade Regulation
\(\Rightarrow 766\)

The hypothetical monopolist test for identifying the relevant geographic market in a Clayton Act merger case focuses on the area of effective competition between firms; a geographic market does not need to include all of the firm’s competitors, but needs to include the competitors that would substantially constrain the firm’s price-increasing ability. Clayton Act § 7, 15 U.S.C.A. § 18.

12. Antitrust and Trade Regulation
\(\Rightarrow 766\)

A market passes the Elzinga–Hogarty test for identifying the relevant geographic market in a Clayton Act merger case if both: (1) a high level of sales, usually 75 or 90 percent, is to buyers located in the
market and (2) a similarly high percentage of buyers located in the market buys within it. Clayton Act § 7, 15 U.S.C.A. § 18.

13. Antitrust and Trade Regulation  793

In identifying the relevant geographic market in Federal Trade Commission’s (FTC) action challenging proposed merger between two hospital systems under Clayton Act merger provisions, district court erred in characterizing FTC’s expert’s reasoning as circular and as assuming the answer to the geographic market definition question, where expert properly used hypothetical monopolist test to determine if proposed market definition produced situation in which a hypothetical monopolist could have profitably raised prices above competitive levels. Clayton Act § 7, 15 U.S.C.A. § 18.

14. Antitrust and Trade Regulation  793

In identifying the relevant geographic market in Federal Trade Commission’s (FTC) action challenging proposed merger between two hospital systems under Clayton Act merger provisions, district court erred in rejecting as having no economic basis FTC’s expert’s exclusion of “destination hospitals” from proposed geographic market, where expert and witness testimony explained that “destination hospitals” were generally academic medical centers for which demand differed from general acute care hospitals and which drew from a larger geographic area. Clayton Act § 7, 15 U.S.C.A. § 18.

15. Antitrust and Trade Regulation  793

In identifying the relevant geographic market in Federal Trade Commission’s (FTC) action challenging proposed merger between two hospital systems under Clayton Act merger provisions, district court erred in rejecting as based on equivocal evidence FTC’s expert’s determination that patients generally choose hospitals close to their homes, where evidence demonstrated that 73% of patients living in expert’s proposed market received hospital care there, 80% of those patients drove less than 20 minutes or 15 miles to their chosen hospital, and 95% drove less than 30 miles to reach a hospital. Clayton Act § 7, 15 U.S.C.A. § 18.

16. Antitrust and Trade Regulation  793

In identifying the relevant geographic market in Federal Trade Commission’s (FTC) action challenging proposed merger between two hospital systems under Clayton Act merger provisions, district court erred in assuming that measures of patient substitution, such as diversion ratios, which looked at where patients would go for care if their first-choice hospital was unavailable, translated into options for insurers’ networks, where insurers had to consider both whether employers would offer their plans and whether employees would sign up for them in determining what hospitals to include in their networks, which was different than what patients considered in choosing a hospital for care. Clayton Act § 7, 15 U.S.C.A. § 18.

17. Antitrust and Trade Regulation  766

The relevant geographic market for purposes of a Clayton Act merger case does not include every competitor; rather, it is the area of effective competition or the place where the effect of the merger on competition will be direct and immediate. Clayton Act § 7, 15 U.S.C.A. § 18.

18. Antitrust and Trade Regulation  793

The relevant geographic market for purposes of a Clayton Act merger case includes the competitors that discipline the

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division. No. 15 C 11473—Jorge L. Alonso, Judge.


Robert W. Pratt, Attorney, Office of the Attorney General, Civil Appeals Division, Chicago, IL, for Plaintiff–Appellant State of Illinois.


Jeffery Lula, Sallie G. Smylie, Helen E. Witt, Attorneys, Kirkland & Ellis LLP, Chicago, IL, for Intervenor Health Care Service Corporation.

George Jepsen, Office of the Attorney General, Hartford, CT, for Amicus Curiae State of Connecticut.

Brett T. DeLange, Attorney, Office of the Attorney General, Consumer Protection Division, Boise, ID, for Amicus Curiae State of Idaho.

Thomas J. Miller, Attorney, Office of the Attorney General, Des Moines, IA, for Amicus Curiae State of Iowa.

Janet T. Mills, Office of the Attorney General, Augusta, ME, for Amicus Curiae State of Maine.

Maura Healey, Office of the Attorney General, Boston, MA, for Amicus Curiae State of Massachusetts.

Justin Erickson, Attorney, Office of the Attorney General, St. Paul, MN, for Amicus Curiae State of Minnesota.

Jim Hood, Attorney, Office of the Attorney General, Jackson, MS, for Amicus Curiae State of Mississippi.

Tim Fox, Office of the Attorney General, Helena, MT, for Amicus Curiae State of Montana.

Ellen F. Rosenblum, Office of the Attorney General, Salem, OR, for Amicus Curiae State of Oregon.

Bruce L. Castor, Jr., Office of the Attorney General, Harrisburg, PA, for Amicus Curiae State of Pennsylvania.

Robert W. Ferguson, Office of the Attorney General, Seattle, WA, for Amicus Curiae State of Washington.

Paul E. Slater, Attorney, Sperling & Slater, P.C., Chicago, IL, for Amicus Curiae Thirty-three Economists, F.M. Scherer, Aetna Professor Emeritus.

Charles I. Artz, Attorney, Artz McCarrie Health Law, Harrisburg, PA, for Amicus Curiae Association Of Independent Doctors.


Before WOOD, Chief Judge, and BAUER and HAMILTON, Circuit Judges.
HAMILTON, Circuit Judge.


To obtain an injunction, plaintiffs had to demonstrate a likelihood of success on the merits. 15 U.S.C. § 53(b); 15 U.S.C. § 26; West Allis Memorial Hospital, Inc. v. Bowen, 852 F.2d 251, 253 (7th Cir. 1988). To show that the merger may lessen competition, the Commission and Illinois had to identify a relevant geographic market where anticompetitive effects of the merger would be felt. See United States v. Philadelphia National Bank, 374 U.S. 321, 357, 83 S.Ct. 1715, 10 L.Ed.2d 915 (1963); Brown Shoe Co. v. United States, 370 U.S. 294, 323, 82 S.Ct. 1502, 8 L.Ed.2d 510 (1962). Plaintiffs relied on a method called the hypothetical monopolist test. That test asks what would happen if a single firm became the sole seller in a proposed region. If such a firm could profitably raise prices above competitive levels, that region is a relevant geographic market. In re Southeastern Milk Antitrust Litig., 739 F.3d 262, 277–78 (6th Cir. 2014). The Commission’s expert economist, Dr. Steven Tenn, chose an eleven-hospital candidate region and determined that it passed the hypothetical monopolist test.

The district court denied the motion for preliminary injunction. Federal Trade Comm’n v. Advocate Health Care, No. 15 C 11473, 2016 WL 3387163 (N.D. Ill. June 20, 2016). It found that the plaintiffs had not demonstrated a likelihood of success because they had not shown a relevant geographic market. Id. at *5. The plaintiffs appealed, and the district court stayed the merger pending appeal. That stay remains in place.

Even with the deference we give a district court’s findings of fact, the district court’s geographic market finding here was clearly erroneous. The court treated Dr. Tenn’s analysis as if its logic were circular, but the hypothetical monopolist test instead uses an iterative process, first proposing a region and then using available data to test the likely results of a price increase in that region. Also, the evidence was not equivocal on two points central to the commercial reality of hospital competition in this market: most patients prefer to receive hospital care close to home, and insurers cannot market healthcare plans to employers with employees in Chicago’s northern suburbs without including at least some of the merging hospitals in their networks. The district court rejected that evidence because of some patients’ willingness to travel for hospital care. The court’s analysis erred by overlooking the market power created by the remaining patients’ preferences, something economists have called the “silent majority” fallacy.

Part I lays out the facts of the proposed merger, the relevant economics, and the district court proceedings. Part II–A discusses briefly the relevant product market, which is not disputed. Part II–B addresses the disputed issue of the relevant geographic market, looking at the issue first
generally and then with respect to hospitals. Part III explains what we see as the errors in the district court's analysis of the geographic market: in Part III–A, mistak-
ing the nature of the hypothetical monopol-
list test; in Part III–B, the role that aca-
demic medical centers play in markets for
general acute care; in Part III–C, patients' preferences for convenient local hospitals;
and in Part III–D, the “silent majority”
fallacy.

I. The Proposed Merger and the District
Court Proceedings

In the United States today, most hospi-
tal care is bought in two stages. In the
first, which is highly price-sensitive, insur-
ers and hospitals negotiate to determine
whether the hospitals will be in the insur-
ers' networks and how much the insurers
will pay them. Gregory Vistnes, Hospitals,
Mergers, and Two–Stage Competition, 67
Antitrust L.J. 671, 674–75 (2000). In the
second stage, hospitals compete to attract
patients, based primarily on non-price fac-
tors like convenience and reputation for
quality. Id. at 677, 682. Concerns about
potential misuse of market power resulting
from a merger must take into account this
two-stage process.

Chicago area providers of hospital care
include defendant NorthShore University
HealthSystem, which has four hospitals in
Chicago's north suburbs. The area sur-
rounding NorthShore's hospitals has
roughly eight other hospitals. Two of those
hospitals belong to defendant Advocate
Health Care Network, which has a total of
nine hospitals in the Chicago area. A map
of Chicago area hospitals included in the
record is an appendix to this opinion.

In September 2014, Advocate and
NorthShore announced that they intended
to merge. The Federal Trade Commission
and the State of Illinois took action in
December 2015 by filing a complaint in the
Northern District of Illinois seeking a pre-
liminary injunction against the merger.
The court heard six days of evidence on
that motion. Executives from several ma-

or insurers testified. Some of the details
of their testimony are under seal, but they
testified unequivocally that it would be dif-
ficult or impossible to market a network to
employers in metropolitan Chicago that
excludes both NorthShore and Advocate.
Additional evidence shows that no health
insurance product has been successfully
marketed to employers in Chicago without
offering access to either NorthShore hospi-
tals or Advocate hospitals.

The court also heard testimony from
several economic experts, including Dr.
Tenn. He used the “hypothetical monopo-
list test” to identify the geographic market
relevant to the case. That test asks wheth-

er a single firm controlling all output of a
product within a given region would be
able to raise prices profitably a bit above
competitive levels. Economists and anti-
trust cognoscenti refer to such a price
increase as a “SSNIP,” a “small but signif-
icant [usually five percent] and non-transi-
tory increase in price.” U.S. Dep’t of Just-

ice & Federal Trade Comm’n, Horizontal
Merger Guidelines 9 (2010). Dr. Tenn sim-
ulated the market's response to a price
increase imposed by a monopolist control-
lng NorthShore's hospitals and the two
nearby Advocate hospitals. He found that
the monopolist could profitably impose the
increase. He therefore concluded that the
contiguous area including just those six
party hospitals is a relevant geographic
market.

Dr. Tenn also chose a larger candidate
market to test, using three criteria. First,
he distinguished between local hospitals
and academic medical centers, which he
rather inauspiciously called “destination
hospitals.”1 Academic medical centers draw patients from across the Chicago area, including the northern suburbs, even though they are not in the northern suburbs. Dr. Tenn excluded those hospitals from his candidate market, reasoning that patients require insurers to provide them more local and convenient hospital options.

Second, Dr. Tenn identified hospitals that had at least a two percent share of the admissions from the same areas the parties’ hospitals drew from. Finally, he included only hospitals that drew from both Advocate’s and NorthShore’s service areas.

Those criteria produced an eleven-hospital candidate market: the six party hospitals and five other nearby hospitals, without any academic medical centers. Dr. Tenn simulated the response to a price increase by a hypothetical firm controlling those eleven hospitals. He again found that the price increase would be profitable. He therefore concluded that the area around the eleven hospitals is a relevant geographic market. The plaintiffs focused their arguments on the larger, eleven-hospital market both in the district court and on appeal; they and we refer to it as the North Shore Area.

To test how robust his results were, Dr. Tenn also tested another, larger market, selected using less restrictive criteria. He added hospitals that drew only one percent of admissions from either NorthShore or Advocate’s service areas, indicating a fifteen-hospital market. That area included Presence St. Francis, a hospital close to NorthShore’s Evanston hospital. Dr. Tenn concluded that the larger area also passed the hypothetical monopolist test.

As part of his simulations, Dr. Tenn calculated the percentage of patients at each of the North Shore Area hospitals who would turn to each of the other available hospitals if their first choice hospital were closed. For example, he determined that if Advocate’s Lutheran General Hospital closed, 9.3 percent of its patients would likely go to NorthShore’s Evanston Hospital instead. These measures are called diversion ratios. Dr. Tenn calculated that for 48 percent of patients in the North Shore Area, both their first and second choice hospitals were inside the Commission’s proposed market.

Once he identified the relevant geographic market, Dr. Tenn used the Herfindahl–Hirschman Index, a common method for assessing a transaction’s competitive effects, to evaluate the merger’s effects on the market’s concentration. He found that for both the eleven-hospital proposed market and the fifteen-hospital market, the proposed Advocate–NorthShore merger would result in a presumptively unlawful increase in market concentration.

The defendants called their own experts, including economist Dr. Thomas McCarthy, who criticized the criteria Dr. Tenn used to select his candidate market. Dr. McCarthy argued that academic medical centers are substitutes for local hospitals because patients seek the same treatments at both hospital types. He also contended that the candidate market should include competitors to either Advocate or NorthShore, not just competitors to both. A competitor to either system, he reasoned, would also compete with and constrain the merged system.

The district court rejected Dr. Tenn’s analysis, found that plaintiffs had not shown a likelihood of success on the merits, and denied an injunction. Advocate

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1. Dr. Tenn’s “destination hospital” category included four academic medical centers and two specialty hospitals. The parties focused on the academic medical centers, and so do we.
Health Care, 2016 WL 3387163, at *5. Its analysis focused on Dr. Tenn’s candidate-market criteria and echoed Dr. McCarthy’s criticisms of those criteria. Id. at *4–5. There was, the court said, no economic basis for distinguishing between academic medical centers and local hospitals and no reason to think a competitor had to constrain both Advocate and NorthShore to be in the geographic market. Id. The court also criticized Dr. Tenn’s assumption that patients generally insist on access to local hospitals, calling the evidence on that point “equivocal” and pointing to the 52 percent of patients whose second-choice hospitals were outside the proposed market. Id. at *4 n.4. At several points in the opinion, the court implied that Dr. Tenn’s analysis was circular, saying that he “assume[d] the answer” to the geographic market question. Id. at *4–5.


II. Relevant Antitrust Markets

[2, 3] Section 7 of the Clayton Act makes it unlawful to “acquire . . . the assets of another person . . . where in any line of commerce . . . in any section of the country, the effect of such acquisition may be substantially to lessen competition . . . .” 15 U.S.C. § 18. The Act “deal[s] with probabilities,” not “absolute certainties.” Elkco Products Co. v. Federal Trade Comm’n, 347 F.2d 745, 752 (7th Cir. 1965); accord, Brown Shoe, 370 U.S. at 323, 82 S.Ct. 1502 (“Congress used the words ‘may be substantially to lessen competition’ . . . to indicate that its concern was with probabilities, not certainties.”). “All that is necessary is that the merger create an appreciable danger of such consequences in the future.” Hospital Corp. of America v. Federal Trade Comm’n, 807 F.2d 1381, 1389 (7th Cir. 1986). “[D]oubts are to be resolved against the transaction.” Elders Grain, Inc., 868 F.2d at 906.

[4] To show a Section 7 violation, the Commission must identify the relevant “line of commerce” and “section of the country.” See United States v. E.I. du Pont de Nemours & Co., 353 U.S. 586, 593, 77 S.Ct. 872, 1 L.Ed.2d 1057 (1957) (“Determination of the relevant market is a necessary predicate to a finding of a violation of the Clayton Act.”). In other words, it must identify the relevant product and geographic markets. Brown Shoe, 370 U.S. at 324, 82 S.Ct. 1502 (“The ‘area of effective competition’ must be determined by reference to a product market (the ‘line of commerce’) and a geographic market (the ‘section of the country’).”).

A. The Product Market

[5] Product markets usually include the product at issue and its substitutes, the other products that are reasonably interchangeable with it. Brown Shoe, 370 U.S. at 325, 82 S.Ct. 1502. But products can also be “clustered” together if the “‘cluster’ is itself an object of consumer demand.” Green Country Food Market, Inc. v. Bottling Group, LLC, 371 F.3d 1275, 1284–85 (10th Cir. 2004) (emphasis omitted) (affirming finding that branded beverages are not a cluster market); accord, Philadelphia National Bank, 374 U.S. at 356, 83

As in many other hospital merger cases, the parties here agree that the product market here is just such a cluster: inpatient general acute care services—specifically, those services sold to commercial health plans and their members. See Penn State Hershey, 838 F.3d at 338 (parties stipulated); Federal Trade Comm’n v. Tenet Health Care Corp., 186 F.3d 1045, 1051–52 (8th Cir. 1999) (same); Federal Trade Comm’n v. Freeman Hospital, 69 F.3d 260, 268 (8th Cir. 1995) (same). That market is a cluster of medical services and procedures that require admission to a hospital, such as abdominal surgeries, childbirth, treatment of serious infections, and some emergency care.

B. The Geographic Market

[6–8] The dispute here is about the relevant geographic market. The relevant geographic market is “where . . . the effect of the merger on competition will be direct and immediate.” Philadelphia National Bank, 374 U.S. at 357, 83 S.Ct. 1715. It must include the “sellers or producers who have the . . . ‘ability to deprive each other of significant levels of business.’” Rebel Oil Co. v. Atlantic Richfield Co., 51 F.3d 1421, 1434 (9th Cir. 1995), quoting Thurman Industries, Inc. v. Pay ’N Pak Stores, Inc., 875 F.2d 1369, 1374 (9th Cir. 1989). “Congress prescribed a pragmatic, factual approach to the definition of the relevant market and not a formal, legalistic one.” Brown Shoe, 370 U.S. at 336, 82 S.Ct. 1502. The market must “correspond to the commercial realities’ of the industry.” Id., quoting American Crystal Sugar Co. v. Cuban-American Sugar Co., 152 F.Supp. 387, 398 (S.D.N.Y. 1957); see also 42nd Parallel North v. E Street Denim Co., 286 F.3d 401, 406 (7th Cir. 2002) (evaluating geographic market with “sensible awareness of commercial reality”).

1. Geographic Markets in General

[9, 10] Since at least 1982, the Commission has used the “hypothetical monopolist test” to identify relevant geographic markets. Gregory J. Werden, The 1982 Merger Guidelines and the Ascent of the Hypothetical Monopolist Paradigm, 71 Antitrust L.J. 253, 253 (2003). That test asks what would happen if a single firm became the only seller in a candidate geographic region. Federal Trade Comm’n v. Whole Foods Market, Inc., 548 F.3d 1028, 1038 (D.C. Cir. 2008). If that hypothetical monopolist could profitably raise prices above competitive levels, the region is a relevant geographic market. Kenneth G. Elzinga & Anthony W. Swisher, Limits of the Elzinga–Hogarty Test in Hospital Mergers: The Evanston Case, 18 Int’l J. of Economics of Business 133, 136 (2011). But if customers would defeat the attempted price increase by buying from outside the region, it is not a relevant market; the test should be rerun using a larger candidate region. Saint Alphonsus Medical Center–Nampa Inc. v. St. Luke’s Health System, Ltd., 778 F.3d 775, 784 (9th Cir. 2015); In re Southeastern Milk Antitrust Litig., 739 F.3d 262, 277–78 (6th Cir. 2014). This process is iterative, meaning it should be repeated with ever-larger candidates until it identifies a relevant geographic market. Southeastern Milk, 739 F.3d at 278.

That market can be as large as the globe, if for example the buyers and sellers
are sophisticated merchants and transportation costs and other barriers are low. See United States v. Eastman Kodak Co., 63 F.3d 95, 98, 104 (2d Cir. 1995) (using worldwide market for photographic film); United States v. H & R Block, Inc., 833 F.Supp.2d 36, 50 n.7 (D.D.C. 2011) (describing stipulated worldwide geographic market in tax preparation software provided on the Internet); see also Brown Shoe, 370 U.S. at 337, 82 S.Ct. 1715 (“[A]lthough the geographic market in some instances may encompass the entire Nation, under other circumstances it may be as small as a single metropolitan area.”).

Retail markets, on the other hand, are often small, especially when customers are motivated by convenience. Philadelphia National Bank, 374 U.S. at 358, 83 S.Ct. 1715 (“In banking, as in most service industries, convenience of location is essential to effective competition. Individuals and corporations ... find it impractical to conduct their banking business at a distance. The factor of inconvenience localizes banking competition...”) (footnote and citation omitted). (Still, there are limits. See 42nd Parallel North, 286 F.3d at 406 (rejecting as “absurdly small” a proposed market for retail designer jeans and t-shirts comprising only the “central business district” of Highland Park, Illinois.).

[11] The hypothetical monopolist test focuses on “the area of effective competition” between firms. See E. I. du Pont, 353 U.S. at 593, 77 S.Ct. 872 (emphasis added), quoting Standard Oil Co. of California v. United States, 337 U.S. 293, 299 n.5, 69 S.Ct. 1051, 93 L.Ed. 1371 (1949). A geographic market does not need to include all of the firm’s competitors; it needs to include the competitors that would “substantially constrain [the firm’s] price-increasing ability.” AD/SAT, a Division of Skylight, Inc. v. Associated Press, 181 F.3d 216, 228 (2d Cir. 1999) (citation omitted); Rebel Oil, 51 F.3d at 1434 (“[A] ‘market’ is the group of sellers or producers who have the actual or potential ability to deprive each other of significant levels of business.”) (citation omitted).


[12] Put more formally, a market passes the Elzinga–Hogarty test if both: (1) a high level of sales (usually 75 or 90 percent) is to buyers located in the market; and (2) a similarly high percentage of buyers located in the market buys within it. Id.; Kenneth G. Elzinga & Thomas F. Hogarty, The Problem of Geographic Market Delineation Revisited: The Case of Coal, 23 Antitrust Bull. 1, 2 (1978); Federal Trade Comm’n v. Butterworth Health Corp., 946 F.Supp. 1285, 1292 (W.D. Mich. 1996), aff’d mem., 121 F.3d 708 (6th Cir. 1997). The test treats pre-merger customer movement as a proxy for likely post-
merger changes in customer movement. Elzinga & Swisher, \textit{supra}, Int'l J. of Economics of Business at 136. It assumes that if some customers currently buy from firms outside the area, others would also switch to avoid a price increase within the area. \textit{Id.} at 136–37. That assumption holds, however, only if the customers who currently buy from firms outside the area are similar to those who do not. Capps et al., \textit{supra}, at 1.

2. \textit{Geographic Markets for Hospitals}

Markets for hospital services have three notable features. First, because most patients prefer to go to nearby hospitals, there are often only a few hospitals in a geographic market. See \textit{United States v. Rockford Memorial Corp.}, 898 F.2d 1278, 1284–85 (7th Cir. 1990) (approving six-hospital market in part because “for the most part hospital services are local”); \textit{Evanston Northwestern Healthcare Corp.}, F.T.C. No. 9315, 2007 WL 2286195, at *2, *66 (Aug. 6, 2007) (finding that three merged hospitals used market power to increase prices); Steven Tenn, \textit{The Price Effects of Hospital Mergers: A Case Study of the Sutter–Summit Transaction}, 18 Int'l J. of Economics of Business 65, 66, 79 (2011) (plaintiffs’ expert showing a possibly anticompetitive price increase following a two-hospital merger); \textit{Saint Alphonsus}, 778 F.3d at 781, 784 (geographic market included primary care physician services in Nampa, Idaho, without extending to Boise, 20 miles away); Capps et al., \textit{supra}, at 11 (explaining that its analysis “implies that the average patient is highly averse to travel”); cf. \textit{Philadelphia National Bank}, 374 U.S. at 358, 83 S.Ct. 1715 (“The factor of inconvenience localizes [retail] banking competition as effectively as high transpor-

2. Dr. Elzinga is part of a group of economists who submitted a helpful \textit{amicus} brief in this case.
into two stages: one in which hospitals compete to be included in insurers’ networks, and a second in which hospitals compete to attract patients. Saint Alphonsus, 778 F.3d at 784 & n.10; Vistnes, supra, 67 Antitrust L. J. at 672. Insured patients are usually not sensitive to retail hospital prices, while insurers respond to both prices and patient preferences. Id. at 677, 680 (explaining that the credibility of an insurer’s threat to drop a hospital from its network depends on the importance of the hospital to the plan’s enrollees); Capps, supra, 59 Antitrust Bull. at 454–55 (observing that under most health insurance designs, the patient’s and the physician’s incentive to consider price is “either very small or nil”); Penn State Hershey, 838 F.3d at 341 (explaining that insurers “feel the impact of price increases” and that patient behavior “affects the relative bargaining positions of insurers and hospitals as they negotiate rates”).


The Commission and the judiciary have responded to the academy’s evolving understanding of hospital markets. In the 1990s, they relied heavily on the Elzinga–Hogarty test. See, e.g., United States v. Mercy Health Services, 902 F.Supp. 968, 977 (N.D. Iowa 1995) (noting government’s reliance on Elzinga–Hogarty), vacated, 107 F.3d 632 (8th Cir. 1997); Rockford Memorial, 898 F.2d at 1284–85 (approving a hospital geographic market defined by where the defendants’ patients came from); see also Capps, supra, 59 Antitrust Bull. at 455 (“courts in the 1990s relied heavily on analyses of patient inflows and outflows”). The Eighth Circuit briefly resisted that trend. In Freeman Hospital, the court rejected the Commission’s proposed geographic market, which relied on the Elzinga–Hogarty test. 69 F.3d at 264–65, 268. The Commission’s evidence, it reasoned, did not address the “crucial question,” which was not where customers currently go but where they “could practicably go” in response to a price increase. Id. at 270–71. Four years later, the Eighth Circuit embraced the test, rejecting another Commission-proposed market in part because “over twenty-two percent of people ... already use hospitals outside the ... proposed market.” Tenet Health Care, 186 F.3d at 1053.

That reliance produced relatively large geographic markets in hospital merger cases. The Commission’s proposed market in Freeman Hospital, for example, covered a 27–mile radius around Joplin, Missouri. 69 F.3d at 268. In Butterworth Health, 946 F.Supp. at 1291, the Commission proposed a market covering Grand Rapids, Michigan and the 30 miles surrounding that city. Tenet Health rejected as too narrow a market 100 miles across in Missouri. 186 F.3d at 1052–53. And Mercy Health relied on patient movement to argue that hospitals 70 to 100 miles away from the defendant hospitals were viable competitors. 902 F.Supp. at 971–72, 979–80. By way of comparison, in this case, 80 percent of patients in NorthShore’s service area drive 20 minutes or less (and 15 miles or less) to reach their hospital of choice.

As economists have identified the limits of the Elzinga–Hogarty test, courts and the Commission have begun to adjust their approaches to the problem. In Evanston
Northwestern, the Commission heard testimony from Dr. Elzinga about those limits and concluded that patient movement was at best “one potentially very rough benchmark,” to be used “in the context of evaluating other types of evidence.” 2007 WL 2286195, at *66; see also Penn State Hershey, 838 F.3d at 338–40, 353 (reversing denial of preliminary injunction, in part because district court relied on elements of Elzinga–Hogarty test).

That adjustment is necessary. If the analysis uses geographic markets that are too large, consumers will be harmed because the likely anticompetitive effects of hospital mergers will be understated. Penn State Hershey, 838 F.3d at 339 (“empirical research demonstrated that utilizing patient flow data to determine the relevant geographic market resulted in overbroad markets with respect to hospitals”); Evanston Northwestern, 2007 WL 2286195, at *65–66 (finding persuasive Dr. Elzinga’s testimony that “application of the [Elzinga–Hogarty] test to patient flow data would identify overly broad geographic markets”); see also Cory Capps & David Dranove, Hospital Consolidation and Negotiated PPO Prices, 23 Health Affairs 175, 179 (2004) (“most consolidating hospitals raise prices by more than the median price increase in their markets”); Leemore S. Dafny, Estimation and Identification of Merger Effects: An Application to Hospital Mergers 26 (Nat’l Bureau of Econ. Research, Working Paper No. 11673, 2005) (“there is conclusive evidence that mergers of independent hospitals can lead to large increases in area prices”); Martin Gaynor & Robert Town, The Impact of Hospital Consolidation—Update, Technical Report (Robert Wood Johnson Foundation/The Synthesis Project, Princeton, N.J.), June 2012, at 2 (“Hospital mergers in concentrated markets generally lead to significant price increases.”).

For example, in 2001 the Northern District of California refused to enjoin a hospital merger, relying in part on patient movement data. California v. Sutter Health System, 130 F.Supp.2d 1109, 1131–32, 1137 (N.D. Cal. 2001). In 2011, a follow-up study found that the cheaper of the two hospitals raised its prices by 29 to 72 percent, much more than a control group had. Tenn, supra, 18 Int’l J. of Economics of Business at 75–76. Other merger case studies produced similar results. See Aileen Thompson, The Effect of Hospital Mergers on Inpatient Prices: A Case Study of the New Hanover–Cape Fear Transaction, 18 Int’l J. of Economics of Business at 75–76. Other merger case studies produced similar results. See Aileen Thompson, The Effect of Hospital Mergers on Inpatient Prices: A Case Study of the New Hanover–Cape Fear Transaction, 18 Int’l J. of Economics of Business at 75–76. Other merger case studies produced similar results. See Aileen Thompson, The Effect of Hospital Mergers on Inpatient Prices: A Case Study of the New Hanover–Cape Fear Transaction, 18 Int’l J. of Economics of Business at 75–76.

NorthShore’s own history makes the point. NorthShore was created in 2000 by a smaller merger between Evanston Northwestern Healthcare Corporation and Highland Park Hospital, involving just three hospitals. Evanston Northwestern, 2007 WL 2286195, at *2; see also Messner v. Northshore University HealthSystem, 669 F.3d 802, 809 (7th Cir. 2012). Four years later, the Federal Trade Commission challenged the merger alleging a violation of Section 7. NorthShore “substantially and immediately raised its prices after the merger.” Evanston Northwestern, 2007 WL 2286195, at *53. NorthShore’s own expert found price increases of nine to ten percent above price increases of a control
group of hospitals. Id. at *21, *54. After a hearing before an administrative law judge and an appeal to the Commission, the Commission found that the merger violated the Clayton Act. Id. at *4, *76.3

III. Analysis

We review the district court’s decision in this case in light of this history. As noted, we review the court’s legal determinations de novo, its factual findings for clear error, and its ultimate decision for abuse of discretion. Penn State Hershey, 838 F.3d at 334; Abbott Laboratories, 971 F.2d at 12–13. We find that the district court made clear factual errors. Its central error was its misunderstanding of the hypothetical monopolist test: it overlooked the test’s results and mistook the test’s iterations for logical circularity. Even if the court’s focus on the candidate market had been correct, its criticisms were mistaken in three ways. It incorrectly found that Dr. Tenn lacked a basis for distinguishing local hospitals from academic medical centers. It erroneously determined that the evidence about patient preferences for local hospitals was “equivocal.” Finally, its analysis fell prey to a version of the silent majority fallacy.

A. The Hypothetical Monopolist Test

[13] As explained above, the hypothetical monopolist test is an iterative analysis. The analyst proposes a candidate market, simulates a monopolization of that market, then adjusts the candidate market and re-runs the simulation as necessary. The district court criticized Dr. Tenn’s candidate market but did not mention his results. The court did not explain why it thought that a narrow candidate market would produce incorrect results. Nor do the hospitals. We have not found support for that assumption. The economic literature explains that if a candidate market is too narrow, the test will show as much, and further iterations will broaden the market until it is big enough. See Elzinga & Swisher, supra, 18 Int’l J. of Economics of Business at 136.

The district court seems to have mistaken those iterations for circularity. It criticized Dr. Tenn’s candidate market for “assum[ing] the answer” to the market definition question. Advocate Health Care, 2016 WL 3387163, at *4–5. But in fact, the candidate market offers a hypothetical answer to that question; the hypothetical monopolist analysis then tests the hypothesis and adjusts the market definition if the results require it. That is not circular reasoning.

B. Academic Medical Centers

[14] When Dr. Tenn proposed a candidate market, he excluded what he called “destination hospitals,” which are primarily academic medical centers—that attract patients at long distances from throughout the Chicago metropolitan area. The district court criticized that classification, saying it had no “economic basis.” Advocate Health Care, 2016 WL 3387163, at *4. The record belies that assessment: the witnesses consistently used the term “academic medical center” and recognized that demand for those few hospitals differs from demand for general acute care hospitals like these parties’ hospitals, which draw patients from much smaller geographic areas.

For example, one insurance executive explained that some insured patients will independent teams to negotiate with insurers, one for each of the pre-merger hospital systems. Id. at *79.
“travel . . . for a higher level of care potentially at an Academic Medical Center.”

NorthShore’s CEO also distinguished between academic medical centers and community hospitals, explaining that the former provide both “basic” and “complex” services. Other witnesses agreed. Another insurance executive explained that individual consumers want their insurance network to include “[their] physician, [their] community hospital, and maybe potential access to an academic medical center.” An executive of one academic medical center differentiated between “community hospitals” and “an Academic Medical Center” in terms of the complexity of the services provided. Another insurance executive explained that NorthShore and Advocate hospitals were not academic medical centers. That testimony provides an obvious and sound basis for distinguishing between academic medical centers and other hospitals like those operated by Advocate and NorthShore.

C. Patient Preference for Local Hospitals

[15] Before Dr. Tenn chose a candidate market, he determined that patients generally choose hospitals close to their homes. The district court called the evidence on that point “equivocal,” citing testimony that workplace locations and outpatient relationships also influence patient choices. Advocate Health Care, 2016 WL 3387163, at *4. But most of the cited testimony addressed medical care broadly, not inpatient acute care specifically. For instance, one insurance executive testified that Chicago area consumers use “services” close to both their homes and their workplaces. Similarly, another witness explained that employees choose providers based on where they live, work, and have relationships with doctors, but that witness was speaking about “people . . . consuming benefits” generally, not about hospital choice in particular.

When it came to hospital care, the evidence was not equivocal on Dr. Tenn’s central point. As one insurance executive put it: “Typically [patients] seek [hospital] care in their own communities.” The evidence on that point is strong, not equivocal. For example, 73 percent of patients living in plaintiffs’ proposed market receive hospital care there. Eighty percent of those patients drive less than 20 minutes or 15 miles to their chosen hospital. Ninety-five percent of those patients drive 30 miles or less—the north-to-south length of plaintiffs’ proposed market—to reach a hospital. That evidence that many patients care about convenience is consistent with what we said in Rockford Memorial: “for the most part hospital services are local.” 898 F.2d at 1285. That is consistent with retail markets generally, at least where the seller (hospital) and buyer (patient) must come face to face. See Philadelphia National Bank, 374 U.S. at 358, 83 S.Ct. 1715.

D. The Silent Majority Fallacy

[16] The insurance executives were unanimous on a second point: in the North Shore Area, an insurer’s network must include either Advocate or NorthShore to offer a product marketable to employers. The record as a whole supports that testimony. There is no evidence that a network has succeeded with employers without one or the other of the merging parties in its network. (One company offers a network in the Chicago area without either of the merging parties, but that network’s membership is overwhelmingly individuals rather than employers. And fewer than two percent of those individual members live near NorthShore’s hospitals.) Cf. Penn State Hershey, 838 F.3d at 342 (noting that
antitrust defendant in theory “may be able to demonstrate that enough patients would buy a health plan . . . with no in-network hospital in the proposed geographic market,” but not when an insurer that tried it “lost half of its membership”).

The district court discounted that testimony, citing Dr. Tenn’s diversion ratios, although it did not explain what it inferred from the ratios. Advocate Health Care, 2016 WL 3387163, at *4 n.4. We assume the court was referring to two of their features: the proportion (52 percent) of patients who, if their first choice hospital were unavailable, would seek care outside the proposed market, and the proportion (7.2–29.2 percent) of patients who, if their first choice hospital were unavailable, would divert to Northwestern Memorial Hospital, an academic medical center outside Dr. Tenn’s proposed market.4

If patients were the relevant buyers in this market, those numbers would be more compelling since diversion ratios indicate which hospitals patients consider substitutes. But as we have explained, insurers are the most relevant buyers. Insurers must consider both whether employers would offer their plans and whether employees would sign up for them. “[E]mployers generally try to provide all of their employees at least one attractive option,” and may not offer even a broadly appealing plan if it lacks services in a particular region. Vistnes, supra, 67 Antitrust L.J. at 678. As a result, measures of patient substitution like diversion ratios do not translate neatly into options for insurers. The district court erred in assuming they did.5

4. The hospitals understand the district court’s use of diversion ratios differently. They argue that the court disregarded the insurer testimony because one insurance executive incorrectly identified customers’ preferred hospitals. That executive viewed Advocate’s Lutheran General Hospital as the main alternative to NorthShore’s Evanston hospital, and saw Advocate Condell Medical Center as the primary alternative to NorthShore’s Highland Park Hospital. The diversion ratios, the hospitals point out, indicate that Northwestern Memorial is the most common second choice for NorthShore’s Evanston, and that Northwestern Lake Forest is the main alternative to NorthShore’s Highland Park.

We do not believe that was the district court’s reasoning. The court did not cite that testimony and was not addressing insurers’ testimony about patient hospital choices—it was addressing insurers’ testimony about plan marketability. Advocate Health Care, 2016 WL 3387163, at *4 n.4. The reasoning is unpersuasive in any case. One insurance witness’ minor mistake about patient preferences for two hospitals is not a sufficient reason to disregard the overwhelming weight of the evidence showing: (1) the large proportion of patients who prefer hospitals close to their homes and (2) the resulting need for insurers to offer networks that include community hospitals close to their customers’ homes.

5. The hospitals raise a related point on appeal, arguing that the diversion ratios indicate that Northwestern Memorial Hospital is the closest substitute for some NorthShore hospitals. They then point to the Merger Guidelines, which say that in general relevant markets should include a product’s closest substitutes even if the market passes the hypothetical monopolist test without them. See U.S. Dep’t of Justice & Federal Trade Comm’n, supra, Horizontal Merger Guidelines at 9. The hospitals’ reliance on the diversion ratios, like the district court’s, overlooks insurers’ role in the marketplace. Even if we take the diversion ratios to mean that a sizable minority of patients consider Northwestern Memorial a close substitute, it does not follow that insurers could offer it as a sufficient substitute for a commercially viable insurance network. And in any event, the hospitals concede that even with Northwestern Memorial included in the market, the Herfindahl–Hirschman Index calculation still indicates that the merger is presumptively unlawful. The hospitals argue that if Northwestern should be included, so should the other academic medical centers. But there is no comparable evidence about those centers as close substitutes for the hospitals of the merging parties.
The hospitals correctly point out that, strictly speaking, that reasoning is not the same as the silent majority fallacy. The silent majority fallacy treats present travel as a proxy for post-merger travel, while diversion ratios predict likely post-merger travel more directly. But the district court’s reasoning and the silent majority fallacy share a critical flaw: they focus on the patients who leave a proposed market instead of on hospitals’ market power over the patients who remain, which means that the hospitals have market power over the insurers who need them to offer commercially viable products to customers who are reluctant to travel farther for general acute hospital care.

[17] That flaw runs through the district court’s decision. The court focused on identifying hospitals that compete with those in the Commission’s proposed market. But the relevant geographic market does not include every competitor. It is the “area of effective competition,” *E. I. du Pont*, 353 U.S. at 593, 77 S.Ct. 872 (emphasis added) (citation omitted), the place where the “effect of the merger on competition will be direct and immediate,” *Philadelphia National Bank*, 374 U.S. at 357, 83 S.Ct. 1715. It includes the competitors that discipline the merging hospitals’ prices. *AD/SAT*, 181 F.3d at 228; *Rebel Oil*, 51 F.3d at 1434. The geographic market question asks in essence, how many hospitals can insurers convince most customers to drive past to save a few percent on their health insurance premiums? We should not be surprised if that number is very small. Plaintiffs have made a strong case that it is.

We REVERSE the district court’s denial of a preliminary injunction and REMAND for further proceedings consistent with this opinion. The merger shall remain enjoined pending the district court’s reconsideration of the preliminary injunction motion.
Attachment

Figure 1: Advocate and NorthShore Hospitals in the Chicago Area
VI. CONCLUSION

For the foregoing reasons, we will vacate the District Court’s judgments and dismiss the petition. We will also instruct the District Court to order that A.D. be returned to the United States forthwith. The Clerk of Court will issue the mandate immediately.

Holdings: The Court of Appeals, Fisher, Circuit Judge, held that:

1. district court’s reliance solely on patient flow data to determine that claimed relevant geographic market was too narrow was not consistent with hypothetical monopolist test;
2. district court incorrectly focused on patient flow data at expense of considering insurers’ likely response in face of small but significant non-transitory increase in price (SSNIP);
3. district court incorrectly rested part of its analysis of relevant geographic market on private agreements between hospitals and insurers;
4. plaintiffs properly defined relevant geographic market;
5. plaintiffs demonstrated anticompetitive effects in geographic market by calculating market concentration;
6. merging hospitals failed to rebut presumption of anticompetitive effects; and
7. equities favored preliminary injunction against proposed merger.

Reversed and remanded.

1. Federal Courts 3616(2)
   Court of Appeals reviews a district court’s findings of fact for clear error, its conclusions of law de novo, and the ultimate decision to grant a preliminary injunction for abuse of discretion.

2. Federal Courts 3634(3)
   Where the definition of the relevant geographic market for a preliminary injunction depends on the “special characteristics” of the healthcare market in antitrust action, the Court of Appeals may not overturn a district court’s factual findings unless they are clearly erroneous.

appeal of the District Court’s denial of the
3. Federal Courts 3634(3)

Although market definition is generally regarded as a question of fact on a motion for a preliminary injunction in antitrust action, a district court’s determination of the market may be reversed where that tribunal has erred as a matter of law.

4. Federal Courts 3634(3)

On a motion for a preliminary injunction, where a district court applies an incomplete economic analysis or an erroneous economic theory to those facts that make up the relevant geographic market in antitrust action, it has committed legal error subject to plenary review.

5. Antitrust and Trade Regulation 996

When the Federal Trade Commission (FTC) seeks a preliminary injunction to prevent a merger pending administrative adjudication of a potential violation of the Clayton Act’s bar against mergers whose effect “may be substantially to lessen competition, or to tend to create a monopoly,” the court must first consider the FTC’s likelihood of success on the merits and then weigh the equities to determine whether a preliminary injunction would be in the public interest. Federal Trade Commission Act § 18, 15 U.S.C.A. § 53(b); Clayton Act § 7, 15 U.S.C.A. § 18.

6. Antitrust and Trade Regulation 757

In its administrative adjudication regarding a proposed merger, the Federal Trade Commission (FTC) must show that the merger violates the Clayton Act’s bar against mergers whose effect “may be substantially to lessen competition, or to tend to create a monopoly,” and thus the FTC need not establish that the proposed merger would in fact violate that bar, and accordingly, a certainty, even a high probability, need not be shown, and any doubts are to be resolved against the transaction. Clayton Act § 7, 15 U.S.C.A. § 18.

7. Antitrust and Trade Regulation 976

Claims under the Clayton Act’s bar against mergers whose effect “may be substantially to lessen competition, or to tend to create a monopoly” are considered under a burden-shifting framework: first, the government must establish a prima facie case that the merger is anticompetitive; if the government establishes a prima facie case, the burden then shifts to the merging entities to rebut it; and, if the merging entities successfully rebut the government’s prima facie case, the burden of production shifts back to the government and merges with the ultimate burden of persuasion, which is incumbent on the government at all times. Clayton Act § 7, 15 U.S.C.A. § 18.

8. Antitrust and Trade Regulation 765

To establish a prima facie case under the Clayton Act’s bar against mergers whose effect “may be substantially to lessen competition, or to tend to create a monopoly,” the government must (1) propose the proper relevant market and (2) show that the effect of the merger in that market is likely to be anticompetitive. Clayton Act § 7, 15 U.S.C.A. § 18.

9. Antitrust and Trade Regulation 765, 766, 767

Determination of the relevant product and geographic markets is a necessary predicate to deciding whether a merger contravenes the Clayton Act’s bar against mergers whose effect “may be substantially to lessen competition, or to tend to create a monopoly”; without a well-defined relevant market, an examination of the merger’s competitive effects would be without context or meaning. Clayton Act § 7, 15 U.S.C.A. § 18.
10. Antitrust and Trade Regulation

On a claim under the Clayton Act's bar against mergers whose effect "may be substantially to lessen competition, or to tend to create a monopoly," the relevant market is defined in terms of two components: the product market and the geographic market. Clayton Act § 7, 15 U.S.C.A. § 18.

11. Antitrust and Trade Regulation

On a claim under the Clayton Act's bar against mergers whose effect "may be substantially to lessen competition, or to tend to create a monopoly," the "relevant geographic market" is that area in which a potential buyer may rationally look for the goods or services he seeks. Clayton Act § 7, 15 U.S.C.A. § 18. See publication Words and Phrases for other judicial constructions and definitions.

12. Antitrust and Trade Regulation

On a claim under the Clayton Act's bar against mergers whose effect "may be substantially to lessen competition, or to tend to create a monopoly," the relevant geographic market is determined within the specific context of each case, as the market's geographic scope must correspond to the commercial realities of the industry being considered and be economically significant. Clayton Act § 7, 15 U.S.C.A. § 18.

13. Antitrust and Trade Regulation

On a claim under the Clayton Act's bar against mergers whose effect "may be substantially to lessen competition, or to tend to create a monopoly," the plaintiff bears the burden of establishing the relevant geographic market. Clayton Act § 7, 15 U.S.C.A. § 18.

14. Antitrust and Trade Regulation

Under the hypothetical monopolist test for determining the relevant geographic market on a claim under the Clayton Act's bar against mergers whose effect "may be substantially to lessen competition, or to tend to create a monopoly," if a hypothetical monopolist could impose a small but significant non-transitory increase in price (SSNIP) in the proposed market, the market is properly defined, but if consumers would respond to a SSNIP by purchasing the product from outside the proposed market, thereby making the SSNIP unprofitable, the proposed market definition is too narrow. Clayton Act § 7, 15 U.S.C.A. § 18.

15. Antitrust and Trade Regulation

Even if district court's reliance solely on patient flow data to determine that claimed relevant geographic market was too narrow was not consistent with hypothetical monopolist test that court purportedly applied, even though court did not employ strict cutoffs to determine whether too many patients entered or left proposed market, where inadequacy of using patient flow data to determine geographic market did not depend on whether court used exact percentage or whether it used more flexible approach. Clayton Act § 7, 15 U.S.C.A. § 18.

16. Antitrust and Trade Regulation

Even if district court's reliance solely on patient flow data to determine that
claimed relevant geographic market was too narrow was consistent with hypothetical monopolist test on claim by Federal Trade Commission (FTC) and Commonwealth of Pennsylvania, alleging that proposed merger of hospitals violated Clayton Act’s bar against mergers whose effect “may be substantially to lessen competition, or to tend to create a monopoly,” court misapplied that test by considering only patient inflows, and not patient outflows, with respect to relevant product market of general acute care. Clayton Act § 7, 15 U.S.C.A. § 18.

17. Antitrust and Trade Regulation

On claim by Federal Trade Commission (FTC) and Commonwealth of Pennsylvania, alleging that proposed merger of hospitals violated Clayton Act’s bar against mergers whose effect “may be substantially to lessen competition, or to tend to create a monopoly,” district court incorrectly focused on patient flow data at expense of considering insurers’ likely response in face of small but significant non-transitory increase in price (SSNIP), as required under hypothetical monopolist test to determine relevant geographic market, and thus it failed to establish commercial realities of healthcare market, where patients were largely insensitive to healthcare prices because insurance covered majority of their healthcare costs. Clayton Act § 7, 15 U.S.C.A. § 18.

18. Antitrust and Trade Regulation

On a claim under the Clayton Act’s bar against mergers whose effect “may be substantially to lessen competition, or to tend to create a monopoly,” as related to the proposed merger of hospitals, the court must apply the hypothetical monopolist test through the lens of the insurers: if enough insurers, in the face of a small but significant non-transitory increase in price (SSNIP), would avoid the price increase by looking to hospitals outside the proposed geographic market, then the market is too narrow. Clayton Act § 7, 15 U.S.C.A. § 18.

19. Antitrust and Trade Regulation

On claim by Federal Trade Commission (FTC) and Commonwealth of Pennsylvania, alleging that proposed merger of hospitals violated Clayton Act’s bar against mergers whose effect “may be substantially to lessen competition, or to tend to create a monopoly,” district court incorrectly rested part of its analysis of relevant geographic market under hypothetical monopolist test on private agreements between hospitals and insurers; court was supposed to answer whether hypothetical monopolist could profitably impose small but significant non-transitory increase in price (SSNIP), which necessarily rendered irrelevant private contracts between merging parties and their customers in relevant geographic market analysis. Clayton Act § 7, 15 U.S.C.A. § 18.

20. Antitrust and Trade Regulation

In determining the relevant product market on a claim under the Clayton Act’s bar against mergers whose effect “may be substantially to lessen competition, or to tend to create a monopoly,” private contracts are not to be considered. Clayton Act § 7, 15 U.S.C.A. § 18.

21. Antitrust and Trade Regulation

Federal Trade Commission (FTC) and Commonwealth of Pennsylvania properly defined relevant geographic market as four counties encompassing and immediately surrounding Harrisburg, Pennsylvania, on their claim that proposed merger of hospitals violated Clayton Act’s bar.
against mergers whose effect “may be substantially to lessen competition, or to tend to create a monopoly,” where insurers would have no choice but to accept small but significant non-transitory increase in price (SSNIP) from merged hospital in lieu of excluding hospitals from their networks. Clayton Act § 7, 15 U.S.C.A. § 18.

22. Antitrust and Trade Regulation

Market concentration is a useful indicator of the likely anticompetitive effects of a merger, thus supporting a prima facie case under the Clayton Act’s bar against mergers whose effect “may be substantially to lessen competition, or to tend to create a monopoly.” Clayton Act § 7, 15 U.S.C.A. § 18.

23. Antitrust and Trade Regulation

On a claim under the Clayton Act’s bar against mergers whose effect “may be substantially to lessen competition, or to tend to create a monopoly,” the government can establish a prima facie case of anticompetitive effects simply by showing a high market concentration based on the Herfindahl–Hirschman Index (HHI), which is calculated by summing the squares of the individual firms’ market shares, considering both the post-merger HHI number and the increase in the HHI resulting from the merger. Clayton Act § 7, 15 U.S.C.A. § 18.

24. Antitrust and Trade Regulation

Federal Trade Commission (FTC) and Commonwealth of Pennsylvania demonstrated anticompetitive effects in geographic market by calculating market concentration under Herfindahl–Hirschman Index (HHI), thus supporting prima facie case on their claim alleging that proposed merger of hospitals violated Clayton Act’s bar against mergers whose effect “may be substantially to lessen competition, or to tend to create a monopoly,” WHERE merger HHI was more than double that of highly-concentrated market, and increase in HHI was well beyond 200-point increase that triggered presumption of likely enhancement of market power. Clayton Act § 7, 15 U.S.C.A. § 18.

25. Antitrust and Trade Regulation

On claim by Federal Trade Commission (FTC) and Commonwealth of Pennsylvania, alleging that proposed merger of hospitals violated Clayton Act’s bar against mergers whose effect “may be substantially to lessen competition, or to tend to create a monopoly,” merging hospitals’ claimed efficiencies with respect to capacity constraints and capital savings were insufficient to rebut presumption of anticompetitive effects, where evidence was ambiguous at best that one merging hospital needed to construct 100-bed tower to alleviate its capacity constraints, as it needed only 13 additional beds in order to operate at optimal occupancy rate, and hospital’s ability to forego building tower was reduction in output that FTC had no obligation to consider. Clayton Act § 7, 15 U.S.C.A. § 18.

26. Antitrust and Trade Regulation

On claim by Federal Trade Commission (FTC) and Commonwealth of Pennsylvania, alleging that proposed merger of hospitals violated Clayton Act’s bar against mergers whose effect “may be substantially to lessen competition, or to tend to create a monopoly,” merging hospitals’ claimed efficiency of enhancing their efforts to engage in risk-based contracting as alternative payment model was insufficient to rebut presumption of anticompetitive effects, where it remained unclear how this would result in benefit that would be
On claim by Federal Trade Commission (FTC) and Commonwealth of Pennsylvania, alleging that proposed merger of hospitals violated Clayton Act’s bar against mergers whose effect “may be substantially to lessen competition, or to tend to create a monopoly,” merging hospitals’ claim that repositioning, i.e., competitors’ response of offering close substitutes offered by merging hospitals, would constrain post-merger prices was insufficient to rebut presumption of anticompetitive effects, even though there previously had been extensive repositioning in market, where insurers extensively testified that “there would be no network” without separate hospitals. Federal Trade Commission Act § 13, 15 U.S.C.A. § 53(b); Clayton Act § 7, 15 U.S.C.A. § 18.

Equities favored preliminary injunction against proposed merger of two hospitals pending Federal Trade Commission’s (FTC) administrative adjudication of whether merger violated Clayton Act’s bar against mergers whose effect “may be substantially to lessen competition, or to tend to create a monopoly,” even though there were several public benefits that would flow from merger, where, should hospitals consummate merger and FTC subsequently determined that it was unlawful, divestiture would be FTC’s only remedy, but, at that point, since it would be extraordinarily difficult to “unscramble the egg,” it would be too late to preserve competition. Federal Trade Commission Act § 13, 15 U.S.C.A. § 53(b); Clayton Act § 7, 15 U.S.C.A. § 18.


Charles I. Artz, Artz McCarrie Health Law, 200 North 3rd Street, Suite 12–B, Harrisburg, PA 17101, Counsel for Amicus Curiae Association of Independent Doctors

Richard P. Rouco, Quinn Conner Weaver Davies & Rouco, LLP, 2—20th Street North, Suite 930, Birmingham, AL 35203, Counsel for Amici Curiae Economics Professors


William D. Coglianese, Louis K. Fisher [ARGUED], Julie E. McEvoy, Christopher N. Thatch, Adrian Wager–Zito, Alisha M. Crovetto, Jon G. Heintz, Jones Day, 51 Louisiana Avenue, N.W., Washington, DC 20001, James P. DeAngelo, Kimberly A. Selembe, McNees Wallace & Nurick LLC, 100 Pine Street, P.O. Box 1166, Harrisburg, PA 17108, Counsel for Penn State Hershey Medical Center and Pinnacle-Health System

Before: FISHER, GREENAWAY, JR., and KRAUSE, Circuit Judges.

OPINION OF THE COURT

FISHER, Circuit Judge.

At issue in this case is the proposed merger of the two largest hospitals in the Harrisburg, Pennsylvania area: Penn State Hershey Medical Center and Pinnacle-Health System. The Federal Trade Commission ("FTC") opposes their merger and filed an administrative complaint alleging that it violates Section 7 of the Clayton Act because it is likely to substantially lessen competition. In order to maintain the status quo and prevent the parties from merging before the administrative adjudication could occur, the FTC, joined by the Commonwealth of Pennsylvania, filed suit in the Middle District of Pennsylvania under Section 13(b) of the Federal Trade Commission Act ("FTC Act") and Section 16 of the Clayton Act, which authorize the FTC and the Commonwealth, respectively, to seek a preliminary injunction pending the outcome of the FTC's adjudication on the merits. The District Court denied the FTC and the Commonwealth's motion for
a preliminary injunction, holding that they did not properly define the relevant geographic market—a necessary prerequisite to determining whether a proposed combination is sufficiently likely to be anticompetitive as to warrant injunctive relief. For the reasons that follow, we will reverse. We will also remand the case and direct the District Court to enter the preliminary injunction requested by the FTC and the Commonwealth.

I. Background

A. Factual Background

Penn State Hershey Medical Center ("Hershey") is a leading academic medical center and the primary teaching hospital of the Penn State College of Medicine. It is located in Hershey, and it offers 551 beds and employs more than 800 physicians, many of whom are highly specialized. Hershey offers all levels of care, but it specializes in more complex, specialized services that are unavailable at most other hospitals. Because of its advanced services, Hershey draws patients from a broad area both inside and outside Dauphin County.

PinnacleHealth System ("Pinnacle") is a health system with three hospital campuses—two located in Harrisburg in Dauphin County, and the third located in Mechanicsburg in Cumberland County. It focuses on cost-effective primary and secondary services and offers only a limited range of more complex services. It employs fewer than 300 physicians and provides 646 beds.

In June 2014, Hershey and Pinnacle (collectively, the "Hospitals") signed a letter of intent for the proposed merger. Their respective boards subsequently approved the merger in March 2015. The following month, the Hospitals notified the FTC of their proposed merger and, in May 2015, executed a "Strategic Affiliation Agreement."

B. Procedural History

After receiving notification of the proposed merger, the FTC began investigating the combination. Following the investigation, on December 7, 2015, the FTC filed an administrative complaint alleging that the merger violates Section 7 of the Clayton Act. 15 U.S.C. § 18. On December 9, 2015, the FTC and the Commonwealth of Pennsylvania (collectively, the "Government") filed suit in the Middle District of Pennsylvania. Invoking Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), and Section 16 of the Clayton Act, 15 U.S.C. § 26, the Government sought a preliminary injunction pending resolution of the FTC’s administrative adjudication. In its complaint, the Government alleged that the Hospitals’ merger would substantially lessen competition in the market for general acute care services sold to commercial insurers in the Harrisburg, Pennsylvania market. Am. Compl. ¶ 4, at 3–4 (Dist. Ct. ECF 101). According to the Government, the combined Hospitals would control 76% of the market in Harrisburg. See Gov’t Br. 3–4.

The District Court conducted expedited discovery and held five days of evidentiary hearings. During the hearings, the District Court heard testimony from sixteen witnesses and admitted thousands of pages of exhibits into evidence.

Following the hearings, the District Court denied the Government’s request for a preliminary injunction on the basis that the Government had failed to meet its burden to properly define the relevant geographic market. Without a properly defined relevant geographic market, the District Court held there was no way to determine whether the proposed merger was likely to be anticompetitive. Thus, the Government could not show a likelihood of success on the merits, and its failure to
properly define the relevant geographic market was fatal to its motion. The District Court also analyzed what it called “equities,” which it held supported denying the injunction request. The Government timely appealed.

II. Jurisdiction

The District Court had jurisdiction under Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), which authorizes the FTC to request a preliminary injunction in cases involving violations of the Clayton Act, and under Section 16 of the Clayton Act, 15 U.S.C. § 26, which likewise authorizes the Commonwealth of Pennsylvania to seek a preliminary injunction. We have appellate jurisdiction under 28 U.S.C. §§ 1291 and 1292(a)(1).

III. Standard of Review

[1] We begin with the familiar standard of review. We review the District Court’s “findings of fact for clear error, its conclusions of law de novo, and the ultimate decision to grant the preliminary injunction for abuse of discretion.” Miller v. Mitchell, 598 F.3d 139, 145 (3d Cir. 2010). This standard, though easy enough to articulate, often proves difficult to apply, particularly where, as here, we are asked to review determinations made by the District Court that cannot be neatly categorized as either findings of fact or conclusions of law.

The Government argues that the District Court made “three independent legal errors” in rejecting its proffered geographic market. Gov’t Br. 26. Because the errors are legal, the Government would have us apply no deference to the District Court’s determination and exercise plenary review of its conclusions. Id. at 30–31. The Hospitals disagree. They argue that market definition is a factual dispute to which we should apply the most deferential standard: clear error. Hosps. Br. 15.

[2] On several occasions, this Court, and others, have reviewed district courts’ determinations of the relevant geographic market for clear error. E.g., Gordon v. Lewistown Hosp., 423 F.3d 184, 211–13 (3d Cir. 2005); St. Alphonsus Med. Ctr.–Nampa Inc. v. St. Luke’s Health Sys., Ltd., 778 F.3d 775, 783–84 (9th Cir. 2015). In determining that clear-error review applied, the Ninth Circuit in St. Alphonsus reasoned that “[d]efinition of the relevant market is a factual question ‘dependent upon the special characteristics of the industry involved.’ ” 778 F.3d at 783 (quoting Twin City Sportservice, Inc. v. Charles O. Finley & Co., 676 F.2d 1291, 1299 (9th Cir. 1982)). This characterization of the relevant market arose from the Supreme Court’s recognition that “Congress prescribed a pragmatic, factual approach to the definition of the relevant market and not a formal, legalistic one.” Brown Shoe Co. v. United States, 370 U.S. 294, 336, 82 S.Ct. 1502, 8 L.Ed.2d 510 (1962). Thus, where the definition of the geographic market depends on the “special characteristics” of the healthcare market, we may not overturn the District Court’s factual findings unless they are clearly erroneous.

[3] That does not mean, however, that we will always review the District Court’s determination of the relevant market for clear error. “Although market definition is generally regarded as a question of fact, a trial court’s determination of the market may be reversed where that tribunal has erred as a matter of law.” Am. Motor Inns, Inc. v. Holiday Inns, Inc., 521 F.2d 1230, 1252 (3d Cir. 1975); accord White & White, Inc. v. Am. Hosp. Supply Corp., 723 F.2d 495, 499 (6th Cir. 1983) (“The preponderance of authority holds that the determination of a relevant market is composed of the articulation of a legal test
which is then applied to the factual circumstances of each case."); *Little Rock Cardiology Clinic PA v. Baptist Health*, 591 F.3d 591, 599–600 (8th Cir. 2009) (holding that “the theory upon which [the plaintiff] relies to reach the conclusion that a single city is the relevant geographic market is legally flawed”).

In *American Motor Inns*, we held that the district court erred as a matter of law where its opinion did “not demonstrate a consideration of sufficient factors to constitute the type of economic analysis explicat-ed by the Supreme Court.” 521 F.2d at 1252. There, the district court purported to apply the correct standard to determine the relevant product market. The standard was a three-part test set out in *Tampa Electric Co. v. Nashville Coal Co.*, 365 U.S. 320, 81 S.Ct. 623, 5 L.Ed.2d 580 (1961). Relevant here, the third step of the *Tampa Electric* analysis required the district court to find that “the competition foreclosed by the contract . . . constitute[d] a substantial share of the relevant market.” *Am. Motor Inns*, 521 F.2d at 1250 (quoting *Tampa Elec.*, 365 U.S. at 328, 81 S.Ct. 623). The Supreme Court directed lower courts that, to ascertain whether competition in a substantial share of the market had been foreclosed,

it is necessary to weigh the probable effect of the contract on the relevant area of effective competition, taking into account the relative strength of the parties, the proportionate volume of commerce involved in relation to the total volume of commerce in the relevant market area, and the probable immediate and future effects which pre-emption of that share of the market might have on effective competition therein.

*Id.* (quoting *Tampa Elec.*, 365 U.S. at 329, 81 S.Ct. 623).

Although the district court in *American Motor Inns* cited to *Tampa Electric* and purported to apply the *Tampa Electric* test, it did not consider the “the probable immediate and future effects which pre-emption of that share of the market might have within the competitive context of that industry, nor did it in any way advert to the relative strength of the parties.” *Id.* at 1252 (internal quotation marks omitted). We explained that by failing to consider this factor required by the economic analysis as announced by *Tampa Electric*, the district court applied the incorrect legal standard. And application of an incorrect legal standard is error as a matter of law. *Id.*

[4] Consistent with the teaching of our precedent, where a district court applies an incomplete economic analysis or an erroneous economic theory to those facts that make up the relevant geographic market, it has committed legal error subject to plenary review. This understanding of economic theory as legal analysis also comports with the Supreme Court’s recent observation that it has “felt relatively free to revise [its] legal analysis as economic understanding evolves and . . . to reverse antitrust precedents that misperceived a practice’s competitive consequences.” *Kimble v. Marvel Entm’t, LLC*, — U.S. —, 135 S.Ct. 2401, 2412–13, 192 L.Ed.2d 463 (2015).

As we explain further below, the District Court here cited the hypothetical monopolist test and purported to apply it. Both the Government and the Hospitals agree that the hypothetical monopolist test is the correct standard to apply. But the District Court’s application of the hypothetical monopolist test was incomplete and, in many respects, more closely mirrors an economic test that the FTC has abandoned because the test “misperceived a practice’s competitive consequences.” *Id.* at 2413. Although we accept all of the District Court’s factual findings unless they are clearly erroneous,
IV. Analysis

The Government alleges that the proposed merger of Hershey and Pinnacle violates Section 7 of the Clayton Act. In order to prevent the parties from merging until the FTC can conduct an administrative adjudication on the merits to determine whether the merger violates Section 7, the Government seeks a preliminary injunction under Section 13(b) of the FTC Act.

Section 13(b) of the FTC Act empowers the FTC to file suit in the federal district courts and seek a preliminary injunction to prevent a merger pending an FTC administrative adjudication “when the Commission has reason to believe that a corporation is violating, or is about to violate, Section 7 of the Clayton Act.” FTC v. H.J. Heinz Co., 246 F.3d 708, 714 (D.C. Cir. 2001) (quoting FTC v. Staples, Inc., 868 F.2d 901, 906 (7th Cir. 1989)); see 15 U.S.C. § 53(b).

A district court may issue a preliminary injunction “upon a proper showing that, weighing the equities and considering the Commission’s likelihood of ultimate success, such action would be in the public interest.” 15 U.S.C. § 53(b). The public interest standard is not the same as the traditional equity standard for injunctive relief. Under Section 13(b), we first consider the FTC’s likelihood of success on the merits and then weigh the equities to determine whether a preliminary injunction would be in the public interest. FTC v. Univ. Health, Inc., 938 F.2d 1206, 1217–18 (11th Cir. 1991).

A. Likelihood of Success on the Merits

We first consider the FTC’s likelihood of success on the merits. In its administrative adjudication, the FTC must show that the proposed merger violates Section 7 of the Clayton Act. 15 U.S.C. § 18. Section 7 bars mergers whose effect “may be substantially to lessen competition, or to tend to create a monopoly.” Id. “Congress used the words ‘may be substantially to lessen competition’ . . . to indicate that its concern was with probabilities, not certainties,” Brown Shoe, 370 U.S. at 323, 82 S.Ct. 1502, rendering Section 7’s definition of antitrust liability “relatively expansive.” California v. Am. Stores Co., 495 U.S. 271, 284, 110 S.Ct. 1853, 109 L.Ed.2d 240 (1990). At this stage, “[t]he FTC is not required to establish that the proposed merger would in fact violate section 7 of the Clayton Act.” H.J. Heinz, 246 F.3d at 714. Accordingly, “[a] certainty, even a high probability, need not be shown,” and any “doubts are to be resolved against the transaction.” FTC v. Elders Grain, Inc., 868 F.2d 901, 906 (7th Cir. 1989).

We assess Section 7 claims under a burden-shifting framework. First, the Government must establish a prima facie case that the merger is anticompetitive. If the Government establishes a prima facie case, the burden then shifts to the Hospitals to rebut it. If the Hospitals successfully rebut the Government’s prima facie case, “the burden of production shifts back to the Government and merges with the ultimate burden of persuasion, which is incumbent on the Government at all times.” St. Alphonsonus, 778 F.3d at 783 (quoting Chi. Bridge & Iron Co. v. FTC, 534 F.3d 410, 423 (5th Cir. 2008)).

To establish a prima facie case, the Government must (1) propose the proper relevant market and (2) show that the
effect of the merger in that market is likely to be anticompetitive.

1. Relevant Market


a. Relevant Product Market

There is no dispute as to the relevant product market. The District Court found, and the parties stipulated, that the relevant product market is general acute care (“GAC”) services sold to commercial payors. App. 9. GAC services comprise a number of “medical and surgical services that require an overnight hospital stay.” Id. Though the parties agree as to the relevant product market, the Hospitals strongly dispute the relevant geographic market put forth by the Government.

b. Relevant Geographic Market

[11–13] The relevant geographic market “is that area in which a potential buyer may rationally look for the goods or services he seeks.” Gordon, 423 F.3d at 212. Determined within the specific context of each case, a market’s geographic scope must “correspond to the commercial realities of the industry” being considered and “be economically significant.” Brown Shoe, 370 U.S. at 336–37, 82 S.Ct. 1502 (footnote and internal quotation marks omitted). The plaintiff (here, the Government) bears the burden of establishing the relevant geographic market. St. Alphonsus, 778 F.3d at 784.

[14] A common method employed by courts and the FTC to determine the relevant geographic market is the hypothetical monopolist test. Under the Horizontal Merger Guidelines issued by the U.S. Department of Justice’s Antitrust Division and the FTC, if a hypothetical monopolist could impose a small but significant non-transitory increase in price (“SSNIP”) in the proposed market, the market is properly defined. Merger Guidelines, § 4, at 7–8. If, however, consumers would respond to a SSNIP by purchasing the product from outside the proposed market, thereby making the SSNIP unprofitable, the proposed market definition is too narrow. Id. Important for our purposes, both the Government and the Hospitals agree that this test should govern the instant appeal. See Gov’t Br. 25; Hosps. Br. 17–20.

The Government argues, as it did before the District Court, that the relevant geographic market is the “Harrisburg area.” More specifically, the four counties encompassing and immediately surrounding Harrisburg, Pennsylvania: Dauphin, Cumberland, Lebanon, and Perry counties.


2. “Although the Merger Guidelines are not binding on the courts, they are often used as persuasive authority.” St. Alphonsus, 778 F.3d at 784 n.9 (citations and internal quotation marks omitted).
The District Court rejected the Government’s proposed geographic market. It first observed that 43.5% of Hershey’s patients—11,260 people—travel to Hershey from outside the four-county area, which “strongly indicate[d] that the FTC had created a geographic market that [was] too narrow because it does not appropriately account for where the Hospitals, particularly Hershey, draw their business.” App. 13. Second, it held that the nineteen hospitals within a sixty-five-minute drive of Harrisburg “would readily offer consumers an alternative” to accepting a SSNIP. Id. Finally, the District Court found it “extremely compelling” that the Hospitals had entered into private agreements with the two largest insurers in Central Pennsylvania, ensuring that post-merger rates would not increase for five years with one insurer and ten years with the other. App. 13–14. Refusing to “blind [itself] to this reality,” the District Court declined to “prevent [the] merger based on a prediction of what might happen to negotiating position and rates in 5 years.” App. 14. The failure to propose the proper relevant geographic market was fatal to the Government’s motion, and the District Court denied the preliminary injunction request.

We conclude that the District Court erred in both its formulation and its application of the proper legal test. Although the District Court correctly identified the hypothetical monopolist test, its decision reflects neither the proper formulation nor the correct application of that test. We find three errors in the District Court’s analysis. First, by relying almost exclusively on the number of patients that enter the proposed market, the District Court’s analysis more closely aligns with a discredited economic theory, not the hypothetical monopolist test. Second, the District Court focused on the likely response of patients to a price increase, completely neglecting any mention of the likely response of insurers. Third, the District Court grounded its reasoning, in part, on the private agreements between the Hospitals and two insurers, even though these types of private contracts are not relevant to the hypothetical monopolist test.

i. Formulation of the Legal Test

In formulating the legal standard for the relevant geographic market, the District Court relied primarily on the Eighth Circuit’s decision in Little Rock Cardiology, 591 F.3d 591. According to the District Court, to determine the geographic market, a court must apply a two-part test. First, it must determine “the market area in which the seller operates, its trade area.” App. 12 (internal quotation marks omitted) (quoting Little Rock Cardiology, 591 F.3d at 598). Under the District Court’s inquiry, the “end goal” of the relevant geographic market analysis is “to delineate a geographic area where, in the medical setting, few patients leave . . . and few patients enter.” Id. (alteration in original; internal quotation marks omitted) (quoting Little Rock Cardiology, 591 F.3d at 598).

This formulation of the relevant geographic market test is inconsistent with the hypothetical monopolist test. Rather, it is one-half of a different test utilized in non-healthcare markets to define the relevant geographic market: the Elzinga–Hogarty test. The Elzinga–Hogarty test consists of two separate measurements: first, the number of customers who come from outside the proposed market to purchase
goods and services from inside of it, and, second, the number of customers who reside inside the market but leave that market to purchase goods and services.

The Elzinga–Hogarty test was once the preferred method to analyze the relevant geographic market and was employed by many courts. See, e.g., California v. Sutter Health Sys., 130 F.Supp.2d 1109, 1120–24 (N.D. Cal. 2001); FTC v. Freeman Hosp., 911 F.Supp. 1213, 1217–21 (W.D. Mo.), aff’d, 69 F.3d 260 (8th Cir. 1995); United States v. Rockford Mem’l Corp., 717 F.Supp. 1251, 1266–78 (N.D. Ill. 1989), aff’d, 898 F.2d 1278 (7th Cir. 1990). But subsequent empirical research demonstrated that utilizing patient flow data to determine the relevant geographic market resulted in overbroad markets with respect to hospitals. Professor Elzinga himself testified before the FTC that this method “was not an appropriate method to define geographic markets in the hospital sector.” In re Evanston Nw. Healthcare Corp., 2007 WL 2286195, at *64 (F.T.C. Aug. 6, 2007).

The Hospitals dispute that the District Court’s formulation of the relevant geographic market standard is the Elzinga–Hogarty test. The District Court’s opinion does not specifically name or address Elzinga–Hogarty; neither does the Eighth Circuit’s opinion in Little Rock Cardiology. But Little Rock Cardiology’s statement that the market is one in which “few patients leave . . . and few patients enter,” 591 F.3d at 598 (alteration in original), is a direct quote from Rockford Memorial, 717 F.Supp. at 1267.

In Rockford Memorial, the Northern District of Illinois, after observing that, “[i]deally, an area should be delineated where ‘few’ patients leave an area and ‘few’ patients enter,” 591 F.3d at 598 (alteration in original), is a direct quote from Rockford Memorial, 717 F.Supp. at 1267.

In Rockford Memorial, the Northern District of Illinois, after observing that, “[i]deally, an area should be delineated where ‘few’ patients leave an area and

3. Amici are a group of 36 economics professors—including Professor Elzinga—who argue that the District Court engaged in faulty economic reasoning, particularly with regard to geographic market definition.
nomics Professors 11–17. “The silent majority fallacy is the false assumption that patients who travel to a distant hospital to obtain care significantly constrain the prices that the closer hospital charges to patients who will not travel to other hospitals.” Evanston Nw., 2007 WL 2286195, at *64 (citing testimony of Professor Elzinga). The constraining effect is non-existent because patient decisions are based mostly on non-price factors, such as location or quality of services. This fallacy is particularly salient here, where the District Court relied almost exclusively on the fact that Hershey attracts many patients from outside of the Harrisburg area. In deciding that patients who travel to Hershey would turn to other hospitals outside of Harrisburg if the merger gave rise to higher prices, the District Court did not consider that Hershey is a leading academic medical center that provides highly complex medical services. We are skeptical that patients who travel to Hershey for these complex services would turn to other hospitals in the area.

Although the District Court did not employ strict cutoffs to determine whether too many patients enter or leave the proposed market, the silent majority fallacy renders the test employed by the District Court unreliable even in the absence of precise thresholds. In other words, the inadequacy of using patient flow data to determine the geographic market does not depend on whether the District Court used an exact percentage or whether it used a more flexible approach: relying solely on patient flow data is not consistent with the hypothetical monopolist test.4

Moreover, even assuming that relying strictly on patient flow data is consistent with the hypothetical monopolist test, the District Court did not consider the other half of the equation: patient outflows. The Government presented undisputed evidence that 91% of patients who live in Harrisburg receive GAC services in the Harrisburg area. Gov't Br. 10.5 Such a high number of patients who do not travel long distances for healthcare supports the Government's contention that GAC services are inherently local and that, in turn, payors would not be able to market a healthcare plan to Harrisburg-area residents that did not include Harrisburg-area hospitals. Although the District Court was not required to cite every piece of evidence it received, or even on which it relied, citing only patient inflows and ignoring patient outflows creates a misleading picture of the relevant geographic market.

ii. Likely Response of Payors

The next problem with utilizing patient flow data—the payor problem—underscores the second error committed by utilizing a different hospital to defeat a price increase. However, in arriving at the conclusion that patients would turn to other hospitals, the District Court relied exclusively on this measure of patient inflow, save its observation that Central Pennsylvania is largely rural and often requires driving large distances for services. App. 13.

We cite to the parties' briefs for facts in the sealed record that have been made public by virtue of the parties' without objection including them in their publicly-filed briefs.
by the District Court. By utilizing patient flow data as its primary evidence that the relevant market was too narrow, the District Court failed to properly account for the likely response of insurers in the face of a SSNIP. In fact, it completely neglected any mention of the insurers in the healthcare market. This incorrect focus reflects a misunderstanding of the “commercial realities” of the healthcare market. Brown Shoe, 370 U.S. at 336, 82 S.Ct. 1502.

As the FTC and several courts have recognized, the healthcare market is represented by a two-stage model of competition. See St. Alphonsus, 778 F.3d at 784 n.10 (calling the two-stage model the “accepted model”). In the first stage, hospitals compete to be included in an insurance plan’s hospital network. In the second stage, hospitals compete to attract individual members of an insurer’s plan. Gregory Vistnes, Hospitals, Mergers, and Two–Stage Competition, 67 Antitrust L.J. 671, 672 (2000). Patients are largely insensitive to healthcare prices because they utilize insurance, which covers the majority of their healthcare costs. Because of this, our analysis must focus, at least in part, on the payors who will feel the impact of any price increase. Id. at 682, 692.

The Hospitals argue that there is no fundamental difference between analyzing the likely response of consumers through the patient or the payor perspective. We disagree. Patients are relevant to the analysis, especially to the extent that their behavior affects the relative bargaining positions of insurers and hospitals as they negotiate rates. But patients, in large part, do not feel the impact of price increases. Insurers do. And they are the ones who negotiate directly with the hospitals to determine both reimbursement rates and the hospitals that will be included in their networks.

Imagine that a hospital raised the cost of a procedure from $1,000 to $2,000. The patient who utilizes health insurance will still have the same out-of-pocket costs before and after the price increase. It is the insurer who will bear the immediate impact of that price increase. Not until the insurer passes that cost on to the patient in the form of higher premiums will the patient feel the impact of that price increase. And even then, the cost will be spread among many insured patients; it will not be felt solely by the patient who receives the higher-priced procedure. This is the commercial reality of the healthcare market as it exists today.

[18] Thus, consistent with the mandate to determine the relevant geographic market taking into account the commercial realities of the specific industry involved, Brown Shoe, 370 U.S. at 336, 82 S.Ct. 1502, when we apply the hypothetical monopolist test, we must also do so through the lens of the insurers: if enough insurers, in the face of a small but significant non-transitory price increase, would avoid the price increase by looking to hospitals outside the proposed geographic market, then the market is too narrow. This view has been confirmed by several courts. E.g., St. Alphonsus, 778 F.3d at 784 & n.10; see

6. The Hospitals put forth evidence that patients are becomingly increasingly sensitive to prices. Hosps. Br. 29. We do not disagree. But despite the increasing sensitivity of patients to pricing—e.g., through high-deductible plans, coinsurance, and tiered networks—the majority of patients do not feel the impact of the price of a specific procedure or at a specific hospital. The Hospitals’ own study showed that only 2% of respondents considered out-of-pocket costs in choosing a hospital. Corrected Reply Br. 24. Moreover, the Hospitals have not drawn our attention to any specific evidence about the use of health plans that would result in price sensitivity to patients.
Also FTC v. OSF Healthcare Sys., 852 F.Supp.2d 1069, 1083-85 (N.D. Ill. 2012) (concluding that managed care organizations will not be an effective constraint on the ability of the merged entity to use its market power to raise prices). It is also consistent with the FTC’s view. In re ProMedica Health Sys., Inc., 2012 WL 1155392, at *1-10, *23 n.28 (F.T.C. Mar. 28, 2012), adopted as modified, 2012 WL 2450574 (F.T.C. June 25, 2012). It was error for the District Court to completely disregard the role that insurers play in the healthcare market.

We do not mean to suggest that, in the healthcare context, considering the effect of a price increase on patients constitutes error standing alone. Patients, of course, are relevant. For instance, an antitrust defendant may be able to demonstrate that enough patients would buy a health plan marketed to them with no in-network hospital in the proposed geographic market. It would necessarily follow that those patients who purchased the health plan would have to turn to hospitals outside the relevant market (lest they pay significant out-of-pocket costs for an out-of-network hospital). In this scenario, patient response is clearly important, but it is not important with respect to patients’ response to the price increase demanded by the post-merger Hospitals. The District Court here did not address this correlated behavior.

And although it is possible that this scenario could play out in some healthcare market, to assume that it would in Harrisburg defies the payors’ testimony. The payors repeatedly said that they could not successfully market a plan in the Harrisburg area without Hershey and Pinnacle. In fact, one payor that attempted to do just that (with Holy Spirit, a Harrisburg-area hospital, no less) lost half of its membership. Gov’t Br. 13–14. That is to say nothing about whether payors would be able to successfully market a plan without any Harrisburg-area hospital, which is the less burdensome question the Government was tasked with answering under the hypothetical monopolist test.

iii. Private Pricing Agreements

Finally, the District Court erred in using part of its analysis of the relevant geographic market on the private agreements between the Hospitals and the payors. The District Court found it “extremely compelling” that the Hospitals had already entered into contractual agreements with two of Central Pennsylvania’s largest payors to maintain the existing rate structure for five years with Payor A and ten years with Payor B. App. 13–14. Because of the agreements, the District Court believed that the FTC was “asking the Court [to] prevent this merger based on a prediction of what might happen to negotiating position and rates in 5 years.”
App. 14. It declined to make such a prediction "[i]n the rapidly-changing arena of healthcare and health insurance." *Id.*

[20] This reasoning is flawed. We have previously cautioned that, in determining the relevant product market, private contracts are not to be considered. *See Queen City Pizza, Inc. v. Domino's Pizza, Inc.*, 124 F.3d 430, 438–39 (3d Cir. 1997). This same reasoning applies to the relevant geographic market. In determining the relevant market, we “look[ ] not to the contractual restraints assumed by a particular plaintiff,” *id.* but instead, we answer whether a hypothetical monopolist could profitably impose a SSNIP.

For this reason, private contracts between merging parties and their customers have no place in the relevant geographic market analysis. The hypothetical monopolist test is exactly what its name suggests: hypothetical. This is for good reason. If we considered the agreements, then our inquiry would be simple: the Hospitals would not be able to profitably impose a SSNIP because the agreements forbid them from doing so. Determination of the relevant geographic market is a task for the courts, not for the merging entities. Although the District Court declined to predict what might happen to negotiating position and rates, making predictions about parties' and consumers' behavior is exactly what we are asked to do. *See United States v. Phila. Nat'l Bank*, 374 U.S. 321, 362, 83 S.Ct. 1715, 10 L.Ed.2d 915 (1963) (noting that the question “whether the effect of the merger ‘may be substantially to lessen competition’ in the relevant market” requires a “prediction of [the merger’s] impact upon competitive conditions in the future”).

Moreover, if we allowed such private contracts to impact our analysis, any merging entity could enter into similar agreements—that may or may not be enforceable—to impermissibly broaden the scope of the relevant geographic market. This would enable antitrust defendants to escape effective enforcement of the antitrust laws. *See Queen City Pizza*, 124 F.3d at 438 (“Were we to adopt plaintiffs’ position that contractual restraints render otherwise identical products non-interchangeable for purposes of relevant market definition, any exclusive dealing arrangement, output or requirement contract, or franchise tying agreement would support a claim for violation of antitrust laws.”). Although private pricing agreements may be an effective tool for the FTC and merging parties to utilize in regulatory actions, they have no place in the antitrust analysis we engage in today.

* * *

These errors together render the District Court's analysis economically unsound and not reflective of the commercial reality of the healthcare market. In recent years, economists have concluded that the use of patient flow data does not accurately portray the relevant geographic market in the hospital merger context. Instead, economists have proposed, and the FTC has implemented, the hypothetical monopolist test. The realities of the healthcare market—in which payors negotiate prices for GAC services and will therefore feel the impact of any price increase—dictate that we consider the payors in our analysis. The District Court did not properly formulate the hypothetical monopolist test, nor did it properly apply that test. Because our antitrust analysis must be consistent with the evolution of economic understanding, *Kimble*, 135 S.Ct. at 2412–13, and must be tied to the commercial realities of the specific industry at issue, *Brown Shoe*, 370 U.S. at 336, 82 S.Ct. 1502, we hold that the District Court committed legal error in
failing to properly formulate and apply the hypothetical monopolist test.

We emphasize, however, that our holding is narrow. We are not suggesting that the hypothetical monopolist test is the only test that the district courts may use in determining whether the Government has met its burden to properly define the relevant geographic market. In our case, the District Court, the Hospitals, and the Government all agreed that the hypothetical monopolist test was the proper standard to apply. The District Court identified the standard and purported to apply it. But in doing so, it incorrectly defined and misapplied that standard. This was error.

iv. The Government Has Properly Defined the Relevant Geographic Market

[21] Our conclusion that the District Court incorrectly formulated and misapplied the proper standard does not end the inquiry. We must still determine whether the Government has met its burden to properly define the relevant geographic market. We conclude that it has.

The Government presented extensive evidence showing that insurers would have no choice but to accept a price increase from a combined Hershey/Pinnacle in lieu of excluding the Hospitals from their networks. First, two of Central Pennsylvania's largest insurers—Payor A and Payor B—testified that they could not successfully market a network to employers without including at least one of the Hospitals. Gov't Br. 13–14, 37–38. Payor A's representative stated in his deposition that "[y]ou wouldn't have a whole lot of choice" if Hershey and Pinnacle raised their prices following a merger and there was no price agreement; that "there would be no network without" a combined Hershey and Pinnacle; and that the combined entity would have more bargaining leverage. Id. at 14; see Corrected Reply Br. 13–14. He estimated that the insurer would lose half of its membership in Dauphin County if they tried to market a plan that excluded Pinnacle and Hershey. Gov't Br. 13–14; Corrected Reply Br. 14 n.9.

He further testified that the insurer previously used the possibility of creating a network that included only Holy Spirit and Hershey in the Harrisburg market in order to get Pinnacle to accept lower prices. Corrected Reply Br. 13. According to him, insurers used the separate existence of Pinnacle and Hershey at the bargaining table: in order to resist a large price increase from Pinnacle, Payor A threatened to form a network with Holy Spirit and Hershey, excluding Pinnacle. After making this threat, Payor A and Pinnacle were able to come to an agreement that included only modest rate increases. The representative conceded that, without the ability to create a network with Hershey, this threat would not have been credible—Payor A could not have threatened to form a network with only Holy Spirit. Gov't Br. 15. This is strong evidence that the separate existence of Pinnacle and Hershey constrains prices.

A representative from a second large insurer, Payor B, also expressed concerns that the Hospitals would control greater than 50% of the market and would have too much leverage. Gov't Br. 16, 38. He testified that the insurer would need to market a combined Hershey/Pinnacle in its network in order to be marketable. Id. at 14–15, 37–38; Corrected Reply Br. 14. Employers in the area similarly stated that they would have a difficult time marketing a health plan without the Hospitals after the merger. Corrected Reply Br. 20 n.12.

The results of one natural experiment also support the insurer's testimony. From 2000 until 2014, Payor E was able to market a viable network in Harrisburg that
included only Holy Spirit and Pinnacle but did not include Hershey. In August 2014, Pinnacle terminated its agreement with Payor E. After losing Pinnacle from its network, Payor E negotiated substantial discounts with Holy Spirit and large hospitals in York and Lancaster counties and was able to offer plans at a substantial discount. Despite being priced much lower than its competitors, Payor E lost half its members, who switched to other health plans. Gov't Br. 13–14. Brokers informed the Payor E representative that it no longer had a viable network without Pinnacle, and even in the face of substantial discounts for Payor E's health plan, patients were willing to pay more to other insurers for health plans that included Hershey or Pinnacle. Corrected Reply Br. 16.

Finally, payors testified that they consider the Harrisburg area a distinct market and do not consider hospitals in other areas, such as York or Lancaster counties, to be suitable alternatives. Gov't Br. 18 & n.4.

The Hospitals argue that the payors have enough bargaining leverage that they would be able to defeat a SSNIP. In the Hospitals' view, the payors, which supply patients to the Hospitals, can threaten to exclude the Hospitals from their network; this would in turn cause the Hospitals to lose significant numbers of patients. Such a loss would render the SSNIP unprofitable and therefore does not satisfy the hypothetical monopolist test. No one disputes that the parties both have bargaining leverage when negotiating reimbursement rates. The question here, however, is whether the merger will cause such a significant increase in the Hospitals' bargaining leverage that they will be able to profitably impose a SSNIP and, in the face of demand for the SSNIP, whether the payors will be forced to accept it. In other words, whatever leverage the payors will have after the merger, they have that leverage now. The Government's evidence shows that the increase in the Hospitals' bargaining leverage as a result of the merger will allow the post-merger combined Hershey/Pinnacle to profitably impose a SSNIP on payors.

All of the aforementioned evidence answered an even narrower question than the one presented: the Government was not required to show that payors would accept a price increase rather than excluding the merged Hershey/Pinnacle entity from their networks; it was required to show only that payors would accept a price increase rather than excluding all of the hospitals in the Harrisburg area. That is the inquiry under the hypothetical monopolist test. Considering the evidence put forth by the Government, we conclude that the Government has met its burden to properly define the relevant geographic market. It is the four-county Harrisburg area.

2. Prima Facie Case

[22] "Once the relevant geographic market is determined, a prima facie case is established if the plaintiff proves that the merger will probably lead to anticompetitive effects in that market." St. Alphonsus, 778 F.3d at 785. Market concentration is a useful indicator of the likely competitive, or anticompetitive, effects of a merger. Merger Guidelines, § 5.3, at 18; see also H.J. Heinz, 246 F.3d at 715–16 ("Increases in concentration above certain levels are thought to raise a likelihood of interdependent anticompetitive conduct." (internal quotation marks and alterations omitted)).

[23] Market concentration is measured by the Herfindahl–Hirschman Index ("HHI"). The HHI is calculated by summing the squares of the individual firms' market shares. In determining whether the HHI demonstrates a high market con-
centration, we consider both the post-merger HHI number and the increase in the HHI resulting from the merger. *Merger Guidelines*, § 5.3, at 18–19. A post-merger market with a HHI above 2,500 is classified as “highly concentrated,” and a merger that increases the HHI by more than 200 points is “presumed to be likely to enhance market power.” Id. § 5.3, at 19.

The Government can establish a prima facie case simply by showing a high market concentration based on HHI numbers. See *St. Alphonsus*, 778 F.3d at 788 (“The extremely high HHI on its own establishes the prima facie case.”); *H.J. Heinz*, 246 F.3d at 716 (“Sufficiently large HHI figures establish the FTC’s prima facie case that a merger is anti-competitive.”).

[24] The Government put forth undisputed evidence that the post-merger HHI is 5,984—more than twice that of a highly concentrated market. The increase in HHI is 2,582—well beyond the 200-point increase that is presumed likely to enhance market power. Gov’t Br. 20. These numbers, the accuracy of which the Hospitals conceded at oral argument, are significantly higher than post-merger HHIs and HHI increases that other courts have deemed presumptively anticompetitive. See *ProMedica Health Sys., Inc. v. FTC*, 749 F.3d 559, 568 (6th Cir. 2014) (post-merger HHI of 4,391 and HHI increase of 1,078 was presumptively anticompetitive), cert. denied, — U.S. ——, 135 S.Ct. 2049, 191 L.Ed.2d 956 (2015); *H.J. Heinz*, 246 F.3d at 716 (post-merger HHI of 4,775 and HHI increase of 510 was presumptively anticompetitive). Furthermore, the Government has alleged that the post-merger combined Hershey/Pinnacle will control 76% of the market in Harrisburg. Gov’t Br. 3–4, 20. Together, these numbers demonstrate that the merger is presumptively anticompetitive.

### 3. Rebutting the Prima Facie Case

Once the Government has established a prima facie case that the merger may substantially lessen competition, the burden shifts to the Hospitals to rebut the Government’s prima facie case. In order to rebut the prima facie case, the Hospitals must show either that the combination would not have anticompetitive effects or that the anticompetitive effects of the merger will be offset by extraordinary efficiencies resulting from the merger. See *H.J. Heinz*, 246 F.3d at 718–25. The Hospitals present two efficiencies-based defenses. First, they put forth considerable evidence in an attempt to show that the merger will produce procompetitive effects, including relieving Hershey’s capacity constraints and allowing Hershey to avoid construction of an expensive bed tower that would save $277 million—savings which could be passed on to patients. Second, the Hospitals claim that the merger will enhance their efforts to engage in risk-based contracting. And finally, in addition to their efficiencies defense, the Hospitals argue that, because of repositioning by other hospitals in the area, the merger will not have anticompetitive effects.

#### a. Efficiencies Defense

We note at the outset that we have never formally adopted the efficiencies defense. Neither has the Supreme Court. Contrary to endorsing such a defense, the Supreme Court has instead, on three occasions, cast doubt on its availability. First, in *Brown Shoe*, the Supreme Court, though acknowledging that mergers may sometimes produce benefits that flow to consumers, reasoned that “Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets. It resolved these competing considerations in
favor of decentralization.” 370 U.S. at 344, 82 S.Ct. 1502. Next, in Philadelphia National Bank, the Supreme Court made clear that
a merger the effect of which “may be substantially to lessen competition” is not saved because, on some ultimate reckoning of social or economic debits and credits, it may be deemed beneficial…. Congress determined to preserve our traditionally competitive economy. It therefore proscribed anti-competitive mergers, the benign and the malignant alike, fully aware, we must assume, that some price might have to be paid.

374 U.S. at 371, 83 S.Ct. 1715. Finally, in FTC v. Procter & Gamble Co., 386 U.S. 568, 87 S.Ct. 1224, 18 L.Ed.2d 303 (1967), the Supreme Court cautioned that “[p]ossible economies cannot be used as a defense to illegality.” Id. at 580, 87 S.Ct. 1224.

Based on this language and on the Clayton Act’s silence on the issue, we are skeptical that such an efficiencies defense even exists. Nevertheless, other courts of appeals have held that the efficiencies defense is cognizable. E.g., Univ. Health, 938 F.2d at 1222 (“We think . . . that an efficiency defense to the government’s prima facie case in section 7 challenges is appropriate in certain circumstances.”). And still others have analyzed the efficiencies to determine whether they might overcome the presumption of illegality. See St. Alphonsus, 778 F.3d at 788–92 (expressing skepticism that the defense exists but nevertheless addressing it); H.J. Heinz, 246 F.3d at 720 (acknowledging that the Supreme Court has never “sanctioned the use of the efficiencies defense,” but noting that “the trend among lower courts is to recognize the defense”); see also ProMedica Health, 749 F.3d at 571 (recognizing that merging parties often put forth the efficiencies defense). The FTC’s Merger Guidelines also recognize the defense. See Merger Guidelines, § 10, at 30 (“The Agencies will not challenge a merger if cognizable efficiencies are of a character and magnitude such that the merger is not likely to be anticompetitive in any relevant market.”). Because we conclude that the Hospitals cannot clearly show that their claimed efficiencies will offset any anticompetitive effects of the merger, we need not decide whether to adopt or reject the efficiencies defense. However, because the District Court concluded otherwise, we address the requirements of the efficiencies defense and each of the Hospitals’ claimed benefits in turn.

Those courts of appeals to recognize the defense have articulated several requirements, which are also found in the Merger Guidelines. In order to be cognizable, the efficiencies must, first, offset the anticompetitive concerns in highly concentrated markets. See St. Alphonsus, 778 F.3d at 790. Second, the efficiencies must be “merger specific,” id.—meaning, “they must be efficiencies that cannot be achieved by either company alone.” H.J. Heinz, 246 F.3d at 722. Otherwise, “the merger’s . . . benefits [could] be achieved without the concomitant loss of a competitor.” Id. Third, the efficiencies “must be verifiable, not speculative,” St. Alphonsus,

8. Some commentators have argued that, because the efficiencies defense has never been squarely presented to the Supreme Court, the issue has never been definitively decided. Moreover, they suggest that, although possible economies are not a defense, efficiencies that do not lessen competition and are certain, as opposed to merely possible, may be enough to rebut the presumption of illegality. See Mark N. Berry, Efficiencies and Horizontal Mergers: In Search of a Defense, 33 San Diego L. Rev. 515, 525 (1996); Timothy J. Muris, The Efficiency Defense Under Section 7 of the Clayton Act, 30 Case W. Res. L. Rev. 381, 412–13 (1980).
778 F.3d at 791; they “must be shown in what economists label ‘real’ terms.” Univ. Health, 938 F.2d at 1223 (quoting Procter & Gamble, 386 U.S. at 604, 87 S.Ct. 1224 (Harlan, J., concurring)). Finally, the efficiencies must not arise from anticompetitive reductions in output or service. Merger Guidelines, § 10, at 30.

Remaining cognizant that the “language of the Clayton Act must be the linchpin of any efficiencies defense,” and that the Clayton Act speaks in terms of “competition,” we must emphasize that “a successful efficiencies defense requires proof that a merger is not, despite the existence of a prima facie case, anticompetitive.” St. Alphonsus, 778 F.3d at 790. The presumption of illegality may be overcome only where the defendants “demonstrate that the intended acquisition would result in significant economies and that these economies ultimately would benefit competition and, hence, consumers.” Univ. Health, 938 F.2d at 1223.

Efficiencies are not the same as equities. In assessing whether a preliminary injunction may issue in a Section 7 case, a court must always weigh the equities as part of its determination that granting the injunction would be in the public interest. This essential step is expressly required by Section 13(b) of the FTC Act: “Upon a proper showing that, weighing the equities and considering the Commission’s likelihood of ultimate success, such action would be in the public interest . . . a preliminary injunction may be granted . . .” 15 U.S.C. § 53(b) (emphasis added). The efficiencies defense, on the other hand, is a means to show that any anticompetitive effects of the merger will be offset by efficiencies that will ultimately benefit consumers. It is not mentioned in Section 7 of the Clayton Act, nor is it part of the standard for granting a preliminary injunction.

Some of the considerations may overlap, but they are properly viewed as distinct inquiries, in part, because of the rigorous standard that applies to efficiencies, which must be merger specific, verifiable, and must not arise from any anticompetitive reduction in output or service. And importantly, the efficiencies defense, because it is aimed at rebutting the Government’s prima facie case that the merger is anticompetitive, must “demonstrate that the prima facie case portrays inaccurately the merger’s probable effects on competition.” St. Alphonsus, 778 F.3d at 790 (internal quotation marks and alterations omitted).

The District Court analyzed several claimed efficiencies and concluded that they weigh in favor of denying the preliminary injunction. But it did not address whether those claimed efficiencies meet the demanding scrutiny that the efficiencies defense requires.9

[25] Our review of the Hospitals’ claimed efficiencies leads us to conclude that they are insufficient to rebut the presumption of anticompetitiveness. With respect to the Hospitals’ capacity constraints and capital savings claims, the District Court found that the merger will alleviate Hershey’s capacity constraints because, upon consummating the merger, Hershey

9. The District Court engaged in an analysis of what it called “equities,” even though it held that the Government failed to demonstrate a likelihood of success on the merits. But after articulating the standard for weighing the equities as required by Section 7, the District Court immediately articulated the standard for the efficiencies defense. App. 16–17. It then, in its discussion of the equities, considered the Hospitals’ claims that: (1) the proposed merger would alleviate Hershey’s capacity constraints, App. 17–23; (2) repositioning by competitors will constrain prices at Hershey and Pinnacle, App. 23–25; (3) the merger will increase the Hospitals’ ability to adapt to risk-based contracting, App. 25–27; and (4) the public interest will be served by the merger, App. 27–28.
will immediately be able to transfer patients to Pinnacle. The District Court also credited the testimony of Hershey CEO Craig Hilfemeier that, because Hershey will transfer patients to Pinnacle, it can avoid constructing a new planned bed tower aimed at providing additional beds at Hershey, resulting in capital savings of nearly $277 million.

The parties dispute whether capital savings can constitute efficiencies. Compare *FTC v. Butterworth Health Corp.*, 946 F.Supp. 1285, 1300–01 (W.D. Mich. 1996) (capital savings are cognizable efficiencies), with *FTC v. ProMedica Health Sys., Inc.*, No. 3:11–cv–47, 2011 WL 1219281, at *36–37 (N.D. Ohio Mar. 29, 2011) (capital savings are not cognizable efficiencies). We turn to the Merger Guidelines in answering this question. As the Merger Guidelines explain, competition is what “usually spurs firms to achieve efficiencies internally.” *Merger Guidelines*, § 10, at 29. One of the rationales for recognizing the efficiencies defense is that a merger may produce efficiencies that “result in lower prices, improved quality, enhanced service, or new products.” *Id.* Thus, although capital savings, in and of themselves, would not be cognizable efficiencies, we can foresee that an antitrust defendant could demonstrate that its avoidance of capital expenditures would benefit the public by, for example, lowering prices or improving the quality of its services. In such a case, so long as the capital savings result in some tangible, verifiable benefit to consumers, capital savings may play a role in our efficiencies analysis.

Our recognition that capital savings are cognizable efficiencies does not decide this issue, however, because even if capital savings are efficiencies, they must nonetheless be verifiable and must not result in any anticompetitive reduction in output. It is on these requirements that the Hospitals’ efficiencies claim fails. As an initial matter, we are bound to accept the District Court’s findings of fact unless they are clearly erroneous. And, as the District Court observed, we do not second guess the business judgments of Hershey’s able executives. We do, however, require that the Hospitals provide clear evidence showing that the merger will result in efficiencies that will offset the anticompetitive effects and ultimately benefit consumers. First, the evidence is ambiguous at best that Hershey needed to construct a 100-bed tower to alleviate its capacity constraints. The Hospitals' own efficiencies analysis shows that Hershey needs only thirteen additional beds in order to operate at 85% capacity, which is a hospital's optimal occupancy rate. App. 18; Corrected Reply Br. 28 n.18. Second, Hershey's ability to forego building the 100-bed tower is a reduction in output. The *Merger Guidelines* expressly indicate that the FTC will not consider efficiencies that “arise from anticompetitive reductions in output or service.” *Merger Guidelines*, § 10, at 30.

Even if we were to agree with the Hospitals that their ability to forego building a new 100-bed tower as a result of the merger is a cognizable efficiency that is verified, merger specific, and did not arise from any anticompetitive reduction in output, we cannot overlook that the HHI numbers here eclipse any others we have identified in similar cases. They render this combination not only presumptively anticompetitive, but so likely to be anticompetitive that “extraordinarily great cognizable efficiencies [are] necessary to prevent the merger from being anticompetitive.” *Id.*, § 10, at 31. This high standard is not met here—nor, we note, has this high standard been met by any proposed efficiencies considered by a court of appeals.

[26] Second, the Hospitals claim that the merger will enhance their efforts to
engage in risk-based contracting. Risk-based contracting is an alternative payment model to the traditional fee-for-service model in which healthcare providers bear some of the financial risk and upside in the cost of treatment. The Hospitals' expert testified that large systems that control the entire continuum of care are better suited to risk-based contracting, partly because they are able to spread out the financial risk involved. The Government disputes that a system as large as the combined Hershey/Pinnacle system has any advantages over a smaller, albeit still large, healthcare system. The District Court seemingly agreed with the Government that both Pinnacle and Hershey are capable of independently operating under the risk-based contracting model. But it found that the merger will be beneficial to the Hospitals in increasing their ability to engage in risk-based contracting, which in turn will allow Hershey “to continue to use its revenue to operate its College of Medicine and draw high-quality medical students and professors to Hershey. An efficiencies analysis requires more than speculative assurances that a benefit enjoyed by the Hospitals will also be enjoyed by the public. It is similarly unclear how this ability to engage in risk-based contracting will counteract any of the anticompetitive effects of the merger. Finally, the District Court’s finding that both Pinnacle and Hershey are capable of independently engaging in risk-based contracting contravenes its conclusion that this is a cognizable efficiency because the benefit is not merger specific. See H.J. Heinz, 246 F.3d at 722 (the efficiencies must not be achievable by either company alone; otherwise, the merger’s benefits could be achieved without the loss of a competitor).

b. Anticompetitive Effects

In an attempt to show that the merger will not, despite high HHI numbers, produce anticompetitive effects, the Hospitals claim that repositioning—the response by competitors to offer close substitutes offered by the merging firms—will be sufficient to constrain post-merger prices. The Merger Guidelines recognize that, in certain cases, repositioning by other competitors may be sufficient to deter or counteract the anticompetitive effects of a merger. Merger Guidelines, § 6.1, at 22. In evaluating repositioning, the Merger Guidelines call for consideration of “timeliness, likelihood, and sufficiency.” The District Court noted that “the market that Hershey and Pinnacle exist within has al-

10. In risk-based contracting, healthcare providers bear some financial risk and share in the financial upside based on the quality and value of the services they provide. Consider the following hypothetical example: A payor would pay the hospital $300 per member per month to care for a member. If the patient is generally in good health and goes to the doctor once per year, the hospital still receives the $300/month payment and can keep the excess. But if the patient is sick and requires much more expensive treatment, the hospital still receives only $300/month and must bear the excess cost.
ready been subject to extensive repositioning.” App. 23. It specifically noted that Geisinger Health System recently acquired Holy Spirit Hospital near Harrisburg; WellSpan Health acquired Good Samaritan Hospital in Lebanon County; the University of Pennsylvania acquired Lancaster General Hospital in Lancaster County; and Community Health Systems acquired Carlisle Regional Hospital in Cumberland County. App. 24. We agree that these recent affiliations and acquisitions, at least in the Harrisburg area, assuage some of the concerns that the proposed combination will have anticompetitive effects. We do not believe, however, that repositioning by these hospitals would have the ability to constrain post-merger prices, as evidenced by the extensive testimony by payors that “there would be no network” without Hershey and Pinnacle.

We therefore conclude that the Hospitals have not rebutted the Government’s prima facie case that the merger is likely to be anticompetitive. Accordingly, we hold that the Government has carried its burden to demonstrate that it is likely to succeed on the merits.

B. Weighing the Equities

[28] “Although the [Government’s] showing of likelihood of success creates a presumption in favor of preliminary injunctive relief, we must still weigh the equities in order to decide whether enjoining the merger would be in the public interest.” H.J. Heinz, 246 F.3d at 726; see 15 U.S.C. § 53(b). The question is whether the harm that the Hospitals will suffer if the merger is delayed will, in turn, harm the public more than if the injunction is not issued. See Univ. Health, 938 F.2d at 1225. Once we determine that the proposed merger is likely to substantially lessen competition, the Hospitals “face a difficult task in justifying the nonissuance of a preliminary injunction.” Id.

[29] Although the statute mandates that we weigh the “equities,” it is silent as to what specifically those equities are. The prevailing view is that, although private equities may be considered, they are not to be afforded great weight. See id. (“While it is proper to consider private equities in deciding whether to enjoin a particular transaction, we must afford such concerns little weight.”); H.J. Heinz, 246 F.3d at 727 n.25 (same). But see FTC v. Food Town Stores, Inc., 539 F.2d 1339, 1346 (4th Cir. 1976) (Winter, J., sitting alone) (“All of these reasons go to the private injury which may result from an injunction…. [T]hey are not proper considerations for granting or withholding injunctive relief under § 13(b).”). Because private equities are afforded little weight, they cannot outweigh effective enforcement of the antitrust laws. FTC v. Weyerhaeuser Co., 665 F.2d 1072, 1083 (D.C. Cir. 1981) (Ginsburg, J.). Thus, although we may consider private equities in our weighing of the equities, wherever the Government “demonstrates a likelihood of ultimate success, a countershowning of private equities alone would not suffice to justify denial of a preliminary injunction barring the merger.” Id.

[30] “The principal equity weighing in favor of issuance of the injunction is the public’s interest in effective enforcement of the antitrust laws.” Univ. Health, 938 F.2d at 1225. The purpose of Section 13(b) is to preserve the status quo and allow the FTC to adjudicate the anticompetitive effects of the proposed merger in the first instance. Food Town Stores, 539 F.2d at 1342. This factor is particularly important here because should the Hospitals consummate the merger and the FTC subsequently determine that it is unlawful, divestiture would be the FTC’s only remedy. At that
point, since it is extraordinarily difficult to "unscramble the egg," Univ. Health, 938 F.2d at 1217 n.23,11 "it will be too late to preserve competition if no preliminary injunction has issued." H.J. Heinz, 246 F.3d at 727; see Univ. Health, 938 F.2d at 1225.

On the other side, the Hospitals claim that granting the injunction would "preclude the many public benefits recognized by the [district] court." Hosps. Br. 49. In making this argument, the Hospitals misconstrue our equities inquiry. By statute, we are required to weigh the equities in order to decide whether granting the injunction would be in the public interest. In answering this question, therefore, we consider whether the injunction, not the merger, would be in the public interest.

Mindful of the limited scope of our inquiry, we believe that the injunction will not deprive the public of the many benefits found by the District Court. All of the Hospitals' alleged benefits will still be available upon consummation of the merger, even if we were to grant an injunction and the FTC were to subsequently determine the merger is lawful. Although the Hospitals have indicated in their briefs to this Court that they "would have to abandon the combination rather than continu[e] to expend substantial resources litigating' if an injunction is issued," Hosps. Br. 49 (quoting Hosps. Pre–Hrg. Br. 2), they offer no support beyond mere recitation that they would do so. Even more, the District Court made the exact opposite finding below. See App. 27 ("[W]e note that the parties have not emphasized, and we do not credit, any argument that an injunction would kill this merger...") (internal quotation marks omitted)).

Nevertheless, even accepting the Hospitals' assertion that they would abandon the merger following issuance of the injunction, the result—that the public would be denied the procompetitive advantages of the merger—would be the Hospitals' doing. We see no reason why, if the merger makes economic sense now, it would not be equally sensible to consummate the merger following a FTC adjudication on the merits that finds the merger lawful.

On balance, the equities favor granting the injunction. None of the private equities, or those equities that may have public benefit, on the Hospitals' side of the ledger are sufficient to overcome the public's strong interest in effective enforcement of the antitrust laws. We recognize that certain extrinsic factors have made these types of mergers beneficial—perhaps even necessary—to the continued success of some hospital systems. Yet, in this case, we are tasked with deciding only whether preliminary injunctive relief would be in the public interest. Opining on the soundness of any legislative policy that may have compelled the Hospitals to undertake this merger is not within our purview.

V. Conclusion

We therefore conclude that, after determining the Government's likelihood of success and weighing the equities, a preliminary injunction would be in the public interest. Accordingly, we will reverse the District Court's denial of the Government's

11. Although the District Court was correct that it may not be impossible to order divestiture, courts have repeatedly recognized that it is difficult to do so, especially considering the practical implications of denying the preliminary injunction request. For instance, upon consummating the merger, the Hospitals will presumably share confidential information and begin transferring patients from Hershey to Pinnacle. Should the FTC adjudication determine that the merger is unlawful, the FTC will be tasked with divorcing the Hospitals' now-shared confidential information and forcing patients to return to Hershey. These practical difficulties cannot be written off so easily.
motion for a preliminary injunction. We will also remand the case and direct the District Court to preliminarily enjoin the proposed merger between Hershey and Pinnacle pending the outcome of the FTC's administrative adjudication.

AVAYA INC., RP, Appellant in 14–4174 v. TELECOM LABS, INC.; Teamtli.com Corp., Continuant, Inc., Scott Graham; Douglas Graham; Bruce Shelby Telecom Labs Inc., Continuant Inc., Appellants in 14–4277
Nos. 14–4174 & 14–4277
United States Court of Appeals, Third Circuit.
Argued January 19, 2016
(Filed: September 30, 2016)

Background: Manufacturer of telecommunications equipment brought common-law claims against provider of software-based maintenance services, relating to provider's performance of independent maintenance services for equipment purchasers after parties had severed their business relationship. Provider counterclaimed for federal antitrust violations. During jury trial, the United States District Court for the District of New Jersey, Joseph E. Irenas, Senior Judge, 2014 WL 4661089, granted provider's motion for judgment as a matter of law (JMOL) on manufacturer's common-law claims, and after jury was instructed that none of provider's actions could be considered unlawful, jury found manufacturer liable for attempted monopolization of private branch exchange (PBX) maintenance market in violation of § 2 of Sherman Act, and unlawfully tying predictive dialing system (PDS) software patches to maintenance services in violation of § 1 of Sherman Act. Manufacturer appealed and provider conditionally cross-appealed.

Holdings: The Court of Appeals, Jordan, Circuit Judge, held that:
(1) manufacturer's claims for tortious interference with prospective business advantage and unfair competition presented issues for jury;
(2) manufacturer's fraud claim presented issue for jury;
(3) error in granting JNOV to provider was not harmless with respect to jury's finding of manufacturer's antitrust liability;
(4) manufacturer was not liable for attempted monopolization, with respect to purchasers who had clear contractual notice that they could not allow software-based maintenance through independent maintenance service providers;
(5) provider did not show impermissible tying of PDS software patches and maintenance services; and
(6) manufacturer's action was not a sham lawsuit, as would provide exception to antitrust immunity under Noerr-Pennington doctrine.

Affirmed in part, vacated in part, and remanded with instructions.

Hardiman, Circuit Judge, filed an opinion concurring in part and dissenting in part.

1. Federal Civil Procedure 2127, 2142.1
A motion for judgment as a matter of law (JMOL) should be granted only if, viewing the evidence in the light most
Roundtable: Current Substantive and Procedural Issues Facing Merger Practitioners

MODERATORS

JOE KRAUSS: Thank you for your willingness to sit down with us today. The first thing I wanted to start with is the Horizontal Merger Guidelines. The 2010 revisions are now six years old. We have six years of experience and practice with those Guidelines on the private side, on the government side, and in federal court. I was wondering if you could give your perspectives on whether they are working, whether there are areas that you think need to be revised, or improved, or updated.

DEBBIE FEINSTEIN: Carl should chime in, but I think the 2010 Guidelines were really meant to reflect what the Agencies were already doing. In terms of helping guide the staff in how to think about whether to bring a case, I think they’re working quite well. Even though we have all been doing this for years, I’m amazed at how often we turn to the Guidelines as we are considering different issues.

The Guidelines are particularly helpful in spelling out theories that don’t arise every day. The Commission’s challenge to the Superior/Canexus transaction is a good example. The FTC challenged a combination of sodium chlorate producers. The FTC argued that the primary harm would come through coordination on output and output reduction, which is one of the theories laid out in the Guidelines at Section 6.3.
The Guidelines set forth a structure for us to consider what we would need to believe such an anticompetitive effect was likely and for the parties to argue why the conditions for the theory were not set forth. The Guidelines set forth a framework that allowed us to have a clear conversation with the parties about what evidence was relevant and what it showed—even if we did not ultimately agree.

In terms of litigation, the courts generally consider the Merger Guidelines even though they are not binding.

CARL SHAPIRO: Let me pick up on that. As someone who played a leading role at the Antitrust Division in the development of the 2010 Horizontal Merger Guidelines, I think transparency was certainly a big part of what we were doing. And, look, it’s not surprising—basically we were working with the 1992 Guidelines and there had been a significant shift in practice. So we were writing down that shift but at the same time we were changing emphasis in some ways.

From my perspective as someone who has worked with the Agencies and with private parties on mergers in the past four years since I came back to Berkeley from D.C., I think practitioners understand what the 2010 Guidelines say—it comports with their experiences. Plus, they are workable in terms of telling clients what needs to be done in front of the Agencies to most effectively address Agency concerns. So in that sense I think the 2010 Guidelines are working fine.

The litigation issues are distinct and only apply to those very few mergers that are litigated. The courts are certainly very interested in market definition, and this remains true even though the Guidelines probably do deemphasize market definition because that’s the way the Agency investigations actually proceed. When you get to court, market definition is going to play a significant role, and that is going to remain the case unless and until the case law changes.

JOE KRAUSS: Dave and Jeff, you both have had experience in presenting these Guidelines in court. What are your perspectives on how the Guidelines are playing in the courts?

—CARL SHAPIRO

DAVID GELFAND: Before I get to how they’re playing out in the courts let me just echo a little bit of what both Debbie and Carl said in the following sense. This is a very important, substantive, and useful document. I actually view it as a bit more than Guidelines because there’s a lot of substance in here about how you think about competition problems.

It’s not just a set of principles about when the Agencies will act and when they won’t act. And in that sense I think they’re extremely helpful. It’s one of the only things I had on my desk my entire three years at DOJ. I actually had a pocket Guidelines, kind of like a pocket Constitution—the pages were worn at the edges because I was looking at them a lot.

No matter how much you think you know about antitrust, you’re a better lawyer if when confronted with a problem that is covered by the Guidelines you go back and just read it again. And just look at it, stare at it, and ask yourself, am I adhering to some of these basic principles?

In terms of how they play in the courts, I think that remains to be seen how influential they will ultimately be in cases that are decided. They’re obviously relied on for certain principles and taken as a substantive statement of law or at least legal and economic principles. But they’re also just one side’s version, and judges I think understand that. So whether courts will adhere to all of the sections we’re dealing with, all of the defenses or ways to think about market definition, etc., I think that remains to be seen.

JEFF PERRY: There have been a significant number of litigated merger cases recently, brought by
both the FTC and DOJ, and the Guidelines have been relied upon and cited extensively. In terms of whether the Guidelines are working, I generally agree with what’s been said so far, but I might come at this in a slightly different way.

At the very beginning of the Guidelines, there’s a comment to the effect that the Guidelines are intended to be instructive both for practitioners and for the business community. As for the first group, yes, the Guidelines are excellent and very helpful for practitioners. I think they are exactly what antitrust lawyers and antitrust economists need; they help us think about competition problems and issues and they really do reflect “how the sausage is made” at the Agencies.

Frankly, I’m less optimistic that the Guidelines are as digestible for the second group—clients and the courts. That’s not intended to be a criticism of the Guidelines or of these audiences. It’s just that the Guidelines are extremely specialized and are written in such a way and in a language that they are more easily understood by people who spend their entire careers practicing antitrust law. They’re better suited to that audience than a generalist judge or a business person who isn’t dealing with these issues on a daily basis.

And I think one point I would offer as evidence of that is what Debbie and Dave have already said, which I agree with completely, and that is that even experienced practitioners need to read the Guidelines frequently. The Guidelines are that dense and that technical, even for experienced practitioners.

And because of this, the Guidelines leave somewhat of a gap if the intention is to speak to the business community and to speak to generalist judges. So I think there’s tremendous value when the Agencies supplement the Guidelines with case-specific closing statements, with the frequently asked questions publications, and with merger statistics. This is critical, because, as helpful as the Guidelines are, if you take those other pieces out or if they’re not continually refreshed, I don’t think the Guidelines standing alone give us everything that we need.

MANDY REEVES: Can you comment about what role the Guidelines play in your case development and strategy as you prepare for litigation?

JEFF PERRY: I have the Guidelines in mind throughout the life of a merger investigation and litigation, but I would say the Guidelines are more of a focus during the Agency engagement, rather than during litigation. There’s a feeling that when you’re going in to meet with Commissioners, or with Debbie or Dave when he was at Justice, that everybody knows that the Guidelines are the “Bible.” Not everybody agrees with everything that’s in the Guidelines but you know they are going to be the touchstone that people look to. So this is the language you speak and this is the framework you use to present your arguments.

The Guidelines are helpful in front of a generalist judge too, but for somewhat different reasons. The Guidelines help to validate the arguments you make in litigation. So if you or your expert are going to offer a UPP (upward pricing pressure) analysis, for example, or talk about diversion ratios, or make some other point that may not be particularly intuitive, it’s extremely helpful to be able to point to the Guidelines and have the judge understand that even if he or she isn’t familiar with every word in the Guidelines, it’s clear that your arguments or analysis aren’t being made up for litigation, but instead are part of the principles of merger analysis put out by the Agencies themselves.

DEBBIE FEINSTEIN: Yes, and we certainly have seen that the way the Guidelines get discussed in the context of a litigation is through the experts. A good expert will explain how the Guidelines
apply in a simple way to the industry in issue and how these economic principles translate into real-world behavior. Of course, the other side’s expert will try to do the same. Usually, the parties’ economist will accept the framework of the Guidelines but disagree on how they should apply in a particular case.

CARL SHAPIRO: Let me pick up on the expert witness side of that because I agree with what Debbie just said.

I’ve tracked cases and in every case that I know of, the economic expert for the merging companies says, “Oh yes, I’m following the Guidelines too.” Now, this is significant, because then I imagine the judge is thinking, “OK, so both sides’ economic experts are following the Guidelines, so at least when hearing their testimony I can evaluate their testimony using that framework. And especially on the government side, I can ask whether the Agency is being faithful to its own Guidelines or have they left something out?” So the Guidelines have a substantial impact on litigation at least in this way.

Now, this is quite different from the investigation phase where, as Jeff said, everyone knows the Guidelines are like the Bible. But the impact on litigation remains significant. At the very least, the Guidelines are an interesting reference and authority to the judge. Plus, given that the defense expert says that he or she is following the Guidelines, this leads to certain logical questions, either from the judge or in cross-examination. “Did you apply the hypothetical monopolist test?” or “What is your basis for concluding that entry would be sufficient? So the Guidelines play an important role in framing the analysis and the issues in a way that is very much present in court.

JOE KRAUSS: I understand Judge Diane Wood in the Advocate argument last week did make a comment that maybe the district judge did get the hypothetical monopolist test wrong. Is this suggesting that perhaps some aspects of the Guidelines might be too complicated and “too economic” for generalist judges? If that is a fair criticism?

DEBBIE FEINSTEIN: I think there’s a difference between the hypothetical monopolist test conceptually and the hypothetical monopolist test in its application when there are various facts and data that are at issue. Generalist judges can—and do—understand the concept. In my view, the hypothetical monopolist test is conceptually driven from the Supreme Court’s Brown Shoe practical alternatives tests—what are the practical alternatives to which a buyer can turn?

Where it gets complicated is when one economist says “I use this particular model” and another economist criticizes this model or offers an alternative model. That kind of battle of the experts is obviously going to be an issue. Judge Amit Mehta talked at an ABA Fall Forum presentation about his inability to determine the precise equation that should be used for the hypothetical monopolist test when two economic papers suggested different equations. Obviously it will be difficult for a judge to make that kind of determination.

Then it comes down to whether our economist’s view of the hypothetical monopolist test is consistent with other evidence in the case. Judges do not typically have difficulty with that aspect of deciding product market.

CARL SHAPIRO: One of the things we did in working on the 2010 Guidelines was to go back and look at previous Guidelines and, indeed, how they were greeted when they were released. The hypothetical monopolist test dates back to the 1982 Guidelines when Bill Baxter was Assistant Attorney General for Antitrust. They were greeted with quite a bit of—how should I put it—skepti-
cism. Many practicing attorneys were wondering what the hell this “hypothetical monopolist test” was all about and what it meant for their practice. The test was criticized as being incredibly complicated, and many practitioners were wondering how to actually apply it.

Well, 35 years later, the hypothetical monopolist test has become routine at the Agencies, well established in case law, and widely adopted around the world. So I think the litigation issue now is not so much whether we use the test in court but, rather, how to perform the test in a manner that is understandable and credible to judges, what do judges make of conflicting expert testimony regarding the test, and how do judges balance the results of the test with other evidence regarding the relevant market.

DAVE GELFAND: Joe, coming back to your question of whether the Guidelines should be simplified or made more accessible to generalist judges. First of all, let me say that in my experience, people in our profession spend a lot of time agonizing about how you can explain things to judges that are very complicated concepts that we talk about among ourselves as antitrust lawyers and economists. And one thing that has struck me over the years is, every time an opinion comes out it is remarkable how much a judge who has never been exposed to a merger case before absorbs not just the Guidelines but the case law, how much they absorb from the witnesses, the business documents, and the economists.

They get what this whole exercise is about and ultimately, it’s about deciding whether a merger is going to hurt consumers and be anticompetitive; and there are steps along the way to try to get to that decision. So I think it would be a mistake for us to think that we have to oversimplify all of these concepts. But at the same time, we do have to have conversations among ourselves as antitrust lawyers and economists. We have to have conversations with the Agencies that are at a level that you’ll never think about putting into evidence at trial because it’s too extensive, it’s too esoteric, it’s too complicated, there’s too much “what if,” too many alternative runs with the model.

At the end of the day, you’ve got to decide what it is you’re going to distill it down to. And one of the big challenges we have as antitrust lawyers involved in a litigation is picking and choosing. You can’t put it all into the record, you’ve got to decide what your theme is, what your case is, what your key points are. And that’s an art that you’re never going to be able to capture in a single document.

JEFF PERRY: I agree with Dave. I think it’s a mistake to think that judges aren’t sophisticated enough to get it, they are. As I mentioned earlier, the issue is that the Guidelines are just written in a different language than most judges are used to speaking, and frankly in a different language than most of us spoke 20 years ago practicing antitrust law; it’s just changed. So that’s one point.

Second point, the cases that end up in litigation are almost always the types of cases where both sides are able to point to the Guidelines and say, “aha, they support our arguments.” There’s so much in the Guidelines that can be used by both sides in a litigation, particularly given the fact that the close cases are the ones that tend to litigate. So however these cases are decided, you’re always going to have one of the litigants who thinks the judge interpreted the Guidelines correctly and the other party that says the judge didn’t understand the Guidelines or misapplied them. And I think that speaks as much to the nature of the case as it does to the sophistication of the judges.

The other point that is important to keep in mind—and this isn’t a criticism of the document—but the Guidelines are not a formulaic, step-by-step document where you plug in market share and margins, and the time it takes to enter, for example, and then the Guidelines give you the answer. In other words, the Guidelines do a great job at highlighting the factors that weigh for or
against a merger, but they’re not easily or objectively implemented. Certainly, when I was at the 
FTC I was surrounded by a ton of lawyers and economists who understand the Guidelines, and 
still we had lots of good, vibrant debate about how to apply the Guidelines to a particular set of 
facts. So even apart from litigation arguments or advocacy, you can have serious differences of 
opinion among people as to a particular merger, even though they will all believe they are follow-
ing the merger Guidelines precisely.

So I think the big challenge with generalist judges is just translating the language, it’s not a mat-
ter of simplifying things.

JOE KRAUSS: We could talk forever about various aspects of the Guidelines, but let’s move on to 
a couple of specific things. We’ve seen cluster markets used successfully by the FTC in the 
Staples case and alleged in some of the hospital merger cases. What does this recent use imply 
for market definition going forward?

JEFF PERRY: For better or worse, I’ve been on both the winning and losing ends of these cluster 
market cases. I had the good fortune to work on a number of hospital cases while I was at the FTC, 
and since then I have worked on some of the more recent cases. I don’t think there’s much contro-
versial or new in the concept of a cluster market. For example, you won’t hear people clamoring 
in a shoe merger to define a relevant market for the sale of size nine and a half blue shoes.

So I think it’s well settled that, for analytical convenience, it’s appropriate to group products 
together for purposes of analysis, so long as you can do so in a way that doesn’t distort the analy-
sis. If you ask 10 lawyers and 10 economists, you’ll get 20 people who all agree with that. The chal-
lenge, however, is the balance in how much evidence should be required to support the conclu-
sion that competitive conditions are similar enough for that kind of grouping. Because on the one 
hand there has to be some meat on the bone; you can’t just group products together in a cluster 
without demonstrating that it’s appropriate and not misleading to do so. But, on the other hand, if 
you do a full-blown analysis to justify the clustering, at some point you’ve destroyed the whole ben-
efit of cluster markets in the first place.

So the concept itself is pretty straightforward, but the implementation can be difficult. The way 
I tend to think about it is if you’re on the plaintiff side, you should need to demonstrate that the 
competitors are the same across products, that market shares are roughly the same, and that on 
the supply side entry and repositioning conditions are roughly the same. If you can show those 
things in a reasonably substantial way, then it’s fair to cluster products together and it’s a tried and 
true method to apply, but the debate is always going to center around the application.

CARL SHAPIRO: Let me pick up on that. The term I always heard and used in decades past was 
not “cluster markets” but “aggregation for convenience” which is the same concept. And Jeff even 
used the word “convenience” just now.

I agree with what Jeff just said: conceptually, the notion of a cluster market is not that compli-
cated, it’s all about what is practical given the available data. But I do not see how the standard 
that Jeff described can work in practice. If you can measure the market shares for each individu-
al product market that’s going to be in the potential cluster, then you’ve pretty much done the 
work. At that point, why cluster rather than define dozens or hundreds of individual markets?

In practice, the issue of cluster markets arises when you do not have the data to measure mar-
ket shares in each individual product market or doing so is just impractical. In that situation, the 
plaintiff cannot show that the market shares are nearly the same in all of these markets. So the
plaintiff has to fall back on something else to say: “Well, here’s other evidence that these individual markets look similar enough so that I’m going to use an aggregated market share, for which I do have the data.” I think you have to be able to go that route otherwise it’s just a mess practically.

**DEBBIE FEINSTEIN:** Yes, look, this is not a new concept, I agree completely with that. *Brown Shoe* was a cluster market; it didn’t use the phrase cluster market but it clearly was a cluster market. The Guidelines don’t use the phrase cluster market, they don’t use the phrase bundle market. There were moments where we thought, “Darn, I wish someone got those concepts in the Guidelines.”

The Guidelines are never going to explain everything and so you go back to the question of: are the Guidelines enough? You’re never going to be able to explain every concept that comes into a merger analysis in the Guidelines; that’s not what it’s meant for. But the litigated decisions give a lot of guidance. I don’t think anybody can honestly say that we haven’t given guidance on how we think about a cluster market in light of the hospital cases and Staples, between our briefs and our expert reports and the ultimate opinions.

I think the world now pretty well understands what a cluster market is, not that I thought that there was any doubt beforehand. And now the question really is about “OK, what does it mean to prove a cluster market?” And that’s really no different than what does it mean to prove any market in terms of the various types of information that we look at.

**DAVE GELFAND:** I think one of the things you have to think about in these cases is, why are we defining markets in the first place? What is the purpose of that? The purpose is to try to find a line of commerce where competition is really going to be harmed by a merger or harmed by a particular conduct at issue.

If we end up obsessing about market definition simply so that parties can say, “Well, something has been proven or not,” it can undermine the objective of antitrust, which is to get to the bottom of competitive effects. For me the question is, what is the end effect on competition?

I don’t know why the debate really exists. It seems natural to me that you would group products like others have said, it’s something that’s been done forever. Unless you’re just trying to say, well, that’s not an appropriate thing to do, therefore you can’t prove your market, therefore you lose the case. But does it really serve the end purpose of figuring out the impact on competition to be obsessed with whether there’s something called a cluster market or a bundled market?

**MANDY REEVES:** Another topic on which there’s been recent litigation is potential competition. We have the *Steris* decision, which gives us one judicial perspective on that. I’d be interested to hear the group’s thoughts on *Steris* and how that shapes what you think the legal standard is for assessing potential competition.

**DEBBIE FEINSTEIN:** It was interesting. The judge basically said, “I’ll accept the government’s view of what the standard is for potential competition,” and it was basically a likelihood standard. And the debate came down to what is likely. And on the facts, I think we just came out in different places; we viewed entry as likely because of all the steps that they were taking. Of course they had not actually done everything necessary to enter or they would have been in the market. And so the question is how far you have to go in proving that they would be in the market. We think it’s bad for antitrust policy if the standard is you must prove that a company already has entered before we can show that it is likely to have entered.
And I think in any case other than FDA cases, that is going to be a factual challenge. It’s easier in the FDA cases where we routinely get consents because you’ve taken all the steps necessary other than FDA approval and we can show that the FDA approval is likely. I think parties recognize that and so they walk in saying “we understand your concerns and know we need to settle in these areas.” I think it’s going to be more of a challenge in the other areas.

I don’t think anything about the Steris opinion will keep us from bringing the next potential competition case. They just don’t arise early and often outside the pharmaceuticals area, but we will continue to look for cases that raise concerns.

Interestingly in Steris, the court wanted to focus only on the question of whether entry was likely and did not let us put in any of the evidence on what the markets look like, on what the competitive effects would be. And it might be that a court that looked at the broader context might have come to a different view of what was required to show that entry was likely.

**I don’t think anything about the Steris opinion will keep us from bringing the next potential competition case.**

DAVE GELFAND: It struck me as a fact-based decision, but I haven’t read the opinion in a while.

CARL SHAPIRO: Yes, it’s a rather short opinion very much focused on the facts. It doesn’t really get into conceptual issues. So I don’t think it has very much precedential impact. This decision will not change how I envision working with clients or the Agencies to look at cases because it’s so fact based. There is a broader discussion about the evidentiary standards for potential competition and loss of innovation competition that is currently swirling about. But I see this case as very narrow.

JEFF PERRY: The court in Steris very specifically said that it assumed the validity of the potential competition doctrine, so I agree that the opinion clearly is fact specific. I think it was a fair standard for the judge to use to say, “FTC, you have to prove to me that Synergy probably would have entered.” I don’t think the judge expected to see actual entry, just the probability. Obviously, whether the judge’s ultimate findings were correct can always be debated, but I think it was a fair standard for the judge to use and a fair way to approach the case.

Also, whether it’s Steris or any other case, there’s always a risk of overreaction to court decisions, whether they are wins or losses. It’s important to remember that each case is just one data point—it’s one case, with one set of facts in front of one particular judge. It’s very easy to read too much into what each case means about the likelihood of winning or losing the next case, and that’s particularly true here given how fact-specific this opinion is.

**I don’t think anything about the Steris opinion will keep us from bringing the next potential competition case.**

DAVE GELFAND: I think an interesting offshoot of this case and this discussion is, whether there’s a different standard for entry as a defense and entry as a Section 7 violation based on potential competition. And I think the government does have to think about whether it wants to be taking the position that certain sets of facts qualify as a potential competition case, if that same government enforcer is unwilling to recognize similar facts as potential entry that could be used as a defense.

MANDY REEVES: Debbie mentioned pharmaceutical cases. How do you think about potential competition in the context of pharmaceutical cases when you know the potential entrants but entry itself may not occur until well into the future? Are there any rules of thumb that you find work in that context?
DEBBIE FEINSTEIN: Typically we do not have concerns where one of the parties is pre-clinical, although there are cases where we have had such concerns depending on the facts of the specific product. When considering likely anticompetitive effects, we consider where the various competitors stack up in terms of when they are likely to obtain FDA approval and enter the market. Sometimes we hear “Company X is a year behind but they will absolutely be an entrant so you should not worry about the combination of Companies A and B, which are farther along.” That doesn’t end the inquiry. First, it might still leave the market with only three competitors rather than four. Second, if we believe there is likely to be interim harm because prices will be higher until that additional entrant enters, we are going to have concerns. In the pharmaceutical market we know that the impact of entry doesn’t happen until the new entrant has actually entered the market. In other markets, that might not be the case. For instance, starting to build a supermarket might lead an incumbent competitor across the street to begin reducing prices or taking other steps to build customer loyalty. So how to think about the relevant time frame for new entry will depend on the industry.

CARL SHAPIRO: Let me link this to what I see as one of the bigger topics in the antitrust economics discussions these days: industrial consolidation in the American economy. People are pointing to overall consolidation, let’s say nationally. A lot of that has occurred, some of it due to geographic rollups. I think we are going to be hearing a lot about industrial consolidation, at least for the next year or two.

To illustrate my point, consider a case where you’ve got two companies which are in the same retail or other distribution business but in different parts of the country. Suppose they are both large and they want to merge to have nationwide presence. Maybe there is already one or two nationwide players. Do we say, “Oh this merger is fine, because you’re not competitors at all, you’re in different regions,” or do we say, “No, this merger is a problem, because if you can’t merge you’ll grow to be national yourself and you’ll attack the other guy’s region”?

What would it take in terms of business plans showing that one of the merging firms planned to enter the other merging firm’s region for this fact pattern to qualify as a serious potential competition case versus a garden variety non-horizontal merger? If anybody can answer that, I’ll be impressed.

DEBBIE FEINSTEIN: We figured if you couldn’t, nobody could.

JEFF PERRY: I’m not about to try.

JOE KRAUSS: Let’s turn to price discrimination, another area that has been dealt with and addressed in some several recent cases, such as GE/Electrolux, Sysco, and Staples.

What’s the view in terms of how the Agency should best assess and evaluate price discrimination markets?

DAVE GELFAND: Well, just speaking briefly based on public information about GE/Electrolux, obviously we saw the contract market there as a so-called price discrimination market or a targeted customer market.

I need to just come back to the same point I tried to make earlier, but for me the purpose of antitrust is figuring out if there is going to be significant harm from either conduct or a transaction. And if there is a group of customers that depend on competition between the merger parties in an important way and the other factors that weigh into the analysis like entry, repositioning, etc.
don’t really protect them, then really what antitrust ought to be seeking to do is get to that answer rather than treating the market definition exercise as if it’s just an exercise in its own right.

Price discrimination markets or targeted customers are just a localized form of competition that can be impacted by a merger or by a transaction. We certainly saw that with the contract customers in GE/Electrolux who depended on bid competition from just three companies. Two of them were the merger parties and there was a third but it was a three-to-two in bid competition for a very large portion of that contract business, and that competition was going to be lost after the transaction.

If you just pull up to 30,000 feet, many markets are price discrimination markets. That’s the whole reason it’s a market, because competitors can price based on the competitive set that is in a particular market. Now at the same time, obviously antitrust needs to be sensible. You don’t want to take targeted customers to such an extreme that you start worrying about one or two small customers in a big transaction that has a lot of efficiencies which will benefit the customer base as a whole.

I think we were absolutely right in GE/Electrolux and I have a fair degree of confidence especially after reading the Staples decision that Judge Sullivan would have gone in our favor on that issue.

CARL SHAPIRO: As somebody who teaches MBAs and works with a lot of companies, my view is that price discrimination is simply the business reality in a great many markets. Many companies have sophisticated pricing strategies that target and segment customers. And that’s why the concept of “targeted customers” was given central billing in the 2010 Guidelines. We recognized that devoting an early section of the Guidelines to targeted customers—before market definition—was a significant change in the narrative flow of the Guidelines. We did this because our internal reviews at the DOJ and the FTC showed that an increasing number of cases involved targeted customers. The Agencies commonly look for vulnerable customer groups and structure their investigations around those customers. We felt it was important for the Guidelines to make that clear.

I think the big issue that remains unresolved, which Dave alluded to, is how to handle situations where a deal looks likely to harm certain targeted customers, but these customers are pretty small compared with all of the customers served by the merging firms. What should we do in these situations? This was certainly the case in Staples/Office Depot because the large customers were a relatively small share of the overall revenues of the two companies, even in office supplies. This is where cognizable efficiencies come into play. How does one balance harm to targeted customers with possible benefits to other customers?

JEFF PERRY: One point I’d like to add, which is reflected in the Guidelines, is that to prove up a case based on price discrimination, it’s not enough just to show that there is a group of customers who appear to consider the merging companies as their top two choices and believe that other competitors or alternatives are less attractive. There has to be an identifiable group that can actually be targeted with an exercise of market power post-merger.

In other words, it’s not just how large or small that customer group is and how we’re going to balance harm against efficiencies, but instead the question of whether the allegedly vulnerable customers are identifiable and can be targeted? And that’s really where the rubber meets the road in these price discrimination cases because if you don’t focus on that issue you end up with a situation where, in any merger of two companies you can find a few customers who will say, “the merging companies are my two best choices.”
So when you’re analyzing whether a truly identifiable group of customers exist, the question is, are there a bunch of other customers who look just like the so-called vulnerable customers but believe they have plenty of other competitive options? And if that’s true, then the similarly positioned customers who believe they are vulnerable should actually be protected. So I think that’s a really important part of the analysis and if you lose focus on that you run the risk of the price discrimination theory really over-predicting harm.

**DEBBIE FEINSTEIN:** That may or may not be right depending on the facts. The Guidelines make clear that you do not have to have clear categories of customers who have the same preferences. If it’s an individualized negotiation I may learn things from prior negotiations or what you requested in an RFP that allows me to determine the extent to which you have good alternatives. As a result, having this information about the extent to which you have alternatives can impact the negotiation even if I am not 100 percent certain of your options.

**CARL SHAPIRO:** For the analysis to properly focus on a group of targeted customers and the merger’s effects on them, the merged company must be able to say, “Here are the characteristics of the customers to whom we are raising price.” However, this absolutely does not mean that the merged entity has to be perfectly accurate in terms of who will then pay the price increase rather than go somewhere else.

The *Ticketmaster/LiveNation* case we handled when I was at DOJ provides a good example. In that case, there were a whole bunch of different types of venues. It turns out that for very large sports stadiums, a lot of the ticketing was done in the form of season tickets, and these venues were not necessarily vulnerable to a post-merger price increase by the merged entity. The situation was quite different for major concert venues. These venues were the targeted customers identified in the DOJ complaint. We did not include in the set of targeted customers the large sports stadiums or a very large number of smaller venues. This reflected the reality of the ticketing business.

So, the key question there was whether the merged entity could profitably impose a targeted price increase on major concert venues. Such a price increase could well be profitable even if some of these venues would shift to other firms for primary ticketing services. The key question is whether an identifiable set of targeted customers is, on the whole, significantly less likely to switch than are other customers.

**JEFF PERRY:** Yes, I generally agree with Carl. I’m not suggesting that for a price discrimination theory to hold water, the suppliers need to have perfect information about customer preferences or that there are no similarly situated customers who serve as counter examples. But if you find enough counter examples—customers who look the same, who seem to fit in the category of allegedly vulnerable customers, but are expressing different preferences—then I think you have to ask the question, would it in fact be profitable to try to target these customers with a price increase?

I agree that if price discrimination would be profitable, then it can support a viable theory of harm, even if the price discrimination couldn’t be implemented perfectly. But if you look at a marketplace and you see that very similar customers are buying from many different suppliers—then I think at some point you have to conclude that trying to price discriminate against a certain group of customers might not be viable or profitable, not just that it wouldn’t be perfect.
CARL SHAPIRO: I agree with that. I would also bring in supply side substitution: if there are suppliers who are serving other types of customers, you have to ask whether they easily could and would serve the targeted customers in the event of a price increase directed at those customers.

DAVE GELFAND: So far we’ve been talking about this as a market definition exercise but again, we should come back to the point that the ultimate purpose here is to try and figure out what the effects are. A lot of the arguments about that go into this market definition exercise related to whether customers turn to alternatives. Will they turn to alternatives? Those issues feed into the parties’ arguments about competitive effects as well.

So you define a market and you get some shares and maybe the shares are high and maybe the court views it as presumptively a violation of Section 7. But parties are still free to come in and bring all that same evidence to bear on the issue of whether there’s a competitive effect, whether the presumption is rebutted in the particular case. If it’s a close call on these questions of whether these can identify a discrimination market or whether you can identify a cluster market, a lot of the same factors that make that a close call can rebut the presumption even if you have high shares, and can be used to persuade the court that those customers are not going to suffer anticompetitive harm as a result of the transaction. They have alternatives to turn to, the suppliers are not going to have an incentive to raise price, there are potential entrants, potential repositioners, etc.

DEBBIE FEINSTEIN: If you go back to the Guidelines, the targeted customers and price discrimination section comes before the market definition section; it is not part of market definition. Courts may discuss it as part of market definition, but I think over time, courts will understand we are talking about the impact of a transaction on a particular group of customers and not need to include the customers as part of the market definition.

MANDY REEVES: Following up on David’s comments about entry, I’d be interested to hear the group’s thoughts on how you think about entry from the standpoint of analyzing the likelihood that a transaction will have competitive effects. In the case of Staples/Office Depot, for example, you had the parties arguing that Amazon was a growing competitive constraint, which the court dismissed. In Google/AdMob, the FTC declined to block the deal because of Apple’s entry. What’s the right way to think about the standard for assessing whether a relatively new and disruptive entrant is or will become a sufficient competitive constraint?

JEFF PERRY: In many ways, this is a highly case-specific and fact-specific question. But one overarching point I want to make is that, when you’re analyzing competitors with different business models, there needs to be symmetry in the analysis so that a disruptive market participant is given similar competitive weight, whether it’s one of the merging parties or a third party. The danger, I think, is that if the Guidelines aren’t applied correctly, or aren’t applied faithfully, you end up looking at the merging companies when they have very similar business models and saying, “Aha, we’re looking at narrow product markets, so these similar competitors must be the first and second choices for customers, and this third-party entrant with a different business model must be a more distant and less important competitor, so we’re not going to give them much weight.”

And the point I want to make is that, if that’s your view, you should stay faithful to that view, so if instead the maverick or disruptor happens to be one of the merging parties, you shouldn’t then change course and say, “Aha, these mavericks with different business models are the ones that really drive competition, so we’re going to more heavily scrutinize an acquisition of a company like
“The role of a maverick, or disruptive entrant, shouldn’t change depending on whether they are one of the merging parties versus a third party.

To your direct point about Amazon’s role in the Staples case, this was a case where the FTC argued that Amazon’s business model was more distant and that Amazon wasn’t going to be significant enough to maintain competition. The parties obviously felt differently, and believed a point that comes up in a number of industries, which is that sometimes the real threat to a business and what really constrains their pricing and competitive behavior is not the company that looks most similar to them; it’s the company that threatens to do something in a way that may be different and better. We argued that this view was reflected in Staples’ and Office Depot’s documents and in the companies’ ordinary course thinking—and that was a factual question in that case, but one that comes up in many cases.

DEBBIE FEINSTEIN: I do not think it has to be symmetrical because we are looking at different issues. In one case, we are asking whether competition is going to be harmed because of a transaction. Considering whether the elimination of a new entrant might harm competition is not the same as asking whether new entry will be timely, likely, and sufficient to mitigate competitive harm.

But putting that issue aside, the question of whether a disruptive innovator will mitigate competitive harm cannot be answered simply by examining the parties’ documents. For instance, if customers say—as they did in Staples—that the “disruptive innovator” is a sufficiently distant competitor, certainly in a bid situation, that competitor will not mitigate the harm, even if the merging companies tell you that is what keeps them up at night. I note that the fact that we look at it case by case is shown by the fact that in Staples/Office Depot, we brought a challenge based on harm in the contract market, but not in the retail market. And we made clear in Office Depot/OfficeMax that we were crediting online suppliers such as Amazon and competitors such as Wal-Mart in the retail market because that’s where the facts took us.

JEFF PERRY: Yes, the point I’m trying to make is not that the company’s documents should trump customer testimony or some other source. The point I was really trying to drive home is, if you believe in a given market that a certain company with a different business model is a significant competitive threat, the analysis shouldn’t change depending on whether they are one of the two merging companies or whether they’re a third party. It’s either a constraint on competition or isn’t.

I agree that customer views can be critically important and if customers on the whole don’t consider a potential new entrant that has a disruptive new business model to be attractive or a good substitute, then that’s important and should be given significant weight.

DAVE GELFAND: I’d like to make a couple of points in response to both Debbie and Jeff.

First, I agree that you can’t rely on company documents exclusively. I think all categories of evidence have the potential to be dispositive and they also have the potential to be absolutely irrelevant. You can’t categorically say without knowing the circumstances of a case how much weight to put on documents versus testimony versus economic analysis, etc. But that’s just a general point.

To Jeff’s point about disruptive competition, leapfrogging the existing competitors can still leave a very serious competitive issue. The example I would give is perhaps the most disruptive competition or among the most disruptive sources of competition we’ve seen in the last 15 or 20 years, namely online news competing with traditional newspapers. Online sources of news have taken an enormous amount of readership away from traditional newspapers.

But when we brought the case involving newspapers in Orange County, California, the fact is that competition between those two local hard copy newspapers which sat right next to each other
on the newsstand still was very meaningful for the 200,000 people who consume their news through newspapers rather than online. So it’s not enough to just say, “Well, there’s going to be disruptive competition that’s going to leapfrog.” The question is, how important is the remaining competition? They might lose 80 percent of their market to an outside alternative, but they still compete for what’s left.

And the third point I want to make and I think this is really important and it often gets confused, is the distinction between entry as it is thought about in the Guidelines or as we sometimes talk about it, and entry that’s going to happen in any event. I think if you have an entrant that’s coming in no matter what, then the analysis is whether that’s going to leave the market so competitive that the loss of competition between the two merger parties just isn’t going to make much difference. The entry that is technically talked about in the Guidelines is entry in response to a price increase or threat of entry that discourages price increases.

Often you’ll hear somebody say, well, we have three competitors going to two, but there’s an entrant about to enter so it’s really a three-to-three transaction. That’s not correct, it’s a four-to-three transaction. There was going to be that third competitor no matter what, so that’s how you have to analyze it. And that really gets mixed up a lot when people are talking about deals and even when evidence is going in at trial.

CARL SHAPIRO: I would just second that, Dave. In fact, in the Staples/Office Depot trial, Amazon obviously was a big factor in terms of their entering. They were entering the market with or without the merger, so the question was whether that entry would be so powerful as to negate concerns about the merger of Staples and Office Depot.

I actually tried in my testimony to make precisely the distinction that you just made, Dave. I even tried to show projected market shares given Amazon’s own plans, which is a good way to handle entry that is not conditional on the merger. To be honest, I think the distinction between unconditional and conditional entry got lost in the larger battle about the significance of Amazon’s entry.

JEFF PERRY: Yes, I generally agree with the distinction. At the same time, however, if you have a case where entry is not prompted by or enhanced by the merger, but instead is happening one way or another, I still would say—as I think Dave said—that if the entry is sufficient to deter or counteract any harm from the merger, then it “counts,” and the merger shouldn’t be a problem. The extreme example would be a situation where ten competitors are entering next Tuesday, and they’re entering whether the merger happens or not. If that entry is sufficient to maintain competition, then the merger should not be a problem.

DEBBIE FEINSTEIN: I think it is quite clear that we always ask who else is entering. In the pharmaceutical cases, we ask about the other companies in the pipeline. In Google/AdMob, the Commission statement said that the Commission initially had concerns, but then saw new entry during the course of the investigation that alleviated its concerns.

We take new entrants into account whether or not they are entering as a reaction to a transaction. It is just a question of how we think about them—as committed entrants pursuant to Section 5.1 of the Guidelines or as new entrants pursuant to Section 9.

JOE KRAUSS: And doesn’t the credit that you give to it really get back to what is the evidence that that entry is likely to occur?
DEBBIE FEINSTEIN: Right. Sometimes I think people think that as long as you can show entry it ends the inquiry. You have to ask what the entrant’s market share and market impact is likely to be. In *Staples*, Carl actually calculated what Amazon’s share would be in 2017. It was trivial.

So we agreed Amazon was coming; “yes, they’re good.” I mean Carl said on the stand numerous times, they’re—I don’t know what the adjective was, excellent, amazing, outstanding company but in . . .

CARL SHAPIRO: “Awesome” I believe is the correct word.

DEBBIE FEINSTEIN: Sometimes people think that as long as they can point to another company that is entering, our concerns will be eliminated. But that ignores the sufficiency prong of entry.

Jeff Perry: Yes. Much of what Debbie and Carl said in concept I agree with. We should be conducting a forward looking analysis and trying to estimate what an entrant’s market share will be over the near and medium term, and hopefully doing more than just projecting market share, but also thinking more broadly about what their competitive significance will be going forward. I think we agree that’s the right way to think about it. This is one where, on the facts of particular cases, obviously we come out very differently in terms of what each side thinks the right answers are but I think for the most part we agree on the question.

I also want to echo something Dave said about disruptive innovators. When you’re thinking about this disruptive competitor with a new business model coming in you’ve really got to look at the particular facts and circumstances to determine how competition will be affected. In some cases that disruptive competitor comes in and steals customers away and essentially shrinks the size of the existing market and creates a new and distinct market. In that case, which I think is the newspaper example Dave gave before, competition within the old market remains important.

But again, every case is different. There are some industries where a company faces a disruptive new competitor and they start bleeding customers, but instead of two distinct markets being created the incumbent has to continue competing against this disruptive entrant to try to keep customers and win new ones. In other words, the customers don’t really separate into distinct, identifiable groups, and so the new entrant will continue to compete against and constrain the existing competitors for all customers. So I really just want to stress that this is a fact intensive inquiry, and you could see both flavors of this.

Dave Gelfand: I agree. And even if they have an identifiable set of customers, they might still choose to compete to retain a broader set of customers. So it is highly fact specific.
JOE KRAUSS: We’ve been talking about innovation markets and it gets back to the 2010 Merger Guidelines, does it adequately address innovation markets? And is this a place where the next administration might consider revisiting and seeing if there are any places where the Guidelines can be improved with dealing with these types of markets?

DAVE GELFAND: I’ll take a quick run at that. I don’t know whether the next administration can improve on it or not. It’s actually just to me an undeveloped area of the law. People don’t quite know how to think about innovation markets in the context of a Section 7 case, you can’t really measure it. If you’re talking about a pure innovation market where the question is whether there are going to be fewer inventions, I can’t really point to which products it’s going to be in. I just know these are the two companies that are doing a lot of research in a general field and if you lose competition between them there are going to be fewer inventions.

I don’t know, it’s kind of hard to find a case on that, it’s kind of hard to find a way to model that. There’s certainly disagreement in the literature about whether even going from two to one, much less three to two, or four to three, whether any of that increases or decreases the incentive to innovate. There are situations where combining R&D programs can lead to more innovation.

So how you capture that in a set of Guidelines when there haven’t been any cases litigated that have really zeroed in on that issue, when there isn’t a well-developed body of economic consensus around how to think about it—I think that’s a big, big challenge.

DEBBIE FEINSTEIN: The phrase innovation market gets used to describe a vast amount of things that are not actually what I think of as a classic innovation market as Dave has explained. The Guidelines are certainly able to take into account R&D concerns in addition to product concerns; that was the case in the DOJ’s Tokyo/Electron challenge. GM/Toyota also raised innovation concerns. The FTC’s investigation of Genzyme/Novazyme (which it ultimately closed) is often referred to as an innovation market case. It was about future competition in a very identifiable product. So not everyone would call that an innovation market.

In contrast, innovation markets are often more generalized innovation concerns, but for products that are not yet identified. There can be a concern that merged firms might compete in a to-be-determined product because they both have a history of innovation. This is an issue the Commission considered in its investigation of Teva/Allergan, e.g., were Teva and Allergan uniquely able to innovate? As the Commission statement makes clear, it did not find such a concern.

So I think it is important to distinguish between the precise innovation concerns at issue in a given matter.

DAVE GELFAND: I agree.

CARL SHAPIRO: Most of the time when people talk about an innovation market, they’re really talking about competition in some product market in the foreseeable future.

This was certainly true in the Genzyme/Novazyme case, and I would say other pharmaceutical cases as well. Personally, I prefer this framing: “Okay, here is the product, here are the customers, we can see the competition coming, and we believe these companies are likely to bump directly up against each other in the foreseeable future for certain identifiable products.”

A broader type of case arises if the merging firms have the best capabilities in some area but we cannot reliably identify specific products that they will likely be selling in direct competition in the foreseeable future. This type of case would really fit more with the notion of an “innovation mar-
ket” rather than a future product market. One could also call this a “capabilities overlap” that could affect a variety of future product markets. The key to such a case would be to identify the technical area where the firms have overlapping capabilities possessed by few if any other firms. Logically, such a case would present horizontal concerns. However, the anticompetitive effects are uncertain and could be very hard for the government to prove since it cannot identify with confidence even the products and customers for which competition may be diminished.

JEFF PERRY: When you get into potential competition and innovation cases, I think these are areas where extra caution is really needed. In a typical merger case, where you’re assessing how a merger will affect competition in an existing market, even that analysis is necessarily predictive because it’s forward-looking. And when you get into potential competition cases or pure innovation cases, you get into areas where you’re really pushing the bounds of prediction.

So I agree that these are important and hot topics, but I think we have to be realistic about how far forward the Agencies and courts can reasonably predict marketplace dynamics, particularly if we’re talking about a true innovation case with affected markets that don’t even exist yet. And one potential risk here is that you may condemn a proposed merger and sacrifice near-term and relatively certain efficiencies based on a much longer-term concern about amorphous harm.

I would also echo a point that Dave made, which is that there’s very little case law in this area to fall back on. It’s one of the things that was disappointing about the Steris case that it failed to offer much discussion or critique of the potential competition doctrine. And as a result, we’re left in a place where, when it comes to potential competition or innovation cases, we’re all citing these non-litigated merger investigations like Genzyme/Novazyme and Applied Materials/Tokyo Electron, where you never had a judge even weigh in on the theory of harm, let alone provide guidance on how the theories should be applied to the facts.

CARL SHAPIRO: Well, there is a line that I’ve seen in the press lately suggesting that antitrust is missing something because big tech companies are purchasing smaller upstarts which could threaten them down the line although they’re not threatening them yet. I don’t know what to make of that, but it’s out there.

JEFF PERRY: Yes, it’s out there, but this is potentially a dangerous area for false-positives in antitrust enforcement.

In many of these potential competition type cases, you have transactions that can be tremendously procompetitive—think about the pharmaceutical area, where you have a whole industry of small innovative companies that are really great idea factories but may be poorly capitalized, or without the resources to really complete R&D, or get to scale production, or actually get a product distributed efficiently to customers. And as Dave and others have mentioned, there can be huge efficiencies—and not just financial efficiencies—but real benefits to patients that come from these transactions.

So when you’re thinking about possible competitive harm from these types of transactions, there’s often so much on the other side of the ledger that I think we’ve got to be really cautious about enforcement here.

DAVE GELFAND: Yes, and if you’re referring to the same sort of commentary that I’m thinking about, Carl, there are several things missing from that. And I view it as a relatively superficial view point to have been articulated.
First of all, you’ve got to be able to predict something about future competition. You can’t just say well, large established companies shouldn’t buy startups or innovators. You’ve got to predict something about the competition that’s going to be lost and it’s very speculative when you have a startup company.

Second, the analysis needs to incorporate how the large company is going to improve what the startup or the smaller company brings to the market. They’re going to invest, they’re going to combine it with their platform, and they’re going to probably bring a lot of great benefits to what that smaller company has to offer.

Third, you can’t forget about the incentive that smaller companies have to invest in the first place, which is usually to be bought by the highest bidder. And if you start interfering with that dynamic, you really run the risk of discouraging investment in biotechs and tech startups and that’s a very dangerous path to start going down based on a speculative competition theory.

And one other problem is you can’t win that case as a government enforcer because you’ve got serious litigation risk trying to find a line of commerce in which competition would be harmed.

JOE KRAUSS: Let’s finish with efficiencies. Debbie, this best starts with you because I was intrigued by your blog in March, and it really hit home with me in discussing efficiency arguments with clients because every time you try to point to some government action evaluating efficiencies, it’s a litigation where the government is trashing the efficiencies claims for the most part. This makes it difficult to talk to clients about how important efficiencies are when they see that and say, well why do I go through the effort to try to do that?

What can the Agencies do and what can we as private practitioners do to better articulate the true standard in terms of how the Agencies are evaluating efficiencies in mergers and not be tilted by that skewed perspective if you only look at the litigated cases?

DEBBIE FEINSTEIN: I think the disconnect is that business efficiencies are not Merger Guidelines efficiencies. Often we keep hearing for months about the business efficiencies before the parties focus on what we might consider efficiencies under the Guidelines. It’s great that you think you’re going to get $2 billion in cost savings, but come to me with a number that reflects an honest assessment of what meets the Guidelines test.

I often hear about nebulous best practices that one party can bring to another. But these are not best practices arising from one party being able to share a particular technology with the other. Rather, parties claim that one firm has smart people who have developed great practices that they can apply to the other firm. But this is clearly not a merger specific benefit.

Similarly, we often hear about cost reductions from rationalizing suppliers. Sometimes those can be credited, but often, the companies are already beginning that effort and they include in their efficiencies everything they will achieve unilaterally and everything that they would do together. Focusing only on the merger-specific and cognizable efficiencies to give us a reasonable assessment of efficiencies from the outset will save a huge amount of time.

In Sysco, we recognized there would be some efficiencies. But even their own economic experts didn’t agree on the numbers. And what their experts said in court was much lower than what they had argued to us throughout the investigation. It would have been more useful for them to come in with those lower numbers from the outset. Instead, we did the work to come up with a reasonable assessment.

The second point is that parties often fail to consider the extent to which the efficiencies would be passed through. For instance, in bid markets, the economics make clear that not all efficiencies get passed through. Yet, parties often don’t take on this issue.
In the early stages, come in with a reasonable number that reflects the Guidelines approach and some consideration of pass-through so we can start from a reasonable point and go from there. Then we’re in a position to say “Great, if you are right on that number, that would address our concerns so now let’s all dig a little bit deeper to see if those numbers hold up.” But we often start so far apart that there’s no way to have that reasonable conversation.

CARL SHAPIRO: I think the situation regarding efficiencies is unfortunate and could be improved upon. I say this having seen from both sides how efficiencies are viewed. The Agencies are very skeptical of efficiencies and have a high bar before they are credited. In part because of this, merging companies often seem to say: “Well, let’s not seriously develop and present an efficiency claim early on because we doubt it will get us very far.” The net result is that the merging companies do not develop an efficiency claim that meets the Agencies’ standards, particularly as regards merger specificity. Or they present an efficiency claim later, which may be less credible.

I think progress could be made, at least in some cases, if merging companies went in earlier with a credible efficiency claim and if the Agencies were more willing to engage with the merging parties on such claims. I realize that it can be very difficult to develop a detailed, credible efficiency analysis, as this often requires combining confidential information from the two companies. The DOJ and the FTC could reward such efforts by taking them seriously and indicating which parts are convincing and which are not, giving the merging parties a chance to refine and strengthen their efficiencies claims.

More generally, if the merging firms can tell a credible goodness story with their merger at an early stage of the investigation, it affects the Agency’s thinking about the deal, even if the Agency sees some problems.

DAVE GELFAND: I was simply going to say that one of the things I was struck by during my three years at DOJ was—and I’m not speaking about any particular case now because there were some cases in which a stronger showing was made on this topic—but I was struck by how superficial the efficiencies arguments often were. They weren’t even arguments half the time, they were just statements to the effect that millions of dollars in overhead would be saved by firing a lot of people.

As Debbie said, parties really need to do something that ties in to merger specificity and the benefit that the market will receive from it.

CARL SHAPIRO: The biggest opening here, in my view, is for companies that can show efficiencies they have actually achieved in other deals that are comparable to the deal on the table. I thought this was a big opportunity for Staples, given the Office Depot/Office Max deal that had happened just a few years earlier. And it’s a pity they never put on a defense so their efficiency claims were never properly presented in court and subjected to cross-examination. Those claims were disputed by the FTC, but Judge Sullivan never had the opportunity to ask questions of the efficiency witnesses on either side.

JEFF PERRY: I don’t agree with that, but I also don’t want to re-litigate the Staples case, so let me just briefly say this. The expert reports, documents, and efficiency arguments in the Staples case were all in evidence. The fact witnesses and expert witnesses were all deposed at least once; so the efficiencies evidence was in the record, but obviously the claims were not ultimately credited by the judge. As Carl points out, there was a recent (Office Depot/OfficeMax) transaction that
looked very similar and led to hundreds of millions of dollars in annual savings that I don’t think anyone debated. And Staples’ own files in the current transaction supported the point that the current acquisition was motivated by, and the valuation was driven by, significant efficiencies of more than a billion dollars per year. And yet in response, the FTC’s efficiency expert said there would be zero dollars in cognizable efficiencies, literally zero dollars. So you can draw from that what you will, but you can see how the private bar or the business community might see that as extraordinarily skeptical.

To your earlier point, I do think that litigation cases provide a skewed sample set—I agree completely. First, because the Agencies are in litigation mode and at that point they’ve made a decision to challenge a transaction, and they do what they should do—they go in guns blazing to try to win that case. But second, and I think this is reflected in the Guidelines, efficiencies really matter the most in marginal cases. So if you bring me a five-to-four merger with combined market shares in the high 20s, I would say get your efficiencies arguments in order, let’s engage early, let’s do everything that Carl, Debbie, and Dave said.

But, if there’s a transaction that the Agencies believe is not a close call, and they believe will lead to significant harm, it’s hard to advise a client that efficiencies are going to be given significant weight. There’s also the question of whether the level of proof required to demonstrate efficiencies in that subset of deals may exceed the level of proof or certainty required when analyzing competitive effects. And, there’s a real risk in these transactions that if you make a strong efficiencies argument, it can be flipped against you where the Agencies may say, “Aha, clearly these smaller competitors don’t have the scale to compete and you’ve made that clear by arguing that this transaction will lead to efficiencies.”

So I agree with Carl on the fact that we’re in somewhat of a bad cycle and there’s room for improvement on both sides, frankly. On the private bar side, there’s room to get in and engage early and more effectively. And respectfully, on the Agency side, there’s room to give a little more credit to efficiencies and to more fully appreciate the challenge in quantifying forward-looking efficiencies to the ledger level of detail.

DEBBIE FEINSTEIN: Where the intuitive story of efficiencies makes sense and is consistent with other facts we are hearing, we do not necessarily need to have mathematical precision on the efficiencies. But often we hear these contradictory stories. On the one hand, we will get scale economies and need those to compete, but the small competitors will constrain any post-merger exercise of market power. That may be right because you have built up an inefficient system but we need an explanation of the seeming inconsistency.

MANDY REEVES: I think that’s a great place to end. Thanks everyone for a terrific discussion.
UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA,

Plaintiff,

v.

CHARTER COMMUNICATIONS, INC.,
TIME WARNER CABLE INC,
ADVANCE/NEWHOUSE PARTNERSHIP, and
BRIGHT HOUSE NETWORKS, LLC,

Defendants.

Civil Action No. 1:16-cv-00759 (RCL)

COMPETITIVE IMPACT STATEMENT

The United States of America (“United States”), pursuant to Section 2(b) of the Antitrust Procedures and Penalties Act (“APPA” or “Tunney Act”), 15 U.S.C. § 16(b)-(h), files this Competitive Impact Statement relating to the proposed Final Judgment submitted for entry in this civil antitrust proceeding.

I. NATURE AND PURPOSE OF THE PROCEEDING

On May 23, 2015, Charter Communications, Inc. (“Charter”) and Time Warner Cable, Inc. (“TWC”), two of the largest cable companies in the United States, agreed to merge in a deal valued at over $78 billion. In addition, Charter and Advance/ Newhouse Partnership, which owns Bright House Networks, LLC (“BHN”), announced that Charter would acquire BHN for $10.4 billion, conditional on the sale of TWC to Charter. As a result of these transactions, the combined company, referred to as “New Charter,” will become one of the largest providers of pay television service in the United States.

The United States filed a civil antitrust Complaint on April 25, 2016, seeking to enjoin the proposed transactions because their likely effect would be to lessen competition substantially
in numerous local markets for the timely distribution of professional, full-length video programming to residential customers (“video programming distribution”) throughout the United States in violation of Section 7 of the Clayton Act, 15 U.S.C. § 18. Specifically, the Complaint alleges that the proposed merger would increase the ability and incentive of New Charter to use its leverage with video programmers to limit the access of online video distributors (“OVDs”) to important content. These OVDs are increasingly offering meaningful competition to cable companies like Charter, and the loss of competition caused by the proposed merger likely would result in lower-quality services, fewer choices, and higher prices for consumers, as well as reduced investment and less innovation in this dynamic industry.

At the same time the Complaint was filed, the United States also filed a Stipulation and proposed Final Judgment, which are designed to eliminate the anticompetitive effects of the proposed merger. Under the proposed Final Judgment, which is explained more fully below, the Defendants will be prohibited from using their bargaining leverage with video programmers to inhibit the flow of video content to OVDs. The proposed Final Judgment will provide a prompt, certain, and effective remedy for consumers by preventing New Charter from using its leverage over programmers to harm competition. The United States and the Defendants have stipulated that the proposed Final Judgment may be entered after compliance with the APPA. Entry of the proposed Final Judgment would terminate this action, except that the Court would retain jurisdiction to construe, modify, or enforce the provisions of the proposed Final Judgment, and to punish and remedy violations thereof.

The proposed merger was also subject to review and approval by the Federal
Communications Commission ("FCC"). On May 5, 2016, the FCC adopted an order approving the transactions subject to certain conditions discussed below, and that order was released publicly on May 10, 2016. The Department and the FCC coordinated closely in their reviews of the proposed merger. The FCC’s remedy is independent of the proposed Final Judgment and not subject to review in this proceeding.

II. DESCRIPTION OF THE EVENTS GIVING RISE TO THE ALLEGED VIOLATION

A. The Defendants and the Proposed Merger

Charter is the third-largest cable company in the United States, and the sixth-largest multichannel video programming distributor ("MVPD") overall. Charter owns cable systems across 28 states, serving approximately 4.8 million residential broadband customers and 4.2 million residential video customers. Charter reported total revenues of around $9.1 billion in 2014, approximately $4.4 billion of which were derived from Charter’s video business.

TWC is the second-largest cable company in the United States (behind only Comcast Corp.), and the fourth-largest MVPD in the country. TWC’s cable systems serve approximately 11.7 million residential broadband and 10.8 million residential video customers in 30 states. TWC reported total revenues of approximately $22.8 billion in 2014, around $10.4 billion of which were derived from TWC’s video business.

BHN is the sixth-largest incumbent cable company in the United States and the ninth-largest MVPD overall. It owns cable systems serving approximately 2 million video customers across six states, the majority of whom are located in the Orlando and Tampa-St. Petersburg, Florida areas. BHN is a wholly-owned subsidiary of Advance/Newhouse Partnership. Although

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1 Under the Communications Act, the FCC has jurisdiction to determine whether mergers involving the transfer of a telecommunications license are in the “public interest, convenience, and necessity.” 47 U.S.C. § 310(d).
the Advance/Newhouse Partnership retains the authority to manage BHN, it has entered into agreements by which TWC performs certain functions for BHN, including the procurement of cable programming. In 2014, BHN generated total revenues of around $3.7 billion, approximately $1.5 billion of which were derived from its video business.

The proposed transactions combining Charter, TWC, and BHN into New Charter, as initially agreed to by the Defendants on May 23, 2015, would lessen competition substantially in numerous local markets for video programming distribution. These transactions are the subject of the Complaint and proposed Final Judgment filed by the United States on April 25, 2016.

B. **The Structure of the Video Programming Distribution Industry**

The video programming distribution industry operates at two distinct levels. At the “upstream” level, video programmers license their content to video programming distributors – both OVDs and traditional MVPDs including Charter, TWC, and BHN. At the “downstream” level, the video programming distributors then sell subscriptions to various packages of that content and deliver the content to residential customers.

![Diagram](Diagram.png)

1. **Video Programmers**

Video programmers produce themselves, or acquire from other copyright holders, a collection of professional, full-length programs and movies. These video programmers then
typically aggregate this content into branded networks (e.g., NBC or The History Channel) that provide a 24-hour schedule that is attractive to consumers. Large video programmers often own multiple individual networks. For instance, The Walt Disney Company owns the ABC broadcast network as well as many cable networks such as ESPN and The Disney Channel.

In order to acquire the rights to distribute each network, video programming distributors pay the video programmer a license fee, generally on a per-subscriber basis. These license fees are an important revenue stream for video programmers. Most of the remainder of their revenues comes from fees for advertisements placed on their networks.

Video programmers rely on video programming distributors – both MVPDs and OVDs – to reach consumers. Unless a video programmer obtains carriage in the packages of video programming distributors that reach a sufficient number of consumers, the programmers will be unable to earn enough revenue in licensing or to attract enough advertising revenue to generate a return on their investments in content. For this reason, video programmers prefer to have as many video programming distributors as possible carry their networks, and particularly seek out the largest MVPDs that reach the most customers. If the programmer is unable to agree on acceptable terms with a particular distributor, the programmer’s content will not be available to that distributor’s customers. This potential consequence gives the largest MVPDs significant bargaining leverage in their negotiations with programmers.

2. Multichannel Video Programming Distributors

Traditional video programming distributors include incumbent cable companies such as Charter and TWC; direct broadcast satellite (“DBS”) providers such as DirecTV and DISH Network; telephone companies (“telcos”) that offer video services such as Verizon and AT&T;
and overbuilders such as Google Fiber and RCN. These distributors are referred to collectively as MVPDs. MVPDs typically offer hundreds of channels of professional video programming to residential customers for a monthly subscription fee.

3. **Online Video Programming Distributors**

OVDs are relatively recent entrants into the video programming distribution market. They deliver a variety of live and/or on-demand video programming over the Internet, whether streamed to Internet-connected televisions or other devices, or downloaded for later viewing. OVDs today include services like Netflix, Hulu, Amazon Prime Instant Video, and Sling TV, although, as discussed in more detail below, their content selection and business models vary greatly. Unlike MVPDs, OVDs do not own distribution facilities and are dependent upon broadband Internet access service providers, including incumbent cable companies such as Charter and TWC, for the delivery of their content to viewers.

C. **The Relevant Market and Market Concentration**

The Complaint alleges that video programming distribution constitutes a relevant product market and line of commerce under Section 7 of the Clayton Act, 15 U.S.C. § 18. The market for video programming distribution includes both traditional MVPDs and their newer OVD rivals.

Consumers purchase video programming distribution services from among those distributors that can offer such services directly to their home. The DBS operators, DirecTV and DISH, can reach almost any customer in the continental United States who has an unobstructed line of sight to their satellites. OVDs are available to any consumer with an Internet service sufficient to deliver video of an acceptable quality. In contrast, wireline-based distributors such

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2 Overbuilders are providers who have constructed an additional wired network to residential consumers for offering video and broadband service (i.e., they have “built over” the cable and phone company networks).
as cable companies and telcos generally must obtain a franchise from local, municipal, or state authorities in order to construct and operate a wireline network in a specific area, and then build lines to homes in that area. A consumer cannot purchase video programming distribution services from a wireline distributor operating outside its franchise area because the distributor does not have the facilities to reach the consumer’s home. Thus, although the set of video programming distributors able to offer service to individual consumers’ residences is generally the same within each local community, the set can differ from one local community to another.

According to the Complaint, each local community whose residents face the same competitive choices in video programming distribution comprises a geographic market and section of the country under Section 7 of the Clayton Act, 15 U.S.C. § 18. The geographic markets relevant to this action are the numerous local markets throughout the United States where either Charter, TWC, or BHN is the incumbent cable operator – an area encompassing 48 million U.S. television households located across 41 states. However, because OVDs typically offer services nationwide, the Complaint alleges that anticompetitive effects of the proposed merger likely extend to the entire United States.

The incumbent cable companies are often the largest video distribution provider in their respective local territories; the Defendants’ market shares, for example, exceed 50 percent in many local markets in which they operate. The DBS providers, DirecTV and DISH Network, account for an average of about one third of video programming subscribers combined in any given local market. The telcos, including AT&T and Verizon, have market shares as high as 40 percent in the communities they have entered, but they are only available in limited areas and account for about 10 percent of video programming customers nationwide. Overbuilders such as Google Fiber can also have moderately high shares in particular local markets, but their services
are only available in a small number of areas and they account for fewer than two percent of nationwide video programming distribution subscribers.

Although OVDs have acquired a significant number of customers over the last several years, most of these customers also purchase traditional MVPD subscriptions. As a result, OVDs currently have a small share of video programming distribution market revenues – likely around 5%.

D. Emerging Competition from OVDs in the Relevant Market

1. OVD Business Models and Participants

OVDs have developed a number of different business models for delivering content to consumers. Several OVDs, including Netflix, Amazon Prime Instant Video, and Hulu Plus, offer “subscription video on demand” (“SVOD”) services where consumers typically obtain access to a wide library of movies, past-season television shows, and original content for a subscription fee.³ In addition, some individual cable programmers, such as CBS and HBO, have begun offering their content directly to consumers on an SVOD basis. For example, HBO’s service, branded HBO NOW, provides subscribers who pay a monthly fee with access to the same HBO content over the Internet that they would receive through a subscription to HBO as part of an MVPD package.

In contrast to these SVOD providers, a few OVDs have recently begun offering MVPD-like bundles of live, scheduled content to consumers over the Internet. In early 2015, DISH launched Sling TV, a monthly subscription service that provides customers access to many of the same cable networks that are available through traditional MVPDs. Sony has launched a similar service called PlayStation Vue. Unlike SVODs, these “virtual” MVPDs (“vMVPDs”) provide

³ Hulu also offers current-season content from various television networks on an ad-supported basis for no subscription fee.
customers the ability to watch live sports and news programming, as well as other scheduled entertainment programming, at the same time it is available on traditional MVPDs.

2. The Effects of OVD Development on Traditional MVPDs

As OVDs have developed new business models and obtained a wider array of attractive video content, they have started to become closer substitutes for traditional MVPD services. Although many consumers treat OVD services as a complement to traditional MVPD service – for example, purchasing services from an SVOD like Netflix to access past season content and Netflix’s original content but subscribing to an MVPD for live and current-season content – some are already using OVDs as substitutes for at least a portion of their video consumption. These consumers buy smaller content packages from traditional MVPDs, decline to take certain premium channels, or purchase fewer VOD offerings, and instead substitute content from OVDs, a practice known as “cord-shaving.” In addition, a small, but growing number of MVPD customers are “cutting the cable cord” completely, using one or more OVDs as a replacement for their MVPD service. Finally, some younger consumers are emerging as “cord nevers” who do not seek out an MVPD subscription in the first place.

Absent interference from the established MVPDs, OVDs are likely to continue to grow, and to become stronger competitors to MVPDs. Moreover, to the extent that OVDs continue to develop services that more closely resemble those offered by traditional MVPDs, such as the live programming offered by vMVPDs or the current season content offered by certain SVODs, traditional MVPDs will likely face greater substitution to OVD services. To this end, the Defendants’ internal documents show that they have typically been comparatively less concerned about competition from certain SVOD providers, like Netflix, that do not offer live or current-
season programming, and more concerned by the threat posed by vMVPDs like Sling TV and SVODs like HBO NOW that offer current season content.

3. Traditional MVPDs’ Responses to the Growth of OVDs

The Defendants and many other MVPDs recognize the threat that the growth of OVDs pose to their video distribution businesses. Numerous internal documents reflect the Defendants’ assessment that OVDs are growing quickly and pose a competitive threat to traditional forms of video programming distribution. MVPDs have responded to this growth in various ways. To keep their customers from migrating some or all of their viewing to OVDs, many MVPDs, including the Defendants, have introduced new and less expensive packages with smaller numbers of channels, increased the amount of content available on an on-demand basis, and made content available to subscribers on devices other than traditional cable set-top boxes. At the same time, however, some MVPDs have sought to restrain nascent OVD competition directly by exercising their leverage over video programmers to restrict video programmers’ ability to license content to OVDs. As alleged in the Complaint, and explained in more detail below, TWC has been an industry leader in seeking such restrictions, and the formation of New Charter will create an entity with an increased ability and incentive to do so.

E. The Anticompetitive Effects of the Proposed Merger

Although Defendants do not compete to provide video distribution services to consumers in the same local geographic markets, the Clayton Act is also concerned with mergers that threaten to reduce the number or quality of choices available to consumers by increasing the merging parties’ incentive or ability to engage in conduct that would foreclose competition.4 For

4 See Brown Shoe Co. v. United States, 370 U.S. 294, 317 (1962) (noting that the Clayton Act intended to make illegal “not only [] mergers between actual competitors, but also [] vertical and conglomerate mergers whose effect may tend to lessen competition in any line of commerce in any section of the country.”); FTC v. Procter & Gamble Co., 386 U.S. 568, 577 (1967) (“All
example, a merger may create, or substantially enhance, the ability or incentive of the merged firm to protect its market power by denying or raising the price of an input to the firm’s rivals.

As alleged in the Complaint, New Charter will be significantly larger than each of the Defendants individually, and thus will have a greater incentive and ability to use its bargaining power with video programmers to protect its market power in the local markets for video programming distribution. Specifically, following the merger, New Charter will be the one of the largest MVPDs in the country, with over 17 million subscribers in 41 states, and will therefore be a critical distribution channel for video programmers. The Complaint alleges that this greater scale will give New Charter more leverage to demand that programmers agree to limit their distribution to OVDs, enabling the merged firm to increase barriers to entry for OVDs or otherwise make OVDs less competitive.

The Complaint also alleges that New Charter will have increased incentive to engage in such behavior because it will stand to lose substantially more profits than Charter, TWC, and BHN individually if OVDs take business from traditional MVPDs, and it will internalize more of the benefits of harming OVDs. The Defendants’ specific means for foreclosing OVDs – ADM clauses and other restrictive contracting provisions – are discussed in more detail below.

1. **TWC Is the Industry Leader in Imposing ADMs and Other Restrictive Programming Clauses that Limit Video Programmers’ Rights to License to OVDs**

   Video programmers sign lengthy licensing agreements with distributors that establish the terms on which the distributors will carry the programmers’ networks. Sometimes, these licensing agreements include restrictions on the other distributors to whom the programmer may license content, or on other ways the programmer may make the content available to consumers.
One type of restriction is often referred to in the industry as an “alternative distribution means” ("ADM") clause. ADM clauses take many forms, and in some cases can have significant consequences for programmers’ ability to license to OVDs. For example, some ADMs prohibit a video programmer from licensing content to OVDs for an extended period of time after the content is first aired on traditional MVPDs – permanently blocking OVDs from being able to offer current-season content from those programmers. Other ADMs prohibit the programmer from licensing content to OVDs unless the OVDs meet a number of strict (and sometimes elaborate) criteria that can be difficult to satisfy.\footnote{For instance, an ADM in one MVPD’s contract with a video programmer prohibited the programmer from licensing to any OVD unless that OVD offered a package that included thirty-five channels, including at least two channels each from three out of a list of six large video programmers.}

TWC has been the most aggressive MVPD at seeking and obtaining restrictive ADM clauses in recent years. The Department’s review of hundreds of programming contracts and ordinary course business documents revealed that TWC has obtained numerous ADMs that limit distribution to paid OVDs. Other distributors, by contrast, have rarely, if ever, sought or obtained such clauses, or have only obtained ADMs that are much less restrictive. TWC’s success in seeking and obtaining ADMs is likely attributable in part to its bargaining leverage over video programmers; although such programmers might disfavor such restrictions because they require the programmer to forsake opportunities to earn revenues from OVDs, they are more likely to agree to a large MVPD such as TWC’s demand to include them because they do not want to lose access to TWC’s millions of cable subscribers.

The Department’s investigation further suggested that TWC may be the most aggressive at obtaining such clauses because, other than Comcast, TWC has more to lose from the expansion of OVDs than any other traditional MVPD. Although Comcast also has substantial
video profits at risk, it is prohibited from entering into or enforcing any provisions that restrict distribution to OVDs under the terms of a consent decree entered in *United States v. Comcast Corp.* By contrast, distributors with fewer subscribers than TWC have less to lose from the expansion of OVDs, and, in some cases, may actually support OVD expansion because they make little or no profit margin on their video distribution businesses and would prefer to improve the attractiveness of their broadband Internet access services. Meanwhile, the two DBS providers, DISH and DirecTV, have historically been comparable to TWC in size, but because of their different distribution technology and their customer demographics, may perceive a lower threat from OVDs. In fact, DISH is offering an OVD service of its own – Sling TV – and DirecTV recently announced plans to offer a similar OVD service.

2. **The Proposed Transaction Increases New Charter’s Ability and Incentive to Obtain ADMs and Other Restrictive Programming Clauses**

The number and scope of the ADMs that TWC obtained prior to the merger suggests that TWC believes that these ADM clauses are worth whatever consideration it must provide video programmers in return. After the merger, New Charter, with over 17 million video subscribers in 41 states, will have even more leverage than TWC to demand that programmers agree to ADMs. Given the importance of New Charter as a distribution channel, programmers will be less likely to risk losing access to New Charter’s considerable subscriber base – which is almost 60 percent larger than TWC alone – and will be more likely to accept to New Charter’s demands. Moreover, since New Charter will have far more profits at risk from increased OVD competition than Charter, TWC, or BHN standing alone, it will be willing to provide greater consideration to programmers to obtain such clauses. As a result, New Charter can be expected to seek and

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obtain ADMs with more programmers than TWC has to date, and the ADMs are likely to be more restrictive than TWC’s current ADM provisions. As alleged in the Complaint, such ADMs could negatively affect OVDs’ business models and undermine their ability to provide robust video offerings that compete with the offerings of traditional MVPDs. The weakening of OVD competition will result in lower-quality services, fewer consumer choices, and higher prices.

4. **Entry Is Unlikely to Reverse the Anticompetitive Effects of the Proposed Merger**

Successful entry into the traditional video programming distribution business is difficult and requires an enormous upfront investment to create a distribution infrastructure. As alleged in the Complaint, additional entry into wireline or DBS distribution is not likely to be significant for the next several years. Telcos have been willing to incur some of the enormous costs to modify their existing telephone infrastructure to distribute video, and will continue to do so, but only in certain areas. Other new providers, such as Google Fiber, are also expanding services, but the time and expense required to build to each new area makes expansion slow. Therefore, traditional MVPDs’ market shares are likely to be fairly stable over the next several years.

OVDs represent the most likely prospect for successful and significant competitive entry into the existing video programming distribution market. However, in addition to the other barriers they face, OVDs must obtain access to a sufficient amount of content to become viable distribution businesses, and the proposed merger will likely increase that barrier to entry even further.

**III. EXPLANATION OF THE PROPOSED FINAL JUDGMENT**

The proposed Final Judgment ensures that New Charter will not impede competition by using programming contracts to prevent the flow of content to OVDs. The proposed Final
Judgment thereby protects consumers by eliminating the likely anticompetitive effects of the proposed merger alleged in the Complaint.

A. The Proposed Final Judgment Prohibits Defendants from Limiting Distribution to OVDs through Restrictive Licensing Practices

As discussed above, certain types of contract provisions, such as ADMs, can have the purpose and effect of limiting distribution to OVDs. However, not all provisions that limit distribution are anticompetitive. Reflecting this reality, Sections IV.A and IV.B of the proposed Final Judgment set forth broad prohibitions on restrictive contracting practices, while Section IV.C delineates a narrowly tailored set of exceptions. Taken together, these provisions ensure that New Charter cannot use restrictive contract terms to harm the development of OVDs, but preserve programmers’ incentives to produce quality programming and New Charter’s ability to compete with other distributors to obtain marquee content.

Section IV.A of the proposed Final Judgment prohibits New Charter from entering into or enforcing agreements that forbid, limit, or create incentives to limit the provision of video programming to OVDs. This language prevents New Charter from enforcing the ADM provisions in current TWC contracts, or from entering into new provisions.

Section IV.B provides additional detail as to the types of terms that could create “incentives to limit” distribution to OVDs. The Department’s investigation revealed that TWC has obtained ADM provisions for the purpose of attempting to limit distribution to OVDs. However, once those agreements are prohibited, New Charter could substitute ADMs with more subtle types of contract provisions that do not directly limit distribution to OVDs, but make it financially unattractive for video programmers to license content to OVDs. For instance, absent relief, New Charter could enter into an agreement that permits a video programmer to license content to an OVD, but specifies that so licensing will entitle New Charter to a massive license
fee discount. To prevent evasion of the ban on ADMs, Section IV.B.1 clarifies that such “penalty” provisions that create incentives to limit distribution to OVDs are not permitted.

Alternatively, New Charter could enter into certain kinds of “most favored nation” (“MFN”) provisions that are designed to create incentives to limit distribution to OVDs. Although MFN provisions are ubiquitous in the industry – for example, many MVPDs use MFN provisions entitling the MVPD to the lowest license fee that the programmer offers to any other MVPD – the Department’s investigation revealed that some MVPDs were utilizing certain provisions that, while referred to as “MFNs,” actually require much more than equal treatment. Specifically, some provisions, commonly referred to as “unconditional MFNs” or “cherry-picking MFNs,” require that a programmer provide an MVPD the most favorable term the programmer has offered to any other distributor, even if that other distributor agreed to additional payment or other conditions in exchange for receiving that term.7 As a result of an unconditional MFN, the programmer may be reluctant to license the additional content to the other distributor in the first place.

Although unconditional MFNs are uncommon today, and the Defendants have only a few such provisions in their current contracts, the Department was concerned that New Charter could replace ADMs with unconditional MFNs in an effort to circumvent the proposed Final Judgment. For example, New Charter might obtain an unconditional MFN from a programmer that would entitle New Charter to receive at no additional cost any content a programmer makes available to

7 For example, a programmer may enter into an agreement with Distributor A that provides Distributor A with extra content (for instance, additional video-on-demand rights) in exchange for an extra payment. If the programmer has an unconditional MFN with Distributor B, the programmer may then be required to provide the additional video-on-demand rights to Distributor B without Distributor B having to make the extra payment. By contrast, a more typical – and less problematic – MFN would entitle Distributor B to the additional content only if Distributor B agreed to pay the same additional fee paid by Distributor A.
an OVD, regardless of payments or other conditions with which the OVD must comply. In such case, by providing programming to an OVD, the programmer might face significant economic disadvantages in the form of losing the opportunity to monetize the content through distribution by New Charter. As a result, unconditional MFNs could create significant disincentives for programmers to license content to OVDs. For these reasons, Section IV.B.2 of the proposed Final Judgment prohibits New Charter from entering into or enforcing unconditional MFNs against programmers for distributing their content to OVDs.8

Section IV.C of the proposed Final Judgment establishes three narrow exceptions to the broad prohibitions in Sections IV.A and IV.B. First, New Charter may prohibit the programmer from making content available on the Internet for free for 30 days after its initial airing, if New Charter has paid a fee for the video programming. The Department’s investigation revealed that such limitations on free distribution are ubiquitous in the industry, and the Department has discovered no evidence that such provisions are harmful to competition.

Second, New Charter may enter into an agreement in which the programmer provides content exclusively to New Charter, and to no other MVPD or OVD. Although uncommon, a few programmers wish to make some of their content available to only one distributor. This relationship then incentivizes the distributor to vigorously market the content, and thus can be procompetitive in some circumstances. The proposed Final Judgment ensures that New Charter can continue to compete with other distributors to obtain these kinds of exclusives. As long as the exclusivity applies to all other video programming distributors, and does not narrowly

8 Specifically, Section IV.B.2.i provides that New Charter may not require a programmer to provide New Charter the same terms offered to an OVD unless New Charter also accepts any conditions that are integrally related, logically linked, or directly tied to those terms. The language chosen for this provision mirrors language that is common in conditional MFN provisions throughout the industry. Also consistent with other conditional MFNs in the industry, Section IV.B.2.ii states that Charter need not comply with related terms and conditions if it is unable to do so for technological or regulatory reasons.
prohibit distribution only to OVDs, the Department has no basis to believe such provisions will always or usually be harmful.9

Third, New Charter may condition carriage of programming on its cable system on terms which require it to receive as favorable material terms as other MVPDs or OVDs, except to the extent such terms would be inconsistent with the purpose of the proposed Final Judgment. That is, New Charter may enter into the kinds of ordinary conditional MFNs that are ubiquitous in the industry, such as a provision which entitles New Charter to the lowest license fee paid by any other distributor. This provision explicitly does not override Section IV.B.2’s ban on the application of unconditional MFNs to OVD distribution. Importantly, New Charter may not use MFNs as a back door to obtain provisions which are otherwise “inconsistent with the purpose of Sections A and B.” For instance, even if another distributor obtains a provision which “create[s] incentives to limit” a programmer’s provision of programming to an OVD, New Charter cannot use an MFN to add that other distributor’s provision to New Charter’s own contract.

2. **The Proposed Final Judgment Prohibits Defendants from Discriminating Against, Retaliating Against, or Punishing Video Programmers**

Section IV.D of the proposed Final Judgment prohibits Defendants from discriminating against, retaliating against, or punishing any Video Programmer for providing programming to any OVD. This provision ensures that even though Defendants are no longer permitted to contractually prohibit or deter video programmers from licensing content to OVDs, the Defendants are not able to instead deter such licensing through threats or punishment. Section IV.D also prohibits Defendants from discriminating against, retaliating against, or punishing any video programmer for invoking any provisions of the proposed Final Judgment or any FCC rule

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9 The Department retains the authority to challenge under Sections 1 or 2 of the Sherman Act any exclusive agreement in the future that the evidence demonstrates unreasonably restrains trade or creates or enhances monopoly power. See Proposed Final Judgment at § VII (No Limitation of Government Rights).
or order, or for furnishing information to the Department concerning Defendants’ compliance with the proposed Final Judgment.

Negotiations between video programmers and MVPDs are often contentious, high-stakes affairs, and it is common for one or both sides to the negotiation to threaten to walk away, or even to temporarily terminate the relationship (sometimes called a “blackout” or “going dark”) in order to secure a better deal. The proposed Final Judgment is not concerned with such negotiating tactics and therefore clarifies that “[p]ursuing a more advantageous deal with a Video Programmer does not constitute discrimination, retaliation, or punishment.” Rather, Section IV.D is designed to prevent situations where New Charter intentionally decides to forgo an agreement with a programmer that would otherwise be economical for New Charter in order to obtain the long-term benefits of deterring video programmers from licensing content to OVDs or cooperating with the Department or the FCC.

3. **Provision of Defendants’ FCC Interconnection Reports**

Although the Department’s Complaint focuses on the likely competitive harm resulting from New Charter’s imposition of ADMs and other contractual restrictions on video programmers, the Department also investigated the potential for the proposed merger to increase the price New Charter will charge Internet content companies, including OVDs, for access to its broadband subscribers. OVDs rely on broadband connections provided by other companies to reach their customers, and the Defendants are also major providers of Internet access service. Therefore, the Department examined whether the merger could increase both the incentive and ability of New Charter to use its control over the interconnection to New Charter’s broadband Internet service provider network to try and disadvantage online video competitors.
The FCC’s order approving the merger imposes an obligation on New Charter to make interconnection available on a non-discriminatory, settlement-free basis to any Internet content provider, transit provider, or content delivery network (“CDN”) who meets certain basic criteria. Although this policy only directly protects those sending large volumes of traffic, even smaller sources who do not qualify for direct interconnection ought to find ample bandwidth available at competitive prices because large transit and CDN providers will be guaranteed access, and could resell that capacity. Thus, the Department expects that the FCC’s order will prevent any merger-related harm to Internet content companies, including OVDs. In light of the FCC’s remedy, the Department did not target interconnection in its Complaint and elected not to pursue duplicative relief with respect to interconnection in the proposed Final Judgment. However, in order to assist the Department in monitoring future developments with regard to interconnection and in taking whatever action might be appropriate to prevent anticompetitive conduct, Section IV.E requires New Charter to provide the Department with copies of the regular reports that New Charter furnishes to the FCC pursuant to the FCC’s order.

D. Term of the Proposed Final Judgment

Section VIII of the proposed Final Judgment provides that the Final Judgment will expire seven years from the date of entry. The Department believes this time period is long enough to ensure that New Charter cannot harm OVD competitors at a crucial point in their development while accounting for the rapidly evolving nature of the video distribution market. After five years, Section VIII permits Charter to request that the Department reevaluate whether the Final Judgment remains necessary to protect competition. If at such time the Department concludes that the market has evolved such that the protections of the decree are no longer necessary, it will recommend to the Court that the Final Judgment be terminated.
IV. REMEDIES AVAILABLE TO POTENTIAL PRIVATE LITIGANTS

Section 4 of the Clayton Act, 15 U.S.C. § 15, provides that any person who has been injured as a result of conduct prohibited by the antitrust laws may bring suit in federal court to recover three times the damages the person has suffered, as well as costs and reasonable attorneys’ fees. Entry of the proposed Final Judgment will neither impair nor assist the bringing of any private antitrust damage action. Under the provisions of Section 5(a) of the Clayton Act, 15 U.S.C. § 16(a), the proposed Final Judgment has no prima facie effect in any subsequent private lawsuit that may be brought against Defendants.

V. PROCEDURES AVAILABLE FOR MODIFICATION OF THE PROPOSED FINAL JUDGMENT

The United States and Defendants have stipulated that the proposed Final Judgment may be entered by the Court after compliance with the provisions of the APPA, provided that the United States has not withdrawn its consent. The APPA conditions entry upon the Court’s determination that the proposed Final Judgment is in the public interest.

The APPA provides a period of at least 60 days preceding the effective date of the proposed Final Judgment within which any person may submit to the United States written comments regarding the proposed Final Judgment. Any person who wishes to comment should do so within 60 days of the date of publication of this Competitive Impact Statement in the Federal Register, or the last date of publication in a newspaper of the summary of this Competitive Impact Statement, whichever is later. All comments received during this period will be considered by the United States, which remains free to withdraw its consent to the proposed Final Judgment at any time prior to the Court’s entry of judgment. The comments and the response of the United States will be filed with the Court. In addition, comments will be
posted on the U.S. Department of Justice, Antitrust Division’s internet website and, under certain circumstances, published in the Federal Register. Written comments should be submitted to:

Scott A. Scheele  
Chief, Telecommunications and Media Enforcement Section  
Antitrust Division  
United States Department of Justice  
450 Fifth Street, N.W., Suite 7000  
Washington, DC 20530

The proposed Final Judgment provides that the Court retains jurisdiction over this action, and the parties may apply to the Court for any order necessary or appropriate for the modification, interpretation, or enforcement of the Final Judgment.

VI. ALTERNATIVES TO THE PROPOSED FINAL JUDGMENT

The United States considered, as an alternative to the proposed Final Judgment, seeking preliminary and permanent injunctions against Defendants’ transactions and proceeding to a full trial on the merits. The United States is satisfied, however, that the relief in the proposed Final Judgment will preserve competition for the provision of video programming distribution services in the United States. Thus, the proposed Final Judgment would protect competition as effectively as would any remedy available through litigation, but avoids the time, expense, and uncertainty of a full trial on the merits.

VII. STANDARD OF REVIEW UNDER THE APPA FOR THE PROPOSED FINAL JUDGMENT

The Clayton Act, as amended by the APPA, requires that proposed consent judgments in antitrust cases brought by the United States be subject to a sixty-day comment period, after which the court shall determine whether entry of the proposed Final Judgment “is in the public interest.” 15 U.S.C. § 16(e)(1). In making that determination, the court, in accordance with the statute as amended in 2004, is required to consider:
(A) the competitive impact of such judgment, including termination of alleged violations, provisions for enforcement and modification, duration of relief sought, anticipated effects of alternative remedies actually considered, whether its terms are ambiguous, and any other competitive considerations bearing upon the adequacy of such judgment that the court deems necessary to a determination of whether the consent judgment is in the public interest; and

(B) the impact of entry of such judgment upon competition in the relevant market or markets, upon the public generally and individuals alleging specific injury from the violations set forth in the complaint including consideration of the public benefit, if any, to be derived from a determination of the issues at trial.

15 U.S.C. § 16(e)(1)(A) & (B). In considering these statutory factors, the Court’s inquiry is necessarily a limited one as the government is entitled to “broad discretion to settle with the defendant within the reaches of the public interest.” United States v. Microsoft Corp., 56 F.3d 1448, 1461 (D.C. Cir. 1995); see generally United States v. SBC Comm’ns, Inc., 489 F. Supp. 2d 1 (D.D.C. 2007) (assessing public interest standard under the Tunney Act); United States v, U.S. Airways Group, Inc., 38 F. Supp. 3d 69, 75 (D.D.C. 2014) (explaining that the “court’s inquiry is limited” in Tunney Act settlements); United States v. InBev N.V./S.A., No. 08-1965 (JR), 2009-2 Trade Cas. (CCH) ¶ 76,736, 2009 U.S. Dist. LEXIS 84787, at *3, (D.D.C. Aug. 11, 2009) (noting that the court’s review of a consent judgment is limited and only inquires “into whether the government's determination that the proposed remedies will cure the antitrust violations alleged in the complaint was reasonable, and whether the mechanism to enforce the final judgment are clear and manageable.”).

As the United States Court of Appeals for the District of Columbia Circuit has held, under the APPA a court considers, among other things, the relationship between the remedy secured and the specific allegations set forth in the government’s complaint, whether the decree

10 The 2004 amendments substituted “shall” for “may” in directing relevant factors for courts to consider and amended the list of factors to focus on competitive considerations and to address potentially ambiguous judgment terms. Compare 15 U.S.C. § 16(e) (2004), with 15 U.S.C. § 16(e)(1) (2006); see also SBC Comm’ns, 489 F. Supp. 2d at 11 (concluding that the 2004 amendments “effected minimal changes” to Tunney Act review).
is sufficiently clear, whether enforcement mechanisms are sufficient, and whether the decree may positively harm third parties. See Microsoft, 56 F.3d at 1458-62. With respect to the adequacy of the relief secured by the decree, a court may not “engage in an unrestricted evaluation of what relief would best serve the public.” United States v. BNS, Inc., 858 F.2d 456, 462 (9th Cir. 1988) (quoting United States v. Bechtel Corp., 648 F.2d 660, 666 (9th Cir. 1981)); see also Microsoft, 56 F.3d at 1460-62; United States v. Alcoa, Inc., 152 F. Supp. 2d 37, 40 (D.D.C. 2001); InBev, 2009 U.S. Dist. LEXIS 84787, at *3. Courts have held that:

[t]he balancing of competing social and political interests affected by a proposed antitrust consent decree must be left, in the first instance, to the discretion of the Attorney General. The court’s role in protecting the public interest is one of insuring that the government has not breached its duty to the public in consenting to the decree. The court is required to determine not whether a particular decree is the one that will best serve society, but whether the settlement is “within the reaches of the public interest.” More elaborate requirements might undermine the effectiveness of antitrust enforcement by consent decree.

Bechtel, 648 F.2d at 666 (emphasis added) (citations omitted).11 In determining whether a proposed settlement is in the public interest, a district court “must accord deference to the government’s predictions about the efficacy of its remedies, and may not require that the remedies perfectly match the alleged violations.” SBC Comm’ns, 489 F. Supp. 2d at 17; see also U.S. Airways, 38 F. Supp. 3d at 75 (noting that a court should not reject the proposed remedies because it believes others are preferable); Microsoft, 56 F.3d at 1461 (noting the need for courts to be “deferential to the government’s predictions as to the effect of the proposed remedies”); United States v. Archer-Daniels-Midland Co., 272 F. Supp. 2d 1, 6 (D.D.C. 2003)

11 Cf. BNS, 858 F.2d at 464 (holding that the court’s “ultimate authority under the [APPA] is limited to approving or disapproving the consent decree”); United States v. Gillette Co., 406 F. Supp. 713, 716 (D. Mass. 1975) (noting that, in this way, the court is constrained to “look at the overall picture not hypercritically, nor with a microscope, but with an artist’s reducing glass”). See generally Microsoft, 56 F.3d at 1461 (discussing whether “the remedies [obtained in the decree are] so inconsonant with the allegations charged as to fall outside of the ‘reaches of the public interest’”).
(noting that the court should grant due respect to the United States’ prediction as to the effect of
proposed remedies, its perception of the market structure, and its views of the nature of the case).

Courts have greater flexibility in approving proposed consent decrees than in crafting
their own decrees following a finding of liability in a litigated matter. “[A] proposed decree
must be approved even if it falls short of the remedy the court would impose on its own, as long
as it falls within the range of acceptability or is ‘within the reaches of public interest.’” United
v. United States, 460 U.S. 1001 (1983); see also U.S. Airways, 38 F. Supp. 3d at 76 (noting that
room must be made for the government to grant concessions in the negotiation process for
settlements (citing Microsoft, 56 F.3d at 1461); United States v. Alcan Aluminum Ltd., 605 F.
Supp. 619, 622 (W.D. Ky. 1985) (approving the consent decree even though the court would
have imposed a greater remedy). To meet this standard, the United States “need only provide a
factual basis for concluding that the settlements are reasonably adequate remedies for the alleged
harms.” SBC Commc’ns, 489 F. Supp. 2d at 17.

Moreover, the court’s role under the APPA is limited to reviewing the remedy in
relationship to the violations that the United States has alleged in its Complaint, and does not
authorize the court to “construct [its] own hypothetical case and then evaluate the decree against
that case.” Microsoft, 56 F.3d at 1459; see also U.S. Airways, 38 F. Supp. 3d at 75 (noting that
the court must simply determine whether there is a factual foundation for the government’s
decisions such that its conclusions regarding the proposed settlements are reasonable); InBev,
2009 U.S. Dist. LEXIS 84787, at *20 (“the ‘public interest’ is not to be measured by comparing
the violations alleged in the complaint against those the court believes could have, or even
should have, been alleged”). Because the “court’s authority to review the decree depends
entirely on the government’s exercising its prosecutorial discretion by bringing a case in the first
place,” it follows that “the court is only authorized to review the decree itself,” and not to
“effectively redraft the complaint” to inquire into other matters that the United States did not
pursue. Microsoft, 56 F.3d at 1459-60. As this Court confirmed in SBC Communications, courts
“cannot look beyond the complaint in making the public interest determination unless the
complaint is drafted so narrowly as to make a mockery of judicial power.” SBC Commc’ns, 489
F. Supp. 2d at 15.

In its 2004 amendments, Congress made clear its intent to preserve the practical benefits
of utilizing consent decrees in antitrust enforcement, adding the unambiguous instruction that
“[n]othing in this section shall be construed to require the court to conduct an evidentiary hearing
or to require the court to permit anyone to intervene.” 15 U.S.C. § 16(e)(2); see also U.S.
Airways, 38 F. Supp. 3d at 76 (indicating that a court is not required to hold an evidentiary
hearing or to permit intervenors as part of its review under the Tunney Act). The language wrote
into the statute what Congress intended when it enacted the Tunney Act in 1974, as Senator
Tunney explained: “[t]he court is nowhere compelled to go to trial or to engage in extended
proceedings which might have the effect of vitiating the benefits of prompt and less costly
settlement through the consent decree process.” 119 Cong. Rec. 24,598 (1973) (statement of Sen.
Tunney). Rather, the procedure for the public interest determination is left to the discretion of
the court, with the recognition that the court’s “scope of review remains sharply proscribed by
precedent and the nature of Tunney Act proceedings.” SBC Commc’ns, 489 F. Supp. 2d at 11.12

“Tunney Act expressly allows the court to make its public interest determination on the basis
of the competitive impact statement and response to comments alone”); United States v. Mid-Am.
Dairymen, Inc., No. 73-CV-681-W-1, 1977-1 Trade Cas. (CCH) ¶ 61,508, at 71,980, *22 (W.D.

A court can make its public interest determination based on the competitive impact statement and response to public comments alone. *U.S. Airways*, 38 F. Supp. 3d at 76.

**VIII. DETERMINATIVE DOCUMENTS**

Appendix B to the FCC’s Memorandum Opinion and Order, *In re Applications of Charter Communications, Inc., Time Warner Cable Inc., and Advance/Newhouse Partnership for Consent to the Transfer of Control of Licenses and Authorizations*, FCC MB Docket No. 15-149 (adopted May 5, 2016; released May 10, 2016), was the only determinative document or material within the meaning of the APPA considered by the Department in formulating the proposed Final Judgment. This document is available on the FCC’s website at https://apps.fcc.gov/edocs_public/attachmatch/FCC-16-59A1.pdf, and will also be made available on the Antitrust Division’s website at https://www.justice.gov/atr/case/us-v-charter-communications-inc-et-al.

Dated: May 10, 2016

Respectfully submitted,

/s/
Robert A. Lepore
Telecommunications & Media Enforcement Section
Antitrust Division
U.S. Department of Justice
450 Fifth Street, N.W., Suite 7000
Washington, DC 20530
Telephone: (202) 532-4928
Facsimile: (202) 514-6381
Email: Robert.Lepore@usdoj.gov

Mo. 1977) (“Absent a showing of corrupt failure of the government to discharge its duty, the Court, in making its public interest finding, should . . . carefully consider the explanations of the government in the competitive impact statement and its responses to comments in order to determine whether those explanations are reasonable under the circumstances.”); S. Rep. No. 93-298, at 6 (1973) (“Where the public interest can be meaningfully evaluated simply on the basis of briefs and oral arguments, that is the approach that should be utilized.”).
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1. Overview

These Guidelines outline the principal analytical techniques, practices, and the enforcement policy of the Department of Justice and the Federal Trade Commission (the “Agencies”) with respect to mergers and acquisitions involving actual or potential competitors (“horizontal mergers”) under the federal antitrust laws.¹ The relevant statutory provisions include Section 7 of the Clayton Act, 15 U.S.C. § 18, Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1, 2, and Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45. Most particularly, Section 7 of the Clayton Act prohibits mergers if “in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.”

The Agencies seek to identify and challenge competitively harmful mergers while avoiding unnecessary interference with mergers that are either competitively beneficial or neutral. Most merger analysis is necessarily predictive, requiring an assessment of what will likely happen if a merger proceeds as compared to what will likely happen if it does not. Given this inherent need for prediction, these Guidelines reflect the congressional intent that merger enforcement should interdict competitive problems in their incipiency and that certainty about anticompetitive effect is seldom possible and not required for a merger to be illegal.

These Guidelines describe the principal analytical techniques and the main types of evidence on which the Agencies usually rely to predict whether a horizontal merger may substantially lessen competition. They are not intended to describe how the Agencies analyze cases other than horizontal mergers. These Guidelines are intended to assist the business community and antitrust practitioners by increasing the transparency of the analytical process underlying the Agencies’ enforcement decisions. They may also assist the courts in developing an appropriate framework for interpreting and applying the antitrust laws in the horizontal merger context.

These Guidelines should be read with the awareness that merger analysis does not consist of uniform application of a single methodology. Rather, it is a fact-specific process through which the Agencies, guided by their extensive experience, apply a range of analytical tools to the reasonably available and reliable evidence to evaluate competitive concerns in a limited period of time. Where these Guidelines provide examples, they are illustrative and do not exhaust the applications of the relevant principle.²

¹ These Guidelines replace the Horizontal Merger Guidelines issued in 1992, revised in 1997. They reflect the ongoing accumulation of experience at the Agencies. The Commentary on the Horizontal Merger Guidelines issued by the Agencies in 2006 remains a valuable supplement to these Guidelines. These Guidelines may be revised from time to time as necessary to reflect significant changes in enforcement policy, to clarify existing policy, or to reflect new learning. These Guidelines do not cover vertical or other types of non-horizontal acquisitions.

² These Guidelines are not intended to describe how the Agencies will conduct the litigation of cases they decide to bring. Although relevant in that context, these Guidelines neither dictate nor exhaust the range of evidence the Agencies may introduce in litigation.
The unifying theme of these Guidelines is that mergers should not be permitted to create, enhance, or entrench market power or to facilitate its exercise. For simplicity of exposition, these Guidelines generally refer to all of these effects as enhancing market power. A merger enhances market power if it is likely to encourage one or more firms to raise price, reduce output, diminish innovation, or otherwise harm customers as a result of diminished competitive constraints or incentives. In evaluating how a merger will likely change a firm’s behavior, the Agencies focus primarily on how the merger affects conduct that would be most profitable for the firm.

A merger can enhance market power simply by eliminating competition between the merging parties. This effect can arise even if the merger causes no changes in the way other firms behave. Adverse competitive effects arising in this manner are referred to as “unilateral effects.” A merger also can enhance market power by increasing the risk of coordinated, accommodating, or interdependent behavior among rivals. Adverse competitive effects arising in this manner are referred to as “coordinated effects.” In any given case, either or both types of effects may be present, and the distinction between them may be blurred.

These Guidelines principally describe how the Agencies analyze mergers between rival suppliers that may enhance their market power as sellers. Enhancement of market power by sellers often elevates the prices charged to customers. For simplicity of exposition, these Guidelines generally discuss the analysis in terms of such price effects. Enhanced market power can also be manifested in non-price terms and conditions that adversely affect customers, including reduced product quality, reduced product variety, reduced service, or diminished innovation. Such non-price effects may coexist with price effects, or can arise in their absence. When the Agencies investigate whether a merger may lead to a substantial lessening of non-price competition, they employ an approach analogous to that used to evaluate price competition. Enhanced market power may also make it more likely that the merged entity can profitably and effectively engage in exclusionary conduct. Regardless of how enhanced market power likely would be manifested, the Agencies normally evaluate mergers based on their impact on customers. The Agencies examine effects on either or both of the direct customers and the final consumers. The Agencies presume, absent convincing evidence to the contrary, that adverse effects on direct customers also cause adverse effects on final consumers.

Enhancement of market power by buyers, sometimes called “monopsony power,” has adverse effects comparable to enhancement of market power by sellers. The Agencies employ an analogous framework to analyze mergers between rival purchasers that may enhance their market power as buyers. See Section 12.

2. Evidence of Adverse Competitive Effects

The Agencies consider any reasonably available and reliable evidence to address the central question of whether a merger may substantially lessen competition. This section discusses several categories and sources of evidence that the Agencies, in their experience, have found most informative in predicting the likely competitive effects of mergers. The list provided here is not exhaustive. In any given case, reliable evidence may be available in only some categories or from some sources. For each category of evidence, the Agencies consider evidence indicating that the merger may enhance competition as well as evidence indicating that it may lessen competition.
2.1 Types of Evidence

2.1.1 Actual Effects Observed in Consummated Mergers

When evaluating a consummated merger, the ultimate issue is not only whether adverse competitive effects have already resulted from the merger, but also whether such effects are likely to arise in the future. Evidence of observed post-merger price increases or other changes adverse to customers is given substantial weight. The Agencies evaluate whether such changes are anticompetitive effects resulting from the merger, in which case they can be dispositive. However, a consummated merger may be anticompetitive even if such effects have not yet been observed, perhaps because the merged firm may be aware of the possibility of post-merger antitrust review and moderating its conduct. Consequently, the Agencies also consider the same types of evidence they consider when evaluating unconsummated mergers.

2.1.2 Direct Comparisons Based on Experience

The Agencies look for historical events, or “natural experiments,” that are informative regarding the competitive effects of the merger. For example, the Agencies may examine the impact of recent mergers, entry, expansion, or exit in the relevant market. Effects of analogous events in similar markets may also be informative.

The Agencies also look for reliable evidence based on variations among similar markets. For example, if the merging firms compete in some locales but not others, comparisons of prices charged in regions where they do and do not compete may be informative regarding post-merger prices. In some cases, however, prices are set on such a broad geographic basis that such comparisons are not informative. The Agencies also may examine how prices in similar markets vary with the number of significant competitors in those markets.

2.1.3 Market Shares and Concentration in a Relevant Market

The Agencies give weight to the merging parties’ market shares in a relevant market, the level of concentration, and the change in concentration caused by the merger. See Sections 4 and 5. Mergers that cause a significant increase in concentration and result in highly concentrated markets are presumed to be likely to enhance market power, but this presumption can be rebutted by persuasive evidence showing that the merger is unlikely to enhance market power.

2.1.4 Substantial Head-to-Head Competition

The Agencies consider whether the merging firms have been, or likely will become absent the merger, substantial head-to-head competitors. Such evidence can be especially relevant for evaluating adverse unilateral effects, which result directly from the loss of that competition. See Section 6. This evidence can also inform market definition. See Section 4.

2.1.5 Disruptive Role of a Merging Party

The Agencies consider whether a merger may lessen competition by eliminating a “maverick” firm, i.e., a firm that plays a disruptive role in the market to the benefit of customers. For example, if one of the merging firms has a strong incumbency position and the other merging firm threatens to
disrupt market conditions with a new technology or business model, their merger can involve the loss of actual or potential competition. Likewise, one of the merging firms may have the incentive to take the lead in price cutting or other competitive conduct or to resist increases in industry prices. A firm that may discipline prices based on its ability and incentive to expand production rapidly using available capacity also can be a maverick, as can a firm that has often resisted otherwise prevailing industry norms to cooperate on price setting or other terms of competition.

2.2 Sources of Evidence

The Agencies consider many sources of evidence in their merger analysis. The most common sources of reasonably available and reliable evidence are the merging parties, customers, other industry participants, and industry observers.

2.2.1 Merging Parties

The Agencies typically obtain substantial information from the merging parties. This information can take the form of documents, testimony, or data, and can consist of descriptions of competitively relevant conditions or reflect actual business conduct and decisions. Documents created in the normal course are more probative than documents created as advocacy materials in merger review. Documents describing industry conditions can be informative regarding the operation of the market and how a firm identifies and assesses its rivals, particularly when business decisions are made in reliance on the accuracy of those descriptions. The business decisions taken by the merging firms also can be informative about industry conditions. For example, if a firm sets price well above incremental cost, that normally indicates either that the firm believes its customers are not highly sensitive to price (not in itself of antitrust concern, see Section 4.1.3) or that the firm and its rivals are engaged in coordinated interaction (see Section 7). Incremental cost depends on the relevant increment in output as well as on the time period involved, and in the case of large increments and sustained changes in output it may include some costs that would be fixed for smaller increments of output or shorter time periods.

Explicit or implicit evidence that the merging parties intend to raise prices, reduce output or capacity, reduce product quality or variety, withdraw products or delay their introduction, or curtail research and development efforts after the merger, or explicit or implicit evidence that the ability to engage in such conduct motivated the merger, can be highly informative in evaluating the likely effects of a merger. Likewise, the Agencies look for reliable evidence that the merger is likely to result in efficiencies. The Agencies give careful consideration to the views of individuals whose responsibilities, expertise, and experience relating to the issues in question provide particular indicia of reliability. The financial terms of the transaction may also be informative regarding competitive effects. For example, a purchase price in excess of the acquired firm’s stand-alone market value may indicate that the acquiring firm is paying a premium because it expects to be able to reduce competition or to achieve efficiencies.

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3 High margins commonly arise for products that are significantly differentiated. Products involving substantial fixed costs typically will be developed only if suppliers expect there to be enough differentiation to support margins sufficient to cover those fixed costs. High margins can be consistent with incumbent firms earning competitive returns.
2.2.2 Customers

Customers can provide a variety of information to the Agencies, ranging from information about their own purchasing behavior and choices to their views about the effects of the merger itself.

Information from customers about how they would likely respond to a price increase, and the relative attractiveness of different products or suppliers, may be highly relevant, especially when corroborated by other evidence such as historical purchasing patterns and practices. Customers also can provide valuable information about the impact of historical events such as entry by a new supplier.

The conclusions of well-informed and sophisticated customers on the likely impact of the merger itself can also help the Agencies investigate competitive effects, because customers typically feel the consequences of both competitively beneficial and competitively harmful mergers. In evaluating such evidence, the Agencies are mindful that customers may oppose, or favor, a merger for reasons unrelated to the antitrust issues raised by that merger.

When some customers express concerns about the competitive effects of a merger while others view the merger as beneficial or neutral, the Agencies take account of this divergence in using the information provided by customers and consider the likely reasons for such divergence of views. For example, if for regulatory reasons some customers cannot buy imported products, while others can, a merger between domestic suppliers may harm the former customers even if it leaves the more flexible customers unharmed. See Section 3.

When direct customers of the merging firms compete against one another in a downstream market, their interests may not be aligned with the interests of final consumers, especially if the direct customers expect to pass on any anticompetitive price increase. A customer that is protected from adverse competitive effects by a long-term contract, or otherwise relatively immune from the merger’s harmful effects, may even welcome an anticompetitive merger that provides that customer with a competitive advantage over its downstream rivals.

Example 1: As a result of the merger, Customer C will experience a price increase for an input used in producing its final product, raising its costs. Customer C’s rivals use this input more intensively than Customer C, and the same price increase applied to them will raise their costs more than it raises Customer C’s costs. On balance, Customer C may benefit from the merger even though the merger involves a substantial lessening of competition.

2.2.3 Other Industry Participants and Observers

Suppliers, indirect customers, distributors, other industry participants, and industry analysts can also provide information helpful to a merger inquiry. The interests of firms selling products complementary to those offered by the merging firms often are well aligned with those of customers, making their informed views valuable.

Information from firms that are rivals to the merging parties can help illuminate how the market operates. The interests of rival firms often diverge from the interests of customers, since customers normally lose, but rival firms gain, if the merged entity raises its prices. For that reason, the Agencies do not routinely rely on the overall views of rival firms regarding the competitive effects of the
merger. However, rival firms may provide relevant facts, and even their overall views may be instructive, especially in cases where the Agencies are concerned that the merged entity may engage in exclusionary conduct.

*Example 2:* Merging Firms A and B operate in a market in which network effects are significant, implying that any firm’s product is significantly more valuable if it commands a large market share or if it is interconnected with others that in aggregate command such a share. Prior to the merger, they and their rivals voluntarily interconnect with one another. The merger would create an entity with a large enough share that a strategy of ending voluntary interconnection would have a dangerous probability of creating monopoly power in this market. The interests of rivals and of consumers would be broadly aligned in preventing such a merger.

### 3. Targeted Customers and Price Discrimination

When examining possible adverse competitive effects from a merger, the Agencies consider whether those effects vary significantly for different customers purchasing the same or similar products. Such differential impacts are possible when sellers can discriminate, e.g., by profitably raising price to certain targeted customers but not to others. The possibility of price discrimination influences market definition (see Section 4), the measurement of market shares (see Section 5), and the evaluation of competitive effects (see Sections 6 and 7).

When price discrimination is feasible, adverse competitive effects on targeted customers can arise, even if such effects will not arise for other customers. A price increase for targeted customers may be profitable even if a price increase for all customers would not be profitable because too many other customers would substitute away. When discrimination is reasonably likely, the Agencies may evaluate competitive effects separately by type of customer. The Agencies may have access to information unavailable to customers that is relevant to evaluating whether discrimination is reasonably likely.

For price discrimination to be feasible, two conditions typically must be met: differential pricing and limited arbitrage.

First, the suppliers engaging in price discrimination must be able to price differently to targeted customers than to other customers. This may involve identification of individual customers to which different prices are offered or offering different prices to different types of customers based on observable characteristics.

*Example 3:* Suppliers can distinguish large buyers from small buyers. Large buyers are more likely than small buyers to self-supply in response to a significant price increase. The merger may lead to price discrimination against small buyers, harming them, even if large buyers are not harmed. Such discrimination can occur even if there is no discrete gap in size between the classes of large and small buyers.

In other cases, suppliers may be unable to distinguish among different types of customers but can offer multiple products that sort customers based on their purchase decisions.

Second, the targeted customers must not be able to defeat the price increase of concern by arbitrage, e.g., by purchasing indirectly from or through other customers. Arbitrage may be difficult if it would void warranties or make service more difficult or costly for customers. Arbitrage is inherently impossible for many services. Arbitrage between customers at different geographic locations may be
impractical due to transportation costs. Arbitrage on a modest scale may be possible but sufficiently costly or limited that it would not deter or defeat a discriminatory pricing strategy.

4. Market Definition

When the Agencies identify a potential competitive concern with a horizontal merger, market definition plays two roles. First, market definition helps specify the line of commerce and section of the country in which the competitive concern arises. In any merger enforcement action, the Agencies will normally identify one or more relevant markets in which the merger may substantially lessen competition. Second, market definition allows the Agencies to identify market participants and measure market shares and market concentration. See Section 5. The measurement of market shares and market concentration is not an end in itself, but is useful to the extent it illuminates the merger’s likely competitive effects.

The Agencies’ analysis need not start with market definition. Some of the analytical tools used by the Agencies to assess competitive effects do not rely on market definition, although evaluation of competitive alternatives available to customers is always necessary at some point in the analysis.

Evidence of competitive effects can inform market definition, just as market definition can be informative regarding competitive effects. For example, evidence that a reduction in the number of significant rivals offering a group of products causes prices for those products to rise significantly can itself establish that those products form a relevant market. Such evidence also may more directly predict the competitive effects of a merger, reducing the role of inferences from market definition and market shares.

Where analysis suggests alternative and reasonably plausible candidate markets, and where the resulting market shares lead to very different inferences regarding competitive effects, it is particularly valuable to examine more direct forms of evidence concerning those effects.

Market definition focuses solely on demand substitution factors, i.e., on customers’ ability and willingness to substitute away from one product to another in response to a price increase or a corresponding non-price change such as a reduction in product quality or service. The responsive actions of suppliers are also important in competitive analysis. They are considered in these Guidelines in the sections addressing the identification of market participants, the measurement of market shares, the analysis of competitive effects, and entry.

Customers often confront a range of possible substitutes for the products of the merging firms. Some substitutes may be closer, and others more distant, either geographically or in terms of product attributes and perceptions. Additionally, customers may assess the proximity of different products differently. When products or suppliers in different geographic areas are substitutes for one another to varying degrees, defining a market to include some substitutes and exclude others is inevitably a simplification that cannot capture the full variation in the extent to which different products compete against each other. The principles of market definition outlined below seek to make this inevitable simplification as useful and informative as is practically possible. Relevant markets need not have precise metes and bounds.
Defining a market broadly to include relatively distant product or geographic substitutes can lead to misleading market shares. This is because the competitive significance of distant substitutes is unlikely to be commensurate with their shares in a broad market. Although excluding more distant substitutes from the market inevitably understates their competitive significance to some degree, doing so often provides a more accurate indicator of the competitive effects of the merger than would the alternative of including them and overstating their competitive significance as proportional to their shares in an expanded market.

*Example 4:* Firms A and B, sellers of two leading brands of motorcycles, propose to merge. If Brand A motorcycle prices were to rise, some buyers would substitute to Brand B, and some others would substitute to cars. However, motorcycle buyers see Brand B motorcycles as much more similar to Brand A motorcycles than are cars. Far more cars are sold than motorcycles. Evaluating shares in a market that includes cars would greatly underestimate the competitive significance of Brand B motorcycles in constraining Brand A’s prices and greatly overestimate the significance of cars.

Market shares of different products in narrowly defined markets are more likely to capture the relative competitive significance of these products, and often more accurately reflect competition between close substitutes. As a result, properly defined antitrust markets often exclude some substitutes to which some customers might turn in the face of a price increase even if such substitutes provide alternatives for those customers. However, a group of products is too narrow to constitute a relevant market if competition from products outside that group is so ample that even the complete elimination of competition within the group would not significantly harm either direct customers or downstream consumers. The hypothetical monopolist test (see Section 4.1.1) is designed to ensure that candidate markets are not overly narrow in this respect.

The Agencies implement these principles of market definition flexibly when evaluating different possible candidate markets. Relevant antitrust markets defined according to the hypothetical monopolist test are not always intuitive and may not align with how industry members use the term “market.”

Section 4.1 describes the principles that apply to product market definition, and gives guidance on how the Agencies most often apply those principles. Section 4.2 describes how the same principles apply to geographic market definition. Although discussed separately for simplicity of exposition, the principles described in Sections 4.1 and 4.2 are combined to define a relevant market, which has both a product and a geographic dimension. In particular, the hypothetical monopolist test is applied to a group of products together with a geographic region to determine a relevant market.

### 4.1 Product Market Definition

When a product sold by one merging firm (Product A) competes against one or more products sold by the other merging firm, the Agencies define a relevant product market around Product A to evaluate the importance of that competition. Such a relevant product market consists of a group of substitute products including Product A. Multiple relevant product markets may thus be identified.

#### 4.1.1 The Hypothetical Monopolist Test

The Agencies employ the hypothetical monopolist test to evaluate whether groups of products in candidate markets are sufficiently broad to constitute relevant antitrust markets. The Agencies use the
The hypothetical monopolist test requires that a product market contain enough substitute products so that it could be subject to post-merger exercise of market power significantly exceeding that existing absent the merger. Specifically, the test requires that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future seller of those products (“hypothetical monopolist”) likely would impose at least a small but significant and non-transitory increase in price (“SSNIP”) on at least one product in the market, including at least one product sold by one of the merging firms. For the purpose of analyzing this issue, the terms of sale of products outside the candidate market are held constant. The SSNIP is employed solely as a methodological tool for performing the hypothetical monopolist test; it is not a tolerance level for price increases resulting from a merger.

Groups of products may satisfy the hypothetical monopolist test without including the full range of substitutes from which customers choose. The hypothetical monopolist test may identify a group of products as a relevant market even if customers would substitute significantly to products outside that group in response to a price increase.

Example 5: Products A and B are being tested as a candidate market. Each sells for $100, has an incremental cost of $60, and sells 1200 units. For every dollar increase in the price of Product A, for any given price of Product B, Product A loses twenty units of sales to products outside the candidate market and ten units of sales to Product B, and likewise for Product B. Under these conditions, economic analysis shows that a hypothetical profit-maximizing monopolist controlling Products A and B would raise both of their prices by ten percent, to $110. Therefore, Products A and B satisfy the hypothetical monopolist test using a five percent SSNIP, and indeed for any SSNIP size up to ten percent. This is true even though two-thirds of the sales lost by one product when it raises its price are diverted to products outside the relevant market.

When applying the hypothetical monopolist test to define a market around a product offered by one of the merging firms, if the market includes a second product, the Agencies will normally also include a third product if that third product is a closer substitute for the first product than is the second product. The third product is a closer substitute if, in response to a SSNIP on the first product, greater revenues are diverted to the third product than to the second product.

Example 6: In Example 5, suppose that half of the unit sales lost by Product A when it raises its price are diverted to Product C, which also has a price of $100, while one-third are diverted to Product B. Product C is a closer substitute for Product A than is Product B. Thus Product C will normally be included in the relevant market, even though Products A and B together satisfy the hypothetical monopolist test.

The hypothetical monopolist test ensures that markets are not defined too narrowly, but it does not lead to a single relevant market. The Agencies may evaluate a merger in any relevant market

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4 If the pricing incentives of the firms supplying the products in the candidate market differ substantially from those of the hypothetical monopolist, for reasons other than the latter’s control over a larger group of substitutes, the Agencies may instead employ the concept of a hypothetical profit-maximizing cartel comprised of the firms (with all their products) that sell the products in the candidate market. This approach is most likely to be appropriate if the merging firms sell products outside the candidate market that significantly affect their pricing incentives for products in the candidate market. This could occur, for example, if the candidate market is one for durable equipment and the firms selling that equipment derive substantial net revenues from selling spare parts and service for that equipment.
satisfying the test, guided by the overarching principle that the purpose of defining the market and measuring market shares is to illuminate the evaluation of competitive effects. Because the relative competitive significance of more distant substitutes is apt to be overstated by their share of sales, when the Agencies rely on market shares and concentration, they usually do so in the smallest relevant market satisfying the hypothetical monopolist test.

Example 7: In Example 4, including cars in the market will lead to misleadingly small market shares for motorcycle producers. Unless motorcycles fail the hypothetical monopolist test, the Agencies would not include cars in the market in analyzing this motorcycle merger.

4.1.2 Benchmark Prices and SSNIP Size

The Agencies apply the SSNIP starting from prices that would likely prevail absent the merger. If prices are not likely to change absent the merger, these benchmark prices can reasonably be taken to be the prices prevailing prior to the merger. If prices are likely to change absent the merger, e.g., because of innovation or entry, the Agencies may use anticipated future prices as the benchmark for the test. If prices might fall absent the merger due to the breakdown of pre-merger coordination, the Agencies may use those lower prices as the benchmark for the test. In some cases, the techniques employed by the Agencies to implement the hypothetical monopolist test focus on the difference in incentives between pre-merger firms and the hypothetical monopolist and do not require specifying the benchmark prices.

The SSNIP is intended to represent a “small but significant” increase in the prices charged by firms in the candidate market for the value they contribute to the products or services used by customers. This properly directs attention to the effects of price changes commensurate with those that might result from a significant lessening of competition caused by the merger. This methodology is used because normally it is possible to quantify “small but significant” adverse price effects on customers and analyze their likely reactions, not because price effects are more important than non-price effects.

The Agencies most often use a SSNIP of five percent of the price paid by customers for the products or services to which the merging firms contribute value. However, what constitutes a “small but significant” increase in price, commensurate with a significant loss of competition caused by the merger, depends upon the nature of the industry and the merging firms’ positions in it, and the Agencies may accordingly use a price increase that is larger or smaller than five percent. Where explicit or implicit prices for the firms’ specific contribution to value can be identified with reasonable clarity, the Agencies may base the SSNIP on those prices.

Example 8: In a merger between two oil pipelines, the SSNIP would be based on the price charged for transporting the oil, not on the price of the oil itself. If pipelines buy the oil at one end and sell it at the other, the price charged for transporting the oil is implicit, equal to the difference between the price paid for oil at the input end and the price charged for oil at the output end. The relevant product sold by the pipelines is better described as “pipeline transportation of oil from point A to point B” than as “oil at point B.”

Market definition for the evaluation of non-merger antitrust concerns such as monopolization or facilitating practices will differ in this respect if the effects resulting from the conduct of concern are already occurring at the time of evaluation.
Example 9: In a merger between two firms that install computers purchased from third parties, the SSNIP would be based on their fees, not on the price of installed computers. If these firms purchase the computers and charge their customers one package price, the implicit installation fee is equal to the package charge to customers less the price of the computers.

Example 10: In Example 9, suppose that the prices paid by the merging firms to purchase computers are opaque, but account for at least ninety-five percent of the prices they charge for installed computers, with profits or implicit fees making up five percent of those prices at most. A five percent SSNIP on the total price paid by customers would at least double those fees or profits. Even if that would be unprofitable for a hypothetical monopolist, a significant increase in fees might well be profitable. If the SSNIP is based on the total price paid by customers, a lower percentage will be used.

4.1.3 Implementing the Hypothetical Monopolist Test

The hypothetical monopolist’s incentive to raise prices depends both on the extent to which customers would likely substitute away from the products in the candidate market in response to such a price increase and on the profit margins earned on those products. The profit margin on incremental units is the difference between price and incremental cost on those units. The Agencies often estimate incremental costs, for example using merging parties’ documents or data the merging parties use to make business decisions. Incremental cost is measured over the change in output that would be caused by the price increase under consideration.

In considering customers’ likely responses to higher prices, the Agencies take into account any reasonably available and reliable evidence, including, but not limited to:

- how customers have shifted purchases in the past in response to relative changes in price or other terms and conditions;
- information from buyers, including surveys, concerning how they would respond to price changes;
- the conduct of industry participants, notably:
  - sellers’ business decisions or business documents indicating sellers’ informed beliefs concerning how customers would substitute among products in response to relative changes in price;
  - industry participants’ behavior in tracking and responding to price changes by some or all rivals;
- objective information about product characteristics and the costs and delays of switching products, especially switching from products in the candidate market to products outside the candidate market;
- the percentage of sales lost by one product in the candidate market, when its price alone rises, that is recaptured by other products in the candidate market, with a higher recapture percentage making a price increase more profitable for the hypothetical monopolist;
- evidence from other industry participants, such as sellers of complementary products;
legal or regulatory requirements; and

- the influence of downstream competition faced by customers in their output markets.

When the necessary data are available, the Agencies also may consider a “critical loss analysis” to assess the extent to which it corroborates inferences drawn from the evidence noted above. Critical loss analysis asks whether imposing at least a SSNIP on one or more products in a candidate market would raise or lower the hypothetical monopolist’s profits. While this “breakeven” analysis differs from the profit-maximizing analysis called for by the hypothetical monopolist test in Section 4.1.1, merging parties sometimes present this type of analysis to the Agencies. A price increase raises profits on sales made at the higher price, but this will be offset to the extent customers substitute away from products in the candidate market. Critical loss analysis compares the magnitude of these two offsetting effects resulting from the price increase. The “critical loss” is defined as the number of lost unit sales that would leave profits unchanged. The “predicted loss” is defined as the number of unit sales that the hypothetical monopolist is predicted to lose due to the price increase. The price increase raises the hypothetical monopolist’s profits if the predicted loss is less than the critical loss.

The Agencies consider all of the evidence of customer substitution noted above in assessing the predicted loss. The Agencies require that estimates of the predicted loss be consistent with that evidence, including the pre-merger margins of products in the candidate market used to calculate the critical loss. Unless the firms are engaging in coordinated interaction (see Section 7), high pre-merger margins normally indicate that each firm’s product individually faces demand that is not highly sensitive to price. Higher pre-merger margins thus indicate a smaller predicted loss as well as a smaller critical loss. The higher the pre-merger margin, the smaller the recapture percentage necessary for the candidate market to satisfy the hypothetical monopolist test.

Even when the evidence necessary to perform the hypothetical monopolist test quantitatively is not available, the conceptual framework of the test provides a useful methodological tool for gathering and analyzing evidence pertinent to customer substitution and to market definition. The Agencies follow the hypothetical monopolist test to the extent possible given the available evidence, bearing in mind that the ultimate goal of market definition is to help determine whether the merger may substantially lessen competition.

4.1.4 Product Market Definition with Targeted Customers

If a hypothetical monopolist could profitably target a subset of customers for price increases, the Agencies may identify relevant markets defined around those targeted customers, to whom a hypothetical monopolist would profitably and separately impose at least a SSNIP. Markets to serve targeted customers are also known as price discrimination markets. In practice, the Agencies identify price discrimination markets only where they believe there is a realistic prospect of an adverse competitive effect on a group of targeted customers.

Example 11: Glass containers have many uses. In response to a price increase for glass containers, some users would substitute substantially to plastic or metal containers, but baby food manufacturers would not. If a high price increase raises profits on sales made at the higher price, but this will be offset to the extent customers substitute away from products in the candidate market. Critical loss analysis compares the magnitude of these two offsetting effects resulting from the price increase. The “critical loss” is defined as the number of lost unit sales that would leave profits unchanged. The “predicted loss” is defined as the number of unit sales that the hypothetical monopolist is predicted to lose due to the price increase. The price increase raises the hypothetical monopolist’s profits if the predicted loss is less than the critical loss.

The Agencies consider all of the evidence of customer substitution noted above in assessing the predicted loss. The Agencies require that estimates of the predicted loss be consistent with that evidence, including the pre-merger margins of products in the candidate market used to calculate the critical loss. Unless the firms are engaging in coordinated interaction (see Section 7), high pre-merger margins normally indicate that each firm’s product individually faces demand that is not highly sensitive to price. Higher pre-merger margins thus indicate a smaller predicted loss as well as a smaller critical loss. The higher the pre-merger margin, the smaller the recapture percentage necessary for the candidate market to satisfy the hypothetical monopolist test.

Even when the evidence necessary to perform the hypothetical monopolist test quantitatively is not available, the conceptual framework of the test provides a useful methodological tool for gathering and analyzing evidence pertinent to customer substitution and to market definition. The Agencies follow the hypothetical monopolist test to the extent possible given the available evidence, bearing in mind that the ultimate goal of market definition is to help determine whether the merger may substantially lessen competition.
The Agencies also often consider markets for targeted customers when prices are individually negotiated and suppliers have information about customers that would allow a hypothetical monopolist to identify customers that are likely to pay a higher price for the relevant product. If prices are negotiated individually with customers, the hypothetical monopolist test may suggest relevant markets that are as narrow as individual customers (see also Section 6.2 on bargaining and auctions). Nonetheless, the Agencies often define markets for groups of targeted customers, i.e., by type of customer, rather than by individual customer. By so doing, the Agencies are able to rely on aggregated market shares that can be more helpful in predicting the competitive effects of the merger.

4.2 Geographic Market Definition

The arena of competition affected by the merger may be geographically bounded if geography limits some customers’ willingness or ability to substitute to some products, or some suppliers’ willingness or ability to serve some customers. Both supplier and customer locations can affect this. The Agencies apply the principles of market definition described here and in Section 4.1 to define a relevant market with a geographic dimension as well as a product dimension.

The scope of geographic markets often depends on transportation costs. Other factors such as language, regulation, tariff and non-tariff trade barriers, custom and familiarity, reputation, and service availability may impede long-distance or international transactions. The competitive significance of foreign firms may be assessed at various exchange rates, especially if exchange rates have fluctuated in the recent past.

In the absence of price discrimination based on customer location, the Agencies normally define geographic markets based on the locations of suppliers, as explained in subsection 4.2.1. In other cases, notably if price discrimination based on customer location is feasible as is often the case when delivered pricing is commonly used in the industry, the Agencies may define geographic markets based on the locations of customers, as explained in subsection 4.2.2.

4.2.1 Geographic Markets Based on the Locations of Suppliers

Geographic markets based on the locations of suppliers encompass the region from which sales are made. Geographic markets of this type often apply when customers receive goods or services at suppliers’ locations. Competitors in the market are firms with relevant production, sales, or service facilities in that region. Some customers who buy from these firms may be located outside the boundaries of the geographic market.

The hypothetical monopolist test requires that a hypothetical profit-maximizing firm that was the only present or future producer of the relevant product(s) located in the region would impose at least a SSNIP from at least one location, including at least one location of one of the merging firms. In this exercise the terms of sale for all products produced elsewhere are held constant. A single firm may operate in a number of different geographic markets, even for a single product.
Example 12: The merging parties both have manufacturing plants in City X. The relevant product is expensive to transport and suppliers price their products for pickup at their locations. Rival plants are some distance away in City Y. A hypothetical monopolist controlling all plants in City X could profitably impose a SSNIP at these plants. Competition from more distant plants would not defeat the price increase because supplies coming from more distant plants require expensive transportation. The relevant geographic market is defined around the plants in City X.

When the geographic market is defined based on supplier locations, sales made by suppliers located in the geographic market are counted, regardless of the location of the customer making the purchase.

In considering likely reactions of customers to price increases for the relevant product(s) imposed in a candidate geographic market, the Agencies consider any reasonably available and reliable evidence, including:

- how customers have shifted purchases in the past between different geographic locations in response to relative changes in price or other terms and conditions;
- the cost and difficulty of transporting the product (or the cost and difficulty of a customer traveling to a seller’s location), in relation to its price;
- whether suppliers need a presence near customers to provide service or support;
- evidence on whether sellers base business decisions on the prospect of customers switching between geographic locations in response to relative changes in price or other competitive variables;
- the costs and delays of switching from suppliers in the candidate geographic market to suppliers outside the candidate geographic market; and
- the influence of downstream competition faced by customers in their output markets.

4.2.2 Geographic Markets Based on the Locations of Customers

When the hypothetical monopolist could discriminate based on customer location, the Agencies may define geographic markets based on the locations of targeted customers. Geographic markets of this type often apply when suppliers deliver their products or services to customers’ locations. Geographic markets of this type encompass the region into which sales are made. Competitors in the market are firms that sell to customers in the specified region. Some suppliers that sell into the relevant market may be located outside the boundaries of the geographic market.

The hypothetical monopolist test requires that a hypothetical profit-maximizing firm that was the only present or future seller of the relevant product(s) to customers in the region would impose at least a SSNIP on some customers in that region. A region forms a relevant geographic market if this price increase would not be defeated by substitution away from the relevant product or by arbitrage.

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7 For customers operating in multiple locations, only those customer locations within the targeted zone are included in the market.
e.g., customers in the region travelling outside it to purchase the relevant product. In this exercise, the terms of sale for products sold to all customers outside the region are held constant.

*Example 13:* Customers require local sales and support. Suppliers have sales and service operations in many geographic areas and can discriminate based on customer location. The geographic market can be defined around the locations of customers.

*Example 14:* Each merging firm has a single manufacturing plant and delivers the relevant product to customers in City X and in City Y. The relevant product is expensive to transport. The merging firms’ plants are by far the closest to City X, but no closer to City Y than are numerous rival plants. This fact pattern suggests that customers in City X may be harmed by the merger even if customers in City Y are not. For that reason, the Agencies consider a relevant geographic market defined around customers in City X. Such a market could be defined even if the region around the merging firms’ plants would not be a relevant geographic market defined based on the location of sellers because a hypothetical monopolist controlling all plants in that region would find a SSNIP imposed on all of its customers unprofitable due to the loss of sales to customers in City Y.

When the geographic market is defined based on customer locations, sales made to those customers are counted, regardless of the location of the supplier making those sales.

*Example 15:* Customers in the United States must use products approved by U.S. regulators. Foreign customers use products not approved by U.S. regulators. The relevant product market consists of products approved by U.S. regulators. The geographic market is defined around U.S. customers. Any sales made to U.S. customers by foreign suppliers are included in the market, and those foreign suppliers are participants in the U.S. market even though located outside it.

5. **Market Participants, Market Shares, and Market Concentration**

The Agencies normally consider measures of market shares and market concentration as part of their evaluation of competitive effects. The Agencies evaluate market shares and concentration in conjunction with other reasonably available and reliable evidence for the ultimate purpose of determining whether a merger may substantially lessen competition.

Market shares can directly influence firms’ competitive incentives. For example, if a price reduction to gain new customers would also apply to a firm’s existing customers, a firm with a large market share may be more reluctant to implement a price reduction than one with a small share. Likewise, a firm with a large market share may not feel pressure to reduce price even if a smaller rival does. Market shares also can reflect firms’ capabilities. For example, a firm with a large market share may be able to expand output rapidly by a larger absolute amount than can a small firm. Similarly, a large market share tends to indicate low costs, an attractive product, or both.

5.1 **Market Participants**

All firms that currently earn revenues in the relevant market are considered market participants. Vertically integrated firms are also included to the extent that their inclusion accurately reflects their competitive significance. Firms not currently earning revenues in the relevant market, but that have committed to entering the market in the near future, are also considered market participants.

Firms that are not current producers in a relevant market, but that would very likely provide rapid supply responses with direct competitive impact in the event of a SSNIP, without incurring
significant sunk costs, are also considered market participants. These firms are termed “rapid entrants.” Sunk costs are entry or exit costs that cannot be recovered outside the relevant market. Entry that would take place more slowly in response to adverse competitive effects, or that requires firms to incur significant sunk costs, is considered in Section 9.

Firms that produce the relevant product but do not sell it in the relevant geographic market may be rapid entrants. Other things equal, such firms are most likely to be rapid entrants if they are close to the geographic market.

*Example 16:* Farm A grows tomatoes halfway between Cities X and Y. Currently, it ships its tomatoes to City X because prices there are two percent higher. Previously it has varied the destination of its shipments in response to small price variations. Farm A would likely be a rapid entrant participant in a market for tomatoes in City Y.

*Example 17:* Firm B has bid multiple times to supply milk to School District S, and actually supplies milk to schools in some adjacent areas. It has never won a bid in School District S, but is well qualified to serve that district and has often nearly won. Firm B would be counted as a rapid entrant in a market for school milk in School District S.

More generally, if the relevant market is defined around targeted customers, firms that produce relevant products but do not sell them to those customers may be rapid entrants if they can easily and rapidly begin selling to the targeted customers.

Firms that clearly possess the necessary assets to supply into the relevant market rapidly may also be rapid entrants. In markets for relatively homogeneous goods where a supplier’s ability to compete depends predominantly on its costs and its capacity, and not on other factors such as experience or reputation in the relevant market, a supplier with efficient idle capacity, or readily available “swing” capacity currently used in adjacent markets that can easily and profitably be shifted to serve the relevant market, may be a rapid entrant. However, idle capacity may be inefficient, and capacity used in adjacent markets may not be available, so a firm’s possession of idle or swing capacity alone does not make that firm a rapid entrant.

5.2 Market Shares

The Agencies normally calculate market shares for all firms that currently produce products in the relevant market, subject to the availability of data. The Agencies also calculate market shares for other market participants if this can be done to reliably reflect their competitive significance.

Market concentration and market share data are normally based on historical evidence. However, recent or ongoing changes in market conditions may indicate that the current market share of a particular firm either understates or overstates the firm’s future competitive significance. The Agencies consider reasonably predictable effects of recent or ongoing changes in market conditions when calculating and interpreting market share data. For example, if a new technology that is important to long-term competitive viability is available to other firms in the market, but is not available to a particular firm, the Agencies may conclude that that firm’s historical market share

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8 If this type of supply side substitution is nearly universal among the firms selling one or more of a group of products, the Agencies may use an aggregate description of markets for those products as a matter of convenience.
overstates its future competitive significance. The Agencies may project historical market shares into the foreseeable future when this can be done reliably.

The Agencies measure market shares based on the best available indicator of firms’ future competitive significance in the relevant market. This may depend upon the type of competitive effect being considered, and on the availability of data. Typically, annual data are used, but where individual transactions are large and infrequent so annual data may be unrepresentative, the Agencies may measure market shares over a longer period of time.

In most contexts, the Agencies measure each firm’s market share based on its actual or projected revenues in the relevant market. Revenues in the relevant market tend to be the best measure of attractiveness to customers, since they reflect the real-world ability of firms to surmount all of the obstacles necessary to offer products on terms and conditions that are attractive to customers. In cases where one unit of a low-priced product can substitute for one unit of a higher-priced product, unit sales may measure competitive significance better than revenues. For example, a new, much less expensive product may have great competitive significance if it substantially erodes the revenues earned by older, higher-priced products, even if it earns relatively few revenues. In cases where customers sign long-term contracts, face switching costs, or tend to re-evaluate their suppliers only occasionally, revenues earned from recently acquired customers may better reflect the competitive significance of suppliers than do total revenues.

In markets for homogeneous products, a firm’s competitive significance may derive principally from its ability and incentive to rapidly expand production in the relevant market in response to a price increase or output reduction by others in that market. As a result, a firm’s competitive significance may depend upon its level of readily available capacity to serve the relevant market if that capacity is efficient enough to make such expansion profitable. In such markets, capacities or reserves may better reflect the future competitive significance of suppliers than revenues, and the Agencies may calculate market shares using those measures. Market participants that are not current producers may then be assigned positive market shares, but only if a measure of their competitive significance properly comparable to that of current producers is available. When market shares are measured based on firms’ readily available capacities, the Agencies do not include capacity that is committed or so profitably employed outside the relevant market, or so high-cost, that it would not likely be used to respond to a SSNIP in the relevant market.

Example 18: The geographic market is defined around customers in the United States. Firm X produces the relevant product outside the United States, and most of its sales are made to customers outside the United States. In most contexts, Firm X’s market share will be based on its sales to U.S. customers, not its total sales or total capacity. However, if the relevant product is homogeneous, and if Firm X would significantly expand sales to U.S. customers rapidly and without incurring significant sunk costs in response to a SSNIP, the Agencies may base Firm X’s market share on its readily available capacity to serve U.S. customers.

When the Agencies define markets serving targeted customers, these same principles are used to measure market shares, as they apply to those customers. In most contexts, each firm’s market share is based on its actual or projected revenues from the targeted customers. However, the Agencies may instead measure market shares based on revenues from a broader group of customers if doing so would more accurately reflect the competitive significance of different suppliers in the relevant market. Revenues earned from a broader group of customers may also be used when better data are thereby available.
5.3 Market Concentration

Market concentration is often one useful indicator of likely competitive effects of a merger. In evaluating market concentration, the Agencies consider both the post-merger level of market concentration and the change in concentration resulting from a merger. Market shares may not fully reflect the competitive significance of firms in the market or the impact of a merger. They are used in conjunction with other evidence of competitive effects. See Sections 6 and 7.

In analyzing mergers between an incumbent and a recent or potential entrant, to the extent the Agencies use the change in concentration to evaluate competitive effects, they will do so using projected market shares. A merger between an incumbent and a potential entrant can raise significant competitive concerns. The lessening of competition resulting from such a merger is more likely to be substantial, the larger is the market share of the incumbent, the greater is the competitive significance of the potential entrant, and the greater is the competitive threat posed by this potential entrant relative to others.

The Agencies give more weight to market concentration when market shares have been stable over time, especially in the face of historical changes in relative prices or costs. If a firm has retained its market share even after its price has increased relative to those of its rivals, that firm already faces limited competitive constraints, making it less likely that its remaining rivals will replace the competition lost if one of that firm’s important rivals is eliminated due to a merger. By contrast, even a highly concentrated market can be very competitive if market shares fluctuate substantially over short periods of time in response to changes in competitive offerings. However, if competition by one of the merging firms has significantly contributed to these fluctuations, perhaps because it has acted as a maverick, the Agencies will consider whether the merger will enhance market power by combining that firm with one of its significant rivals.

The Agencies may measure market concentration using the number of significant competitors in the market. This measure is most useful when there is a gap in market share between significant competitors and smaller rivals or when it is difficult to measure revenues in the relevant market. The Agencies also may consider the combined market share of the merging firms as an indicator of the extent to which others in the market may not be able readily to replace competition between the merging firms that is lost through the merger.

The Agencies often calculate the Herfindahl-Hirschman Index (“HHI”) of market concentration. The HHI is calculated by summing the squares of the individual firms’ market shares, and thus gives proportionately greater weight to the larger market shares. When using the HHI, the Agencies

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9 For example, a market consisting of four firms with market shares of thirty percent, thirty percent, twenty percent, and twenty percent has an HHI of 2600 (30^2 + 30^2 + 20^2 + 20^2 = 2600). The HHI ranges from 10,000 (in the case of a pure monopoly) to a number approaching zero (in the case of an atomistic market). Although it is desirable to include all firms in the calculation, lack of information about firms with small shares is not critical because such firms do not affect the HHI significantly.
consider both the post-merger level of the HHI and the increase in the HHI resulting from the merger. The increase in the HHI is equal to twice the product of the market shares of the merging firms.\textsuperscript{10}

Based on their experience, the Agencies generally classify markets into three types:

- **Unconcentrated Markets**: HHI below 1500
- **Moderately Concentrated Markets**: HHI between 1500 and 2500
- **Highly Concentrated Markets**: HHI above 2500

The Agencies employ the following general standards for the relevant markets they have defined:

- **Small Change in Concentration**: Mergers involving an increase in the HHI of less than 100 points are unlikely to have adverse competitive effects and ordinarily require no further analysis.
- **Unconcentrated Markets**: Mergers resulting in unconcentrated markets are unlikely to have adverse competitive effects and ordinarily require no further analysis.
- **Moderately Concentrated Markets**: Mergers resulting in moderately concentrated markets that involve an increase in the HHI of more than 100 points potentially raise significant competitive concerns and often warrant scrutiny.
- **Highly Concentrated Markets**: Mergers resulting in highly concentrated markets that involve an increase in the HHI of between 100 points and 200 points potentially raise significant competitive concerns and often warrant scrutiny. Mergers resulting in highly concentrated markets that involve an increase in the HHI of more than 200 points will be presumed to be likely to enhance market power. The presumption may be rebutted by persuasive evidence showing that the merger is unlikely to enhance market power.

The purpose of these thresholds is not to provide a rigid screen to separate competitively benign mergers from anticompetitive ones, although high levels of concentration do raise concerns. Rather, they provide one way to identify some mergers unlikely to raise competitive concerns and some others for which it is particularly important to examine whether other competitive factors confirm, reinforce, or counteract the potentially harmful effects of increased concentration. The higher the post-merger HHI and the increase in the HHI, the greater are the Agencies’ potential competitive concerns and the greater is the likelihood that the Agencies will request additional information to conduct their analysis.

\textsuperscript{10} For example, the merger of firms with shares of five percent and ten percent of the market would increase the HHI by 100 ($5 \times 10 \times 2 = 100$).
6. Unilateral Effects

The elimination of competition between two firms that results from their merger may alone constitute a substantial lessening of competition. Such unilateral effects are most apparent in a merger to a monopoly in a relevant market, but are by no means limited to that case. Whether cognizable efficiencies resulting from the merger are likely to reduce or reverse adverse unilateral effects is addressed in Section 10.

Several common types of unilateral effects are discussed in this section. Section 6.1 discusses unilateral price effects in markets with differentiated products. Section 6.2 discusses unilateral effects in markets where sellers negotiate with buyers or prices are determined through auctions. Section 6.3 discusses unilateral effects relating to reductions in output or capacity in markets for relatively homogeneous products. Section 6.4 discusses unilateral effects arising from diminished innovation or reduced product variety. These effects do not exhaust the types of possible unilateral effects; for example, exclusionary unilateral effects also can arise.

A merger may result in different unilateral effects along different dimensions of competition. For example, a merger may increase prices in the short term but not raise longer-term concerns about innovation, either because rivals will provide sufficient innovation competition or because the merger will generate cognizable research and development efficiencies. See Section 10.

6.1 Pricing of Differentiated Products

In differentiated product industries, some products can be very close substitutes and compete strongly with each other, while other products are more distant substitutes and compete less strongly. For example, one high-end product may compete much more directly with another high-end product than with any low-end product.

A merger between firms selling differentiated products may diminish competition by enabling the merged firm to profit by unilaterally raising the price of one or both products above the pre-merger level. Some of the sales lost due to the price rise will merely be diverted to the product of the merger partner and, depending on relative margins, capturing such sales loss through merger may make the price increase profitable even though it would not have been profitable prior to the merger.

The extent of direct competition between the products sold by the merging parties is central to the evaluation of unilateral price effects. Unilateral price effects are greater, the more the buyers of products sold by one merging firm consider products sold by the other merging firm to be their next choice. The Agencies consider any reasonably available and reliable information to evaluate the extent of direct competition between the products sold by the merging firms. This includes documentary and testimonial evidence, win/loss reports and evidence from discount approval processes, customer switching patterns, and customer surveys. The types of evidence relied on often overlap substantially with the types of evidence of customer substitution relevant to the hypothetical monopolist test. See Section 4.1.1.

Substantial unilateral price elevation post-merger for a product formerly sold by one of the merging firms normally requires that a significant fraction of the customers purchasing that product view
products formerly sold by the other merging firm as their next-best choice. However, unless pre-merger margins between price and incremental cost are low, that significant fraction need not approach a majority. For this purpose, incremental cost is measured over the change in output that would be caused by the price change considered. A merger may produce significant unilateral effects for a given product even though many more sales are diverted to products sold by non-merging firms than to products previously sold by the merger partner.

Example 19: In Example 5, the merged entity controlling Products A and B would raise prices ten percent, given the product offerings and prices of other firms. In that example, one-third of the sales lost by Product A when its price alone is raised are diverted to Product B. Further analysis is required to account for repositioning, entry, and efficiencies.

In some cases, the Agencies may seek to quantify the extent of direct competition between a product sold by one merging firm and a second product sold by the other merging firm by estimating the diversion ratio from the first product to the second product. The diversion ratio is the fraction of unit sales lost by the first product due to an increase in its price that would be diverted to the second product. Diversion ratios between products sold by one merging firm and products sold by the other merging firm can be very informative for assessing unilateral price effects, with higher diversion ratios indicating a greater likelihood of such effects. Diversion ratios between products sold by merging firms and those sold by non-merging firms have at most secondary predictive value.

Adverse unilateral price effects can arise when the merger gives the merged entity an incentive to raise the price of a product previously sold by one merging firm and thereby divert sales to products previously sold by the other merging firm, boosting the profits on the latter products. Taking as given other prices and product offerings, that boost to profits is equal to the value to the merged firm of the sales diverted to those products. The value of sales diverted to a product is equal to the number of units diverted to that product multiplied by the margin between price and incremental cost on that product. In some cases, where sufficient information is available, the Agencies assess the value of diverted sales, which can serve as an indicator of the upward pricing pressure on the first product resulting from the merger. Diagnosing unilateral price effects based on the value of diverted sales need not rely on market definition or the calculation of market shares and concentration. The Agencies rely much more on the value of diverted sales than on the level of the HHI for diagnosing unilateral price effects in markets with differentiated products. If the value of diverted sales is proportionately small, significant unilateral price effects are unlikely.11

Where sufficient data are available, the Agencies may construct economic models designed to quantify the unilateral price effects resulting from the merger. These models often include independent price responses by non-merging firms. They also can incorporate merger-specific efficiencies. These merger simulation methods need not rely on market definition. The Agencies do not treat merger simulation evidence as conclusive in itself, and they place more weight on whether their merger simulations consistently predict substantial price increases than on the precise prediction of any single simulation.

11 For this purpose, the value of diverted sales is measured in proportion to the lost revenues attributable to the reduction in unit sales resulting from the price increase. Those lost revenues equal the reduction in the number of units sold of that product multiplied by that product’s price.
A merger is unlikely to generate substantial unilateral price increases if non-merging parties offer very close substitutes for the products offered by the merging firms. In some cases, non-merging firms may be able to reposition their products to offer close substitutes for the products offered by the merging firms. Repositioning is a supply-side response that is evaluated much like entry, with consideration given to timeliness, likelihood, and sufficiency. See Section 9. The Agencies consider whether repositioning would be sufficient to deter or counteract what otherwise would be significant anticompetitive unilateral effects from a differentiated products merger.

6.2 Bargaining and Auctions

In many industries, especially those involving intermediate goods and services, buyers and sellers negotiate to determine prices and other terms of trade. In that process, buyers commonly negotiate with more than one seller, and may play sellers off against one another. Some highly structured forms of such competition are known as auctions. Negotiations often combine aspects of an auction with aspects of one-on-one negotiation, although pure auctions are sometimes used in government procurement and elsewhere.

A merger between two competing sellers prevents buyers from playing those sellers off against each other in negotiations. This alone can significantly enhance the ability and incentive of the merged entity to obtain a result more favorable to it, and less favorable to the buyer, than the merging firms would have offered separately absent the merger. The Agencies analyze unilateral effects of this type using similar approaches to those described in Section 6.1.

Anticompetitive unilateral effects in these settings are likely in proportion to the frequency or probability with which, prior to the merger, one of the merging sellers had been the runner-up when the other won the business. These effects also are likely to be greater, the greater advantage the runner-up merging firm has over other suppliers in meeting customers’ needs. These effects also tend to be greater, the more profitable were the pre-merger winning bids. All of these factors are likely to be small if there are many equally placed bidders.

The mechanisms of these anticompetitive unilateral effects, and the indicia of their likelihood, differ somewhat according to the bargaining practices used, the auction format, and the sellers’ information about one another’s costs and about buyers’ preferences. For example, when the merging sellers are likely to know which buyers they are best and second best placed to serve, any anticompetitive unilateral effects are apt to be targeted at those buyers; when sellers are less well informed, such effects are more apt to be spread over a broader class of buyers.

6.3 Capacity and Output for Homogeneous Products

In markets involving relatively undifferentiated products, the Agencies may evaluate whether the merged firm will find it profitable unilaterally to suppress output and elevate the market price. A firm may leave capacity idle, refrain from building or obtaining capacity that would have been obtained absent the merger, or eliminate pre-existing production capabilities. A firm may also divert the use of capacity away from one relevant market and into another so as to raise the price in the former market. The competitive analyses of these alternative modes of output suppression may differ.
A unilateral output suppression strategy is more likely to be profitable when (1) the merged firm’s market share is relatively high; (2) the share of the merged firm’s output already committed for sale at prices unaffected by the output suppression is relatively low; (3) the margin on the suppressed output is relatively low; (4) the supply responses of rivals are relatively small; and (5) the market elasticity of demand is relatively low.

A merger may provide the merged firm a larger base of sales on which to benefit from the resulting price rise, or it may eliminate a competitor that otherwise could have expanded its output in response to the price rise.

Example 20: Firms A and B both produce an industrial commodity and propose to merge. The demand for this commodity is insensitive to price. Firm A is the market leader. Firm B produces substantial output, but its operating margins are low because it operates high-cost plants. The other suppliers are operating very near capacity. The merged firm has an incentive to reduce output at the high-cost plants, perhaps shutting down some of that capacity, thus driving up the price it receives on the remainder of its output. The merger harms customers, notwithstanding that the merged firm shifts some output from high-cost plants to low-cost plants.

In some cases, a merger between a firm with a substantial share of the sales in the market and a firm with significant excess capacity to serve that market can make an output suppression strategy profitable. This can occur even if the firm with the excess capacity has a relatively small share of sales, if that firm’s ability to expand, and thus keep price from rising, has been making an output suppression strategy unprofitable for the firm with the larger market share.

6.4 Innovation and Product Variety

Competition often spurs firms to innovate. The Agencies may consider whether a merger is likely to diminish innovation competition by encouraging the merged firm to curtail its innovative efforts below the level that would prevail in the absence of the merger. That curtailment of innovation could take the form of reduced incentive to continue with an existing product-development effort or reduced incentive to initiate development of new products.

The first of these effects is most likely to occur if at least one of the merging firms is engaging in efforts to introduce new products that would capture substantial revenues from the other merging firm. The second, longer-run effect is most likely to occur if at least one of the merging firms has capabilities that are likely to lead it to develop new products in the future that would capture substantial revenues from the other merging firm. The Agencies therefore also consider whether a merger will diminish innovation competition by combining two of a very small number of firms with the strongest capabilities to successfully innovate in a specific direction.

The Agencies evaluate the extent to which successful innovation by one merging firm is likely to take sales from the other, and the extent to which post-merger incentives for future innovation will be lower than those that would prevail in the absence of the merger. The Agencies also consider whether the merger is likely to enable innovation that would not otherwise take place, by bringing together

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12 Such a merger also can cause adverse coordinated effects, especially if the acquired firm with excess capacity was disrupting effective coordination.
complementary capabilities that cannot be otherwise combined or for some other merger-specific reason. See Section 10.

The Agencies also consider whether a merger is likely to give the merged firm an incentive to cease offering one of the relevant products sold by the merging parties. Reductions in variety following a merger may or may not be anticompetitive. Mergers can lead to the efficient consolidation of products when variety offers little in value to customers. In other cases, a merger may increase variety by encouraging the merged firm to reposition its products to be more differentiated from one another.

If the merged firm would withdraw a product that a significant number of customers strongly prefer to those products that would remain available, this can constitute a harm to customers over and above any effects on the price or quality of any given product. If there is evidence of such an effect, the Agencies may inquire whether the reduction in variety is largely due to a loss of competitive incentives attributable to the merger. An anticompetitive incentive to eliminate a product as a result of the merger is greater and more likely, the larger is the share of profits from that product coming at the expense of profits from products sold by the merger partner. Where a merger substantially reduces competition by bringing two close substitute products under common ownership, and one of those products is eliminated, the merger will often also lead to a price increase on the remaining product, but that is not a necessary condition for anticompetitive effect.

*Example 21:* Firm A sells a high-end product at a premium price. Firm B sells a mid-range product at a lower price, serving customers who are more price sensitive. Several other firms have low-end products. Firms A and B together have a large share of the relevant market. Firm A proposes to acquire Firm B and discontinue Firm B’s product. Firm A expects to retain most of Firm B’s customers. Firm A may not find it profitable to raise the price of its high-end product after the merger, because doing so would reduce its ability to retain Firm B’s more price-sensitive customers. The Agencies may conclude that the withdrawal of Firm B’s product results from a loss of competition and materially harms customers.

7. **Coordinated Effects**

A merger may diminish competition by enabling or encouraging post-merger coordinated interaction among firms in the relevant market that harms customers. Coordinated interaction involves conduct by multiple firms that is profitable for each of them only as a result of the accommodating reactions of the others. These reactions can blunt a firm’s incentive to offer customers better deals by undercutting the extent to which such a move would win business away from rivals. They also can enhance a firm’s incentive to raise prices, by assuaging the fear that such a move would lose customers to rivals.

Coordinated interaction includes a range of conduct. Coordinated interaction can involve the explicit negotiation of a common understanding of how firms will compete or refrain from competing. Such conduct typically would itself violate the antitrust laws. Coordinated interaction also can involve a similar common understanding that is not explicitly negotiated but would be enforced by the detection and punishment of deviations that would undermine the coordinated interaction. Coordinated interaction alternatively can involve parallel accommodating conduct not pursuant to a prior understanding. Parallel accommodating conduct includes situations in which each rival’s response to competitive moves made by others is individually rational, and not motivated by
retaliation or deterrence nor intended to sustain an agreed-upon market outcome, but nevertheless emboldens price increases and weakens competitive incentives to reduce prices or offer customers better terms. Coordinated interaction includes conduct not otherwise condemned by the antitrust laws.

The ability of rival firms to engage in coordinated conduct depends on the strength and predictability of rivals’ responses to a price change or other competitive initiative. Under some circumstances, a merger can result in market concentration sufficient to strengthen such responses or enable multiple firms in the market to predict them more confidently, thereby affecting the competitive incentives of multiple firms in the market, not just the merged firm.

7.1 Impact of Merger on Coordinated Interaction

The Agencies examine whether a merger is likely to change the manner in which market participants interact, inducing substantially more coordinated interaction. The Agencies seek to identify how a merger might significantly weaken competitive incentives through an increase in the strength, extent, or likelihood of coordinated conduct. There are, however, numerous forms of coordination, and the risk that a merger will induce adverse coordinated effects may not be susceptible to quantification or detailed proof. Therefore, the Agencies evaluate the risk of coordinated effects using measures of market concentration (see Section 5) in conjunction with an assessment of whether a market is vulnerable to coordinated conduct. See Section 7.2. The analysis in Section 7.2 applies to moderately and highly concentrated markets, as unconcentrated markets are unlikely to be vulnerable to coordinated conduct.

Pursuant to the Clayton Act’s incipiency standard, the Agencies may challenge mergers that in their judgment pose a real danger of harm through coordinated effects, even without specific evidence showing precisely how the coordination likely would take place. The Agencies are likely to challenge a merger if the following three conditions are all met: (1) the merger would significantly increase concentration and lead to a moderately or highly concentrated market; (2) that market shows signs of vulnerability to coordinated conduct (see Section 7.2); and (3) the Agencies have a credible basis on which to conclude that the merger may enhance that vulnerability. An acquisition eliminating a maverick firm (see Section 2.1.5) in a market vulnerable to coordinated conduct is likely to cause adverse coordinated effects.

7.2 Evidence a Market is Vulnerable to Coordinated Conduct

The Agencies presume that market conditions are conducive to coordinated interaction if firms representing a substantial share in the relevant market appear to have previously engaged in express collusion affecting the relevant market, unless competitive conditions in the market have since changed significantly. Previous express collusion in another geographic market will have the same weight if the salient characteristics of that other market at the time of the collusion are comparable to those in the relevant market. Failed previous attempts at collusion in the relevant market suggest that successful collusion was difficult pre-merger but not so difficult as to deter attempts, and a merger may tend to make success more likely. Previous collusion or attempted collusion in another product market may also be given substantial weight if the salient characteristics of that other market at the time of the collusion are closely comparable to those in the relevant market.
A market typically is more vulnerable to coordinated conduct if each competitively important firm’s significant competitive initiatives can be promptly and confidently observed by that firm’s rivals. This is more likely to be the case if the terms offered to customers are relatively transparent. Price transparency can be greater for relatively homogeneous products. Even if terms of dealing are not transparent, transparency regarding the identities of the firms serving particular customers can give rise to coordination, e.g., through customer or territorial allocation. Regular monitoring by suppliers of one another’s prices or customers can indicate that the terms offered to customers are relatively transparent.

A market typically is more vulnerable to coordinated conduct if a firm’s prospective competitive reward from attracting customers away from its rivals will be significantly diminished by likely responses of those rivals. This is more likely to be the case, the stronger and faster are the responses the firm anticipates from its rivals. The firm is more likely to anticipate strong responses if there are few significant competitors, if products in the relevant market are relatively homogeneous, if customers find it relatively easy to switch between suppliers, or if suppliers use meeting-competition clauses.

A firm is more likely to be deterred from making competitive initiatives by whatever responses occur if sales are small and frequent rather than via occasional large and long-term contracts or if relatively few customers will switch to it before rivals are able to respond. A firm is less likely to be deterred by whatever responses occur if the firm has little stake in the status quo. For example, a firm with a small market share that can quickly and dramatically expand, constrained neither by limits on production nor by customer reluctance to switch providers or to entrust business to a historically small provider, is unlikely to be deterred. Firms are also less likely to be deterred by whatever responses occur if competition in the relevant market is marked by leapfrogging technological innovation, so that responses by competitors leave the gains from successful innovation largely intact.

A market is more apt to be vulnerable to coordinated conduct if the firm initiating a price increase will lose relatively few customers after rivals respond to the increase. Similarly, a market is more apt to be vulnerable to coordinated conduct if a firm that first offers a lower price or improved product to customers will retain relatively few customers thus attracted away from its rivals after those rivals respond.

The Agencies regard coordinated interaction as more likely, the more the participants stand to gain from successful coordination. Coordination generally is more profitable, the lower is the market elasticity of demand.

Coordinated conduct can harm customers even if not all firms in the relevant market engage in the coordination, but significant harm normally is likely only if a substantial part of the market is subject to such conduct. The prospect of harm depends on the collective market power, in the relevant market, of firms whose incentives to compete are substantially weakened by coordinated conduct. This collective market power is greater, the lower is the market elasticity of demand. This collective market power is diminished by the presence of other market participants with small market shares and little stake in the outcome resulting from the coordinated conduct, if these firms can rapidly expand their sales in the relevant market.
Buyer characteristics and the nature of the procurement process can affect coordination. For example, sellers may have the incentive to bid aggressively for a large contract even if they expect strong responses by rivals. This is especially the case for sellers with small market shares, if they can realistically win such large contracts. In some cases, a large buyer may be able to strategically undermine coordinated conduct, at least as it pertains to that buyer’s needs, by choosing to put up for bid a few large contracts rather than many smaller ones, and by making its procurement decisions opaque to suppliers.

8. Powerful Buyers

Powerful buyers are often able to negotiate favorable terms with their suppliers. Such terms may reflect the lower costs of serving these buyers, but they also can reflect price discrimination in their favor.

The Agencies consider the possibility that powerful buyers may constrain the ability of the merging parties to raise prices. This can occur, for example, if powerful buyers have the ability and incentive to vertically integrate upstream or sponsor entry, or if the conduct or presence of large buyers undermines coordinated effects. However, the Agencies do not presume that the presence of powerful buyers alone forestalls adverse competitive effects flowing from the merger. Even buyers that can negotiate favorable terms may be harmed by an increase in market power. The Agencies examine the choices available to powerful buyers and how those choices likely would change due to the merger. Normally, a merger that eliminates a supplier whose presence contributed significantly to a buyer’s negotiating leverage will harm that buyer.

Example 22: Customer C has been able to negotiate lower pre-merger prices than other customers by threatening to shift its large volume of purchases from one merging firm to the other. No other suppliers are as well placed to meet Customer C’s needs for volume and reliability. The merger is likely to harm Customer C. In this situation, the Agencies could identify a price discrimination market consisting of Customer C and similarly placed customers. The merger threatens to end previous price discrimination in their favor.

Furthermore, even if some powerful buyers could protect themselves, the Agencies also consider whether market power can be exercised against other buyers.

Example 23: In Example 22, if Customer C instead obtained the lower pre-merger prices based on a credible threat to supply its own needs, or to sponsor new entry, Customer C might not be harmed. However, even in this case, other customers may still be harmed.

9. Entry

The analysis of competitive effects in Sections 6 and 7 focuses on current participants in the relevant market. That analysis may also include some forms of entry. Firms that would rapidly and easily enter the market in response to a SSNIP are market participants and may be assigned market shares. See Sections 5.1 and 5.2. Firms that have, prior to the merger, committed to entering the market also will normally be treated as market participants. See Section 5.1. This section concerns entry or adjustments to pre-existing entry plans that are induced by the merger.
As part of their full assessment of competitive effects, the Agencies consider entry into the relevant market. The prospect of entry into the relevant market will alleviate concerns about adverse competitive effects only if such entry will deter or counteract any competitive effects of concern so the merger will not substantially harm customers.

The Agencies consider the actual history of entry into the relevant market and give substantial weight to this evidence. Lack of successful and effective entry in the face of non-transitory increases in the margins earned on products in the relevant market tends to suggest that successful entry is slow or difficult. Market values of incumbent firms greatly exceeding the replacement costs of their tangible assets may indicate that these firms have valuable intangible assets, which may be difficult or time consuming for an entrant to replicate.

A merger is not likely to enhance market power if entry into the market is so easy that the merged firm and its remaining rivals in the market, either unilaterally or collectively, could not profitably raise price or otherwise reduce competition compared to the level that would prevail in the absence of the merger. Entry is that easy if entry would be timely, likely, and sufficient in its magnitude, character, and scope to deter or counteract the competitive effects of concern.

The Agencies examine the timeliness, likelihood, and sufficiency of the entry efforts an entrant might practically employ. An entry effort is defined by the actions the firm must undertake to produce and sell in the market. Various elements of the entry effort will be considered. These elements can include: planning, design, and management; permitting, licensing, or other approvals; construction, debugging, and operation of production facilities; and promotion (including necessary introductory discounts), marketing, distribution, and satisfaction of customer testing and qualification requirements. Recent examples of entry, whether successful or unsuccessful, generally provide the starting point for identifying the elements of practical entry efforts. They also can be informative regarding the scale necessary for an entrant to be successful, the presence or absence of entry barriers, the factors that influence the timing of entry, the costs and risk associated with entry, and the sales opportunities realistically available to entrants.

If the assets necessary for an effective and profitable entry effort are widely available, the Agencies will not necessarily attempt to identify which firms might enter. Where an identifiable set of firms appears to have necessary assets that others lack, or to have particularly strong incentives to enter, the Agencies focus their entry analysis on those firms. Firms operating in adjacent or complementary markets, or large customers themselves, may be best placed to enter. However, the Agencies will not presume that a powerful firm in an adjacent market or a large customer will enter the relevant market unless there is reliable evidence supporting that conclusion.

In assessing whether entry will be timely, likely, and sufficient, the Agencies recognize that precise and detailed information may be difficult or impossible to obtain. The Agencies consider reasonably available and reliable evidence bearing on whether entry will satisfy the conditions of timeliness, likelihood, and sufficiency.
9.1 Timeliness

In order to deter the competitive effects of concern, entry must be rapid enough to make unprofitable overall the actions causing those effects and thus leading to entry, even though those actions would be profitable until entry takes effect.

Even if the prospect of entry does not deter the competitive effects of concern, post-merger entry may counteract them. This requires that the impact of entrants in the relevant market be rapid enough that customers are not significantly harmed by the merger, despite any anticompetitive harm that occurs prior to the entry.

The Agencies will not presume that an entrant can have a significant impact on prices before that entrant is ready to provide the relevant product to customers unless there is reliable evidence that anticipated future entry would have such an effect on prices.

9.2 Likelihood

Entry is likely if it would be profitable, accounting for the assets, capabilities, and capital needed and the risks involved, including the need for the entrant to incur costs that would not be recovered if the entrant later exits. Profitability depends upon (a) the output level the entrant is likely to obtain, accounting for the obstacles facing new entrants; (b) the price the entrant would likely obtain in the post-merger market, accounting for the impact of that entry itself on prices; and (c) the cost per unit the entrant would likely incur, which may depend upon the scale at which the entrant would operate.

9.3 Sufficiency

Even where timely and likely, entry may not be sufficient to deter or counteract the competitive effects of concern. For example, in a differentiated product industry, entry may be insufficient because the products offered by entrants are not close enough substitutes to the products offered by the merged firm to render a price increase by the merged firm unprofitable. Entry may also be insufficient due to constraints that limit entrants’ competitive effectiveness, such as limitations on the capabilities of the firms best placed to enter or reputational barriers to rapid expansion by new entrants. Entry by a single firm that will replicate at least the scale and strength of one of the merging firms is sufficient. Entry by one or more firms operating at a smaller scale may be sufficient if such firms are not at a significant competitive disadvantage.

10. Efficiencies

Competition usually spurs firms to achieve efficiencies internally. Nevertheless, a primary benefit of mergers to the economy is their potential to generate significant efficiencies and thus enhance the merged firm’s ability and incentive to compete, which may result in lower prices, improved quality, enhanced service, or new products. For example, merger-generated efficiencies may enhance competition by permitting two ineffective competitors to form a more effective competitor, e.g., by combining complementary assets. In a unilateral effects context, incremental cost reductions may reduce or reverse any increases in the merged firm’s incentive to elevate price. Efficiencies also may lead to new or improved products, even if they do not immediately and directly affect price. In a
coordinated effects context, incremental cost reductions may make coordination less likely or effective by enhancing the incentive of a maverick to lower price or by creating a new maverick firm. Even when efficiencies generated through a merger enhance a firm’s ability to compete, however, a merger may have other effects that may lessen competition and make the merger anticompetitive.

The Agencies credit only those efficiencies likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects. These are termed merger-specific efficiencies. Only alternatives that are practical in the business situation faced by the merging firms are considered in making this determination. The Agencies do not insist upon a less restrictive alternative that is merely theoretical.

Efficiencies are difficult to verify and quantify, in part because much of the information relating to efficiencies is uniquely in the possession of the merging firms. Moreover, efficiencies projected reasonably and in good faith by the merging firms may not be realized. Therefore, it is incumbent upon the merging firms to substantiate efficiency claims so that the Agencies can verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved (and any costs of doing so), how each would enhance the merged firm’s ability and incentive to compete, and why each would be merger-specific.

Efficiency claims will not be considered if they are vague, speculative, or otherwise cannot be verified by reasonable means. Projections of efficiencies may be viewed with skepticism, particularly when generated outside of the usual business planning process. By contrast, efficiency claims substantiated by analogous past experience are those most likely to be credited.

Cognizable efficiencies are merger-specific efficiencies that have been verified and do not arise from anticompetitive reductions in output or service. Cognizable efficiencies are assessed net of costs produced by the merger or incurred in achieving those efficiencies.

The Agencies will not challenge a merger if cognizable efficiencies are of a character and magnitude such that the merger is not likely to be anticompetitive in any relevant market. The Agencies normally assess competition in each relevant market affected by a merger independently and normally will challenge the merger if it is likely to be anticompetitive in any relevant market. In some cases, however, the Agencies in their prosecutorial discretion will consider efficiencies not strictly in the relevant market, but so inextricably linked with it that a partial divestiture or other remedy could not feasibly eliminate the anticompetitive effect in the relevant market without sacrificing the efficiencies in the other market(s). Inextricably linked efficiencies are most likely to make a difference when they are great and the likely anticompetitive effect in the relevant market(s) is small so the merger is likely to benefit customers overall.

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13 The Agencies will not deem efficiencies to be merger-specific if they could be attained by practical alternatives that mitigate competitive concerns, such as divestiture or licensing. If a merger affects not whether but only when an efficiency would be achieved, only the timing advantage is a merger-specific efficiency.

14 The Agencies normally assess competition in each relevant market affected by a merger independently and normally will challenge the merger if it is likely to be anticompetitive in any relevant market. In some cases, however, the Agencies in their prosecutorial discretion will consider efficiencies not strictly in the relevant market, but so inextricably linked with it that a partial divestiture or other remedy could not feasibly eliminate the anticompetitive effect in the relevant market without sacrificing the efficiencies in the other market(s). Inextricably linked efficiencies are most likely to make a difference when they are great and the likely anticompetitive effect in the relevant market(s) is small so the merger is likely to benefit customers overall.
increases in that market. In conducting this analysis, the Agencies will not simply compare the magnitude of the cognizable efficiencies with the magnitude of the likely harm to competition absent the efficiencies. The greater the potential adverse competitive effect of a merger, the greater must be the cognizable efficiencies, and the more they must be passed through to customers, for the Agencies to conclude that the merger will not have an anticompetitive effect in the relevant market. When the potential adverse competitive effect of a merger is likely to be particularly substantial, extraordinarily great cognizable efficiencies would be necessary to prevent the merger from being anticompetitive. In adhering to this approach, the Agencies are mindful that the antitrust laws give competition, not internal operational efficiency, primacy in protecting customers.

In the Agencies’ experience, efficiencies are most likely to make a difference in merger analysis when the likely adverse competitive effects, absent the efficiencies, are not great. Efficiencies almost never justify a merger to monopoly or near-monopoly. Just as adverse competitive effects can arise along multiple dimensions of conduct, such as pricing and new product development, so too can efficiencies operate along multiple dimensions. Similarly, purported efficiency claims based on lower prices can be undermined if they rest on reductions in product quality or variety that customers value.

The Agencies have found that certain types of efficiencies are more likely to be cognizable and substantial than others. For example, efficiencies resulting from shifting production among facilities formerly owned separately, which enable the merging firms to reduce the incremental cost of production, are more likely to be susceptible to verification and are less likely to result from anticompetitive reductions in output. Other efficiencies, such as those relating to research and development, are potentially substantial but are generally less susceptible to verification and may be the result of anticompetitive output reductions. Yet others, such as those relating to procurement, management, or capital cost, are less likely to be merger-specific or substantial, or may not be cognizable for other reasons.

When evaluating the effects of a merger on innovation, the Agencies consider the ability of the merged firm to conduct research or development more effectively. Such efficiencies may spur innovation but not affect short-term pricing. The Agencies also consider the ability of the merged firm to appropriate a greater fraction of the benefits resulting from its innovations. Licensing and intellectual property conditions may be important to this enquiry, as they affect the ability of a firm to appropriate the benefits of its innovation. Research and development cost savings may be substantial and yet not be cognizable efficiencies because they are difficult to verify or result from anticompetitive reductions in innovative activities.

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15 The Agencies normally give the most weight to the results of this analysis over the short term. The Agencies also may consider the effects of cognizable efficiencies with no short-term, direct effect on prices in the relevant market. Delayed benefits from efficiencies (due to delay in the achievement of, or the realization of customer benefits from, the efficiencies) will be given less weight because they are less proximate and more difficult to predict. Efficiencies relating to costs that are fixed in the short term are unlikely to benefit customers in the short term, but can benefit customers in the longer run, e.g., if they make new product introduction less expensive.
11. Failure and Exiting Assets

Notwithstanding the analysis above, a merger is not likely to enhance market power if imminent failure, as defined below, of one of the merging firms would cause the assets of that firm to exit the relevant market. This is an extreme instance of the more general circumstance in which the competitive significance of one of the merging firms is declining: the projected market share and significance of the exiting firm is zero. If the relevant assets would otherwise exit the market, customers are not worse off after the merger than they would have been had the merger been enjoined.

The Agencies do not normally credit claims that the assets of the failing firm would exit the relevant market unless all of the following circumstances are met: (1) the allegedly failing firm would be unable to meet its financial obligations in the near future; (2) it would not be able to reorganize successfully under Chapter 11 of the Bankruptcy Act; and (3) it has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger.\(^\text{16}\)

Similarly, a merger is unlikely to cause competitive harm if the risks to competition arise from the acquisition of a failing division. The Agencies do not normally credit claims that the assets of a division would exit the relevant market in the near future unless both of the following conditions are met: (1) applying cost allocation rules that reflect true economic costs, the division has a persistently negative cash flow on an operating basis, and such negative cash flow is not economically justified for the firm by benefits such as added sales in complementary markets or enhanced customer goodwill;\(^\text{17}\) and (2) the owner of the failing division has made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed acquisition.

12. Mergers of Competing Buyers

Mergers of competing buyers can enhance market power on the buying side of the market, just as mergers of competing sellers can enhance market power on the selling side of the market. Buyer market power is sometimes called “monopsony power.”

To evaluate whether a merger is likely to enhance market power on the buying side of the market, the Agencies employ essentially the framework described above for evaluating whether a merger is likely to enhance market power on the selling side of the market. In defining relevant markets, the Agencies

\(^{16}\) Any offer to purchase the assets of the failing firm for a price above the liquidation value of those assets will be regarded as a reasonable alternative offer. Liquidation value is the highest value the assets could command for use outside the relevant market.

\(^{17}\) Because the parent firm can allocate costs, revenues, and intra-company transactions among itself and its subsidiaries and divisions, the Agencies require evidence on these two points that is not solely based on management plans that could have been prepared for the purpose of demonstrating negative cash flow or the prospect of exit from the relevant market.
focus on the alternatives available to sellers in the face of a decrease in the price paid by a hypothetical monopsonist.

Market power on the buying side of the market is not a significant concern if suppliers have numerous attractive outlets for their goods or services. However, when that is not the case, the Agencies may conclude that the merger of competing buyers is likely to lessen competition in a manner harmful to sellers.

The Agencies distinguish between effects on sellers arising from a lessening of competition and effects arising in other ways. A merger that does not enhance market power on the buying side of the market can nevertheless lead to a reduction in prices paid by the merged firm, for example, by reducing transactions costs or allowing the merged firm to take advantage of volume-based discounts. Reduction in prices paid by the merging firms not arising from the enhancement of market power can be significant in the evaluation of efficiencies from a merger, as discussed in Section 10.

The Agencies do not view a short-run reduction in the quantity purchased as the only, or best, indicator of whether a merger enhances buyer market power. Nor do the Agencies evaluate the competitive effects of mergers between competing buyers strictly, or even primarily, on the basis of effects in the downstream markets in which the merging firms sell.

Example 24: Merging Firms A and B are the only two buyers in the relevant geographic market for an agricultural product. Their merger will enhance buyer power and depress the price paid to farmers for this product, causing a transfer of wealth from farmers to the merged firm and inefficiently reducing supply. These effects can arise even if the merger will not lead to any increase in the price charged by the merged firm for its output.

13. Partial Acquisitions

In most horizontal mergers, two competitors come under common ownership and control, completely and permanently eliminating competition between them. This elimination of competition is a basic element of merger analysis. However, the statutory provisions referenced in Section 1 also apply to one firm’s partial acquisition of a competitor. The Agencies therefore also review acquisitions of minority positions involving competing firms, even if such minority positions do not necessarily or completely eliminate competition between the parties to the transaction.

When the Agencies determine that a partial acquisition results in effective control of the target firm, or involves substantially all of the relevant assets of the target firm, they analyze the transaction much as they do a merger. Partial acquisitions that do not result in effective control may nevertheless present significant competitive concerns and may require a somewhat distinct analysis from that applied to full mergers or to acquisitions involving effective control. The details of the post-acquisition relationship between the parties, and how those details are likely to affect competition, can be important. While the Agencies will consider any way in which a partial acquisition may affect competition, they generally focus on three principal effects.

First, a partial acquisition can lessen competition by giving the acquiring firm the ability to influence the competitive conduct of the target firm. A voting interest in the target firm or specific governance rights, such as the right to appoint members to the board of directors, can permit such influence. Such
influence can lessen competition because the acquiring firm can use its influence to induce the target firm to compete less aggressively or to coordinate its conduct with that of the acquiring firm.

Second, a partial acquisition can lessen competition by reducing the incentive of the acquiring firm to compete. Acquiring a minority position in a rival might significantly blunt the incentive of the acquiring firm to compete aggressively because it shares in the losses thereby inflicted on that rival. This reduction in the incentive of the acquiring firm to compete arises even if it cannot influence the conduct of the target firm. As compared with the unilateral competitive effect of a full merger, this effect is likely attenuated by the fact that the ownership is only partial.

Third, a partial acquisition can lessen competition by giving the acquiring firm access to non-public, competitively sensitive information from the target firm. Even absent any ability to influence the conduct of the target firm, access to competitively sensitive information can lead to adverse unilateral or coordinated effects. For example, it can enhance the ability of the two firms to coordinate their behavior, and make other accommodating responses faster and more targeted. The risk of coordinated effects is greater if the transaction also facilitates the flow of competitively sensitive information from the acquiring firm to the target firm.

Partial acquisitions, like mergers, vary greatly in their potential for anticompetitive effects. Accordingly, the specific facts of each case must be examined to assess the likelihood of harm to competition. While partial acquisitions usually do not enable many of the types of efficiencies associated with mergers, the Agencies consider whether a partial acquisition is likely to create cognizable efficiencies.
Challenges Faced By Multichannel Video Programming Distributors*

Ali Yurukoglu†

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1 Introduction

While a full growth accounting analysis of the television content and distribution industry over the past twenty five years has not been performed (to my knowledge), I wager that such an analysis would uncover large productivity improvements and large increases to society’s welfare attributable to this industry. Compared to 1991, there is orders of magnitude more diversity in content, more time spent viewing television, higher real expenditures, and higher subscription levels (consistent with consumers valuing the available programming more and more over time). Over this period of industry growth, a number of competition policy issues have waxed and waned in importance and public attention. In these comments, I will discuss academic research on some of these issues, and discuss challenges that remain in analyzing them.

The main uncertainty in the industry today is regarding the impact of new entrants using slightly different technological channels, so to speak. Netflix, Amazon, and Youtube are the most visible “tech” entrants into the video programming space. Their entry alters the relative importance of some of the classic competition policy issues in this industry. The specific matters I will comment on today are: bundling at the retail and wholesale level, the evolution and determination of programming costs, vertical integration of distribution with content and with hardware, and program diversity issues, particularly regarding the news media. My comments will address these issues with a focus on traditional multichannel video distribution providers (MVPD’s), but I will also touch on effects on over-the-top (OTT) providers.

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†Graduate School of Business, Stanford University; ayurukog@stanford.edu
2 Bundling

Bundling, that is the packaging of multiple content channels into one product, occurs at both the retail level and the wholesale level in this industry. The economic analysis of these two different types of bundling is different in many ways which warrants considering them separately.

2.1 Retail Bundling

A common anecdotal gripe of consumers is that they pay for hundreds of channels and only watch a handful. Why can’t they pay less and only get the channels they want? However, this simplistic reasoning is not correct. One obvious retort is that consumers pay for the channels they want, as no one is forcing them to subscribe to a cable package, and the rest comes for free. In any case, the economic theory is more subtle, and theory’s predictions turn out to be ambiguous in the sense that they depend on the values of certain parameters used in the theoretical model.

The main economic theory at play at the retail level is that bundling could be an instrument for price discrimination. Early papers (Stigler, 1963; Adams and Yellen, 1976), showed that a monopoly firm could profit, and consumer surplus could be lower, if the monopoly firm packages two goods together as opposed to selling them separately. These theoretical models and subsequent theoretical work are highly stylized. They often feature just two goods, no competition, and/or unrealistic consumer valuations chosen for tractability. Nonetheless, they provide some justification for wondering whether consumers could be made better off by regulations requiring firms to unbundle.

On the empirical side, unbundling has not occurred much worldwide, let alone in an quasi-experimentally exogenous manner. This lack of variation in unbundling presents an empirical challenge as no direct comparison set is available. One approach, admittedly more speculative, is to create a realistic model of the industry that is general enough to predict what would happen under bundling and under unbundling. The parameters of the model can be chosen by statistical methods to match what we observe under bundling. The structure of the model can then be leveraged to simulate unbundling at the chosen parameters. This effectively resolves the issue of ambiguous theoretical predictions by choosing the parameter set which fits the data the best under bundling.

This is what my co-author and I do in a paper published in 2012 (Crawford and Yurukoglu, 2012). The usefulness of this exercise depends on how realistic the model is. The model we have makes many assumptions, but we claim that it captures many of the first-order short term relationships in the industry. Specifically, the model features consumers choosing what to watch, consumers choosing what bundle and what cable or satellite company to purchase from, cable and satellite companies choosing prices and bundles, and cable and satellite companies negotiating with content conglomerates over carriage fees, and content companies generating advertising

\textsuperscript{1}It will be informative to see what happens in Canada as they experiment with some regulated unbundling.
revenue from viewership. It accounts for heterogeneity in tastes because of demographics and also “unobservable” heterogeneity. It features competition between distributors and between channels. It also estimates the degree of bargaining power between channels and distributors.

Then, within the context of the model, with parameters chosen by statistical methods to match the past, we force the cable and satellite companies to offer channels à la carte.

To summarize our results: the average consumer is basically no better and no worse off under à la carte. Some consumers gain significantly: those who watch few channels, especially non-sports channels. Some consumers are hurt: for example households that watch more than 20 channels. These households either pay the same or less, but receive less content, or they pay more for the same amount or less content. Some households who value a small number of channels enter the market. These can be thought of as “cord-nevers” who would subscribe were à la carte available. One additional lesson from this analysis is that accounting for the renegotiation of carriage fees under the à la carte regulation is essential for getting realistic answers.

A simple example is useful for explaining the economic effects: Consider two consumers: Alice and Bob. Alice likes ESPN and only ESPN. Bob likes a variety of channels, but some of them, for example HGTV, he just watches two or three times a month on which places a modest dollar value. Under bundling, Alice may really like ESPN, but not enough to pay for the bundle. Under à la carte, the price of ESPN will be lower than the price of the bundle and Alice will be better off. Bob is a big TV fan, and subscribes to the bundle. Under unbundling, he will continue to subscribe to the channels he likes the most. However, he faces a decision with channels like HGTV. Either the price of HGTV is too high for his moderate amount of watching, so he doesn’t receive HGTV anymore, or he gets all these channels but ends up paying more than he did with the bundle. The increase of access for people like Alice are weighted against the increase in price or loss of access for Bob. We find on average that these effects offset each other.

On the supply side, we find that distributors benefit from unbundling (before any implementation costs), and that channels mostly suffer, mostly from decreased carriage revenue. While the public typically thinks of cable as a non-competitive business, it is not the case that cable is a monopoly. Satellite providers DirecTV and Dish Network have provided a degree of competition starting from the late 1990’s. Furthermore, overbuilders like RCN and Wave, and recent entrants such as Verizon Fios, AT&T U-Verse, and Google Fiber provide an additional wire-based alternative in a sizeable number of markets. When thinking about retail bundling, one must ask themselves, if competition tends to work in favor of consumers, and if unbundling is good for consumers, why haven’t any of the competitors found a way to try unbundling? Similarly, many of the new OTT services are effectively bundles: Netflix, Amazon Prime, and Youtube all offer a huge variety of content. In the similar sector of streaming music, Spotify has had tremendous success in signing up users using a bundled model.

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2One possibility is that programmers are able to prevent unbundling via contracts.
Our analysis did not consider any long term effects of unbundling. In particular, we did not consider whether unbundling would lead to either exit of existing channels, entry of new channels, or changes in the investment levels of any channels. Some worry that mandatory unbundling would lead some channels to exit the industry. However, it is not clear that this is the case, nor is it clear that if this were to happen, that such exit would be inefficient. Economic theory suggests that unbundling would improve the efficiency of investment decisions in content. Think of a channel considering investing in a new program. The channel alone bears the production cost of the investment. When the channel is part of the bundle, some of the fruits of the investment, for example if the new program were to become a smash hit, is shared with its fellow channels in the bundle. This positive externality leads to under-investment in channel quality. When the channel is unbundled, the only limit to benefiting from the fruits of its investment is the ability to perfectly price discriminate, which is a friction in nearly every industry, and seems unavoidable for a multitude of reasons.

2.2 Wholesale Bundling

The main competition policy concern with wholesale bundling (also refereed to as “tying”) that arises from economic theory is the possibility of foreclosure. The basic idea in these theories, for example Whinston (1990) and Nalebuff (2004), is that a firm with market power in one market (call this the market for product A and suppose the is a monopoly) can leverage that power to keep out entrants in another market (product B) by requiring a customer to purchase both products in order to receive either product. Customers who want both A and B will purchase both from the monopoly in A firm. These can shave enough potential product B sales from the potentially more efficient producer of product B, such that that producer can not meet its fixed costs, and thus does not produce at all. The story in this industry would be that by bundling popular channel A with channel B, potentially more efficient entrants into the genre of channel B are deterred from entering. These issues are not mere theory, these are issues that courts have had to confront. Cablevision had sued Viacom over wholesale bundling practices, but this dispute was settled in late 2015.

Unfortunately, there is even less empirical evidence on the effects of wholesale bundling. Ho et al. (2012) study the video rental market prior to digital distribution, however their analysis focuses on the business strategy aspect of signing wholesale bundling contracts. This is clearly an area where more empirical analysis would have high value. A limiting challenge is that the theoretical effects depend on the efficiency advantage of unknown potential entrants who never actually enter. This unobservability renders the route of analysis by model simulation quite difficult in this case.

\[3\]There are several subtleties in the economic theory here that are necessary to avoid the “one monopoly profit” principle that emerges in simple models.
3 Programming Costs

Programming costs refer to the (typically) linear per-subscriber fees paid by downstream distributors to content providers. The actual contracts are of course more complicated than a single number, but the linear per-subscriber fee is the focus of attention in both industry discussion of content-distribution relationships and academic research. The following graph, Figure 1, plots the ratio of the difference between video revenue and programming costs divided by video revenue over time for a handful of publicly traded cable and satellite firms. The higher the value of this ratio, the larger the fraction of surplus going to the distributor. In other words, channels want this number to be low, and distributors prefer this number to be high.

**Figure 1: Downstream Markups**

![Downstream Markups Graph](image)

*Notes:* This figure from Doudchenko and Yurukoglu (2016) shows the ratio of video revenues minus programming costs to video revenues over time for a group of publicly traded MVPD’s. The data is from their annual 10k reports. The dashed lines represent total U.S. subscriber numbers for satellite and telco’s, respectively.

There are two key relationships to note. First programming costs relative to video revenues have been increasing, and increasing faster than retail prices. Second, larger cable providers such as Comcast seem to pay lower costs than smaller cable providers. We explore these relationships in preliminary work in Doudchenko and Yurukoglu (2016).

Economic bargaining theory suggests that the share going to content should increase when contents best outside option increases. Compared to the mid-1990s, content has more paths to delivery into households. First, the rise of satellite distributors increased the outside option for content: before satellite, if a cable company dropped the content, they had no alternative.
avenue into peoples homes. With satellite, if the cable company drops the content, the content may still be available on satellite, and hardcore fans might switch companies. All else equal, this creates leverage that can work in favor of the content companies. The rise of Verizon and AT&T create a similar dynamic. Finally, the threat of going over-the-top directly to consumers pushes in the same direction.

Another interesting phenomenon in this industry is that larger distributors in terms of total subscribers tend to pay lower per-subscriber fees. That this occurs is part of the folk-wisdom in this industry; and there is a host of supporting anecdotal evidence. The graph above is also suggestive in this direction. Economic theory does not make clear predictions in general for whether large distributors will pay less, equal, or more for inputs. Reasonable assumptions can deliver all three possibilities. One set of assumptions that delivers what we see in this industry is that the outside option is better for larger distributors than for smaller distributors. This is a theory put forth in Katz (1987). This would be the case, for example, if under a hypothetical carriage disagreement between Comcast and Food Network, Comcast would be able to start its own Food Network for cheaper than Cox, or another smaller cable provider, would be able to. The actual step of creating need not ever happen for this to generate size effects. The threat is enough. Furthermore, it is reasonable to believe that Comcast would enjoy such an advantage because of its scale as well as its scope in having programming assets.

We have some preliminary results on two implications of size effects in Doudchenko and Yu-rukoglu (2016). First, size effects mean that mergers between distributors, like Charter and Time Warner Cable, should result in lower programming costs for the new entity. Holding the quality of content fixed, such monopsony power is a good thing in this constant marginal cost industry. Similar to the case of bundling, the dynamic effects on programming investment are unknown. In theory, programming quality could improve or deteriorate. Second, these size effects create a barrier to entry for new competitors, including over-the-top distributors. Effectively, to offer low prices and gain market share, one must have low programming fees. However, to achieve low programming fees, one must have high market share and scale. Eliminating such effects might result in increased entry, however one must balance this against the loss of incentive to grow large by cutting price or becoming more efficient in order to achieve input cost decreases.

4 Vertical Integration

Much content is vertically integrated in this industry. NBC is integrated with Comcast. Cablevision and Rainbow Networks share a history and shareholders, and similar for Time Warner and Time Warner Cable. Perhaps the most visible vertical integration is between regional sports

4Chipty and Snyder (1999) looks at another avenue that would generate size differences in negotiated fees, specifically the shape of the advertising surplus function. They conclude that the concavity of the advertising surplus function implies that larger distributors should be at a bargaining disadvantage. Their effect could exist but be outweighed by the Katz (1987) scale effects in reality. That is, the two theories have opposite predictions, but they do not preclude the other force from existing.
networks (RSNs) and distributors: Comcast, DirecTV, Time Warner Cable, Charter, and Cox all have ownership interests in regional sports networks. The economic theory of vertical integration highlights a few key effects: vertically integrated entities may avoid the so-called double marginalization problem, and vertical integration may result in more efficient investment patterns. On the other hand, vertical integration might lead to foreclosure, whereby a vertically integrated unit does not deal with a rival of its sister unit: for example, a cable-owned RSN might not deal with a satellite provider. Short of full exclusion, the cable-owned RSN might charge a higher price to the satellite provider as it internalizes the effect of serving the satellite provider on its downstream distribution profits.

In Crawford et al. (2015), we explore the double marginalization and foreclosure effects. We find that, the efficiency effects of removing double marginalization are substantial, and outweigh costs from foreclosure. However, a regulatory policy, such as the FCC’s program access rules, can push the industry towards realizing the efficiency benefits without suffering loses from foreclosure. Regarding foreclosure, we find that absent any such regulations, some integrated channels would be exclusive to their distribution arm, and other integrated channels would negotiate prices with rival distributors significantly higher than what they negotiate were they not integrated. Earlier work in Chipty (2001) found some favoritism in carriage of vertically integrated content, but concluded that this behavior was pro-competitive.

Again, our analysis does not consider investment. Here, one theoretical suggests vertical integration should be good for achieving efficiency in non-contractible investment with an intuition similar to that under bundling. When a content provider makes a non-contractible investment, some of the benefits will accrue to the downstream distributor while the costs are borne entirely by the investor. This creates a misalignment of incentives that could lead to socially sub-optimal investment levels. More empirical research in this direction would be valuable.

An analogous issue arises in hardware. This has received notable policy attention recently with the discussion on set-top boxes. It is not out of the question that similar issues could arise with monitors, tablets, and/or television sets in the future. While the flow of money is slightly different here, the economics are the same. Complementary goods lead to a double marginalization problem. Integration can solve the double marginalization problem, but might lead to foreclosure. Given the entry of OTT firms which also make hardware (including the rumored entry by Apple), integration of hardware and distribution seems like an area of future competition policy issues. Furthermore, firms could be integrated across all three areas: for example Comcast with its NBCU content, X1 set-top box and navigation system, and its distribution infrastructure.
5 Program Diversity and Externalities associated with Television Consumption

This final section argues that the challenges faced by multichannel video distributors have special importance because of the role of television in culture and in information acquisition. Television programs, including televised sports, have a large market share of conversation. Research suggests that behavior learned from watching television can affect outcomes such as gender stereotypes and teen pregnancy (Jensen and Oster, 2009; Kearney and Levine, 2014), as well as cognitive skills (Gentzkow and Shapiro, 2007). It is indisputable that some television shows are cultural phenomena. They are also exports which potentially shape the views of the world towards the US.

Related, television news is a major source of information. Research suggests that television news affects elector turnout and partisan voting (Gentzkow, 2006; DellaVigna and Kaplan, 2007; Martin and Yurukoglu, 2015). This role of media creates externalities on society which should figure in a benevolent regulatory policy framework. For example, unbundling may decrease the fraction of population who has access to news programs that differ from their own opinions. This could in turn drive polarization cycles. While the research on this is not definitive, erring on the side of caution might be appropriate when formulating regulatory policy towards this special industry.

6 Conclusion

The multichannel video industry has been a hotbed of classical issues in competition and regulatory policy including evaluating horizontal mergers, evaluating vertical mergers, bundling, tying, exclusive dealing, and rate regulation. Competition policy issues arise when firms have market power. While technology has increased the level of competition throughout all levels in the industry, market power remains an issue. My goal in these comments was to illustrate how economic modelling can be useful to help guide policy choices, for example in thinking about policy toward product bundling and policy towards vertical integration. The primary mode of analysis is via economic model counterfactual simulation methods. A key caveat is that predicting the long term effects of policy changes on content quality and diversity is challenging. Given the huge progress in the quality and diversity dimensions that the industry has achieved over the last twenty five years, these under-studied long term effects may be the most consequential. Finally, given the special role of television media in both culture and news, competition policy in this industry can have important effects on social outcomes.
References


Abstract: We discuss in this essay three of the matters on which economists in the Bureau of Economics (BE) at the Federal Trade Commission (FTC) have worked this past year. BE revisited familiar ground in the first matter, a proposed merger of office supply retailers. The second part of the essay considers efficiency claims in health care mergers, with focus on the acquisition of a physician group by a health care system in Idaho. The final part of the essay discusses empirical work that was undertaken by the Bureau to investigate claims made by marketers of an alleged get-rich-quick scheme.

Keywords: Antitrust, Consumer Protection, Fraud, FTC, Healthcare, Retailing

Address for all authors but Gaynor: Federal Trade Commission, Bureau of Economics, 600 Pennsylvania Ave., N.W., Washington, DC 20580, USA.
Gaynor address: H. John Heinz III College, Carnegie Mellon University, Pittsburgh, PA 15213, USA

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I. Introduction

A. The Bureau of Economics

The Bureau of Economics (BE) at the U.S. Federal Trade Commission (FTC) provides economic analysis to support the FTC’s strategic goals of protecting consumers and maintaining competition (http://www.ftc.gov/about-ftc/bureaus-offices/bureau-economics). This is accomplished by the more than 80 Ph.D. economists, several financial analysts, and research and support staff who comprise the BE staff.

BE plays three major roles at the FTC: First, BE provides economic analysis to the Commission on enforcement matters in the competition and consumer protection areas. Second, BE conducts research on issues that are relevant to the agency’s mission. Third, BE works on policy and advocacy issues, usually in concert with the Office of Policy Planning.¹

On law enforcement matters, BE staff typically work in teams with attorneys from the Bureaus of Competition and Consumer Protection. However, BE provides independent assessments and recommendations to the Commission. While antitrust enforcement is a key part of the agency’s mission, consumer protection is a very large, and growing component of the FTC’s activities.

In terms of volume, most of our resources are devoted to evaluations of pending mergers and acquisitions (M&As), which are largely, but not exclusively, driven by the notification requirements of the Hart-Scott-Rodino (HSR) Act. Consumer protection activities having to do with deceptive or unfair business practices harming consumers also occupy much of the Bureau’s attention. In addition, we also devote substantial resources to investigations of alleged anticompetitive conduct (e.g., how Google displays its search results; pay-for-delay deals between branded pharmaceutical manufacturers and would-be generic entrants), and competition policy efforts (e.g., developing a policy for evaluating “accountable care organizations” [ACOs] in the health care sector).

During fiscal year 2013, U.S. merger and acquisition activity declined slightly, with 1,326 transactions that were reported to the U.S. Department of Justice (DOJ) and the FTC, as compared to 1,429 in fiscal year 2012. M&A activity has been highly cyclical: Over the past decade, these figures have ranged between 716 (in 2009) and 2,201 (in 2007). The vast majority of proposed mergers are cleared within the “waiting period” that is imposed by the HSR Act (usually 30 days; 15 for cash-tender offers or bankruptcy sales).

During FY 2013, the FTC opened 25 formal merger investigations, and brought 23 merger enforcement actions (some of which were initiated in preceding years). Sixteen of these actions involved consent orders (permitting the transaction to proceed, albeit with modifications); two transactions were abandoned or restructured during the investigations; the Commission filed a complaint in federal court to permanently enjoin one transaction; and four transactions prompted administrative litigation.

The FTC’s original enabling legislation in 1914 contains a mandate to conduct research, which BE fulfills by undertaking significant research activities throughout the year. This can take the form of Commission studies of important phenomena, studies that are requested by Congress, and studies that are initiated by the Bureau or independently by the staff (http://www.ftc.gov/policy/reports/policy-reports/economics-research). In addition to economists’ publishing frequently in academic journals, we also have a working paper series. We sponsor and disseminate mission-related research through seminars and conferences. In November 2013, we hosted our sixth annual Microeconomics Conference. Topics included the economics of privacy; the effects of Internet-based advertising on search and product quality; and structural models of firm entry and conduct. Plans are well underway for the seventh annual conference, to be held in October 2014. We also have an active seminar series that features academic and government researchers.

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3 FTC Act, 15 U.S.C. § 46(f)
5 For example, a study of authorized generic drugs (FTC, 2011) and a study of the use of credit scores in the pricing of automobile insurance policies (FTC, 2007).
6 See http://www.ftc.gov/policy/reports/policy-reports/economics-research/working-papers.
B. This Year’s Article

In this year’s installment of our annual article in the *Review of Industrial Organization*’s antitrust and regulation issue, we highlight the work done by BE on two merger investigations and a consumer protection case. The antitrust investigations focused on a merger of office supply retailers and the acquisition of a physician group by a health system. The consumer protection matter involved the sale of training material that purported to help consumers make large profits in financial transactions, which in reality were not achieved by the vast majority of customers.

The section on the Office Depot and OfficeMax merger provides an interesting opportunity to compare the current competitive landscape for the sale of office supplies to that which existed more than 15 years ago when the FTC successfully challenged the merger of Staples and Office Depot. Although many of the empirical techniques used in the previous investigation again proved useful and informative, the conclusions reached were significantly different due to the evolving nature of competition in the relevant market.

Antitrust investigations often focus on the impact of a merger on prices in the relevant market. However, the second section of this article considers instead the impact that mergers can have on the quality of services. Specifically, it discusses the FTC’s approach to analyzing the effect that mergers in healthcare markets can have on the quality of care that is provided by the merging parties, which is clearly an important factor that affects consumer welfare. Although the standards of evidence are no different than those that are used to analyze efficiency claims in any merger, the mechanisms for potentially achieving the efficiencies in healthcare settings are unique, and so the analysis must be tailored accordingly. This section starts with a general exposition of that analysis, and then discusses its application to the acquisition of the Saltzer Medical Group by the St. Luke's Health System in Idaho.

The final section discusses the economic analysis that was conducted by the FTC that refuted a particular claim made by the purveyor of an alleged get-rich-quick scheme. The defendants, the Dalbey Educational Institute and associated individuals, were charged with deceptively marketing instructional materials that purported to teach consumers how to find, broker, and earn commissions on seller-financed promissory notes or cash flow notes. When presented with evidence that very few of their clients were eventually able to broker these notes or earn commissions, they offered the creative defense that these individuals suffered from the same sort of behavioral biases that cause many individuals to buy gym memberships that
subsequently go unused. This section describes the evidence that BE economists developed to refute this claim in court.

II. Office Depot / OfficeMax

In 1997, the FTC successfully challenged the proposed merger of Staples and Office Depot (ODP), which, along with OfficeMax (OMX), comprised the office supply superstore (OSS) product market that the FTC successfully alleged in that case (Ashenfelter, et al., 2006).

In 2013, the proposed merger of ODP and OMX would again combine two of the largest office supply retail chains and two of the largest suppliers of office products to businesses in the U.S. In both of these broad segments, ODP, OMX, and Staples supply a range of products that includes: office supplies (e.g., legal pads, tape, staplers, pens, binders, and file folders); printer and copier paper; ink and toner; office furniture; technology products; custom print and copy offerings; and janitorial, sanitation, and break room supplies. Locally and nationally, ODP, OMX, and Staples supplied these products directly to individual consumers and small businesses through their retail stores and to institutions and businesses in a variety of ways that include contractual arrangements.

Much had changed since 1997. In addition to an increased presence of other retailers, such as Wal-Mart and club stores, office supplies could be obtained from the three OSS retailers online, and through other online suppliers such as Amazon. Nonetheless, the traditional bricks-and-mortar competition between OSS retailers that was the focus of the FTC’s challenge in Staples/ODP might still have been significant.⁹

In this section, we summarize the empirical analyses conducted by the FTC in assessing the likely competitive effects of the proposed merger in the bricks-and-mortar retail segment. Although confidentiality restrictions prevent us from reporting specific coefficient estimates, the model specification and qualitative discussion of the results below still provide a thorough roadmap of BE’s analysis of the empirical evidence in this case.

Similar to the analyses conducted by the FTC’s econometric expert in Staples, and in subsequent matters such as Whole Foods,¹⁰ we used reduced-form regression models to estimate

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⁹ See, for example, a Wall Street Journal study from December 12, 2012, that suggested Staples’ online prices were lower when the requesting computer was located near an ODP or OMX retail store, Valentino-Devries (2012).

¹⁰ See Murphy (2007).
the relationship between ODP and OMX margins and prices and the number of competitor stores within given drive-time thresholds of the parties’ stores.\textsuperscript{11} The estimated relationship was then used to predict the effect of the hypothetical closure of all OMX(ODP) stores on margins and prices of ODP(OMX). Again, following Staples, we estimated both panel data and cross-sectional regressions.\textsuperscript{12} We also used different dependent variables, including store/department-level margins that were constructed from data at the stock-keeping unit (SKU) and department levels; store/SKU-level prices; and store-level price indices that were constructed by the parties.\textsuperscript{13}

We applied the regression models to various combinations of ODP and OMX stores and products. While the baseline models included all ODP and OMX stores, we also estimated the models using two subsets of stores: First, we limited the set of stores by excluding any ODP (OMX) store that did not experience any Staples or OMX (ODP) entry or exit over the sample period. The rationale was that, because demand conditions in these two types of areas may have been fundamentally different, stores in areas that experienced no competing OSS entry or exit over the entire sample period may have been poor controls for stores in areas that did experience such entry or exit.

Second, we limited the set of stores by excluding any ODP (OMX) stores that did not have a Staples store within 30 minutes at any point in the sample period, as the effect of OMX (ODP) entry/exit events on ODP (OMX) prices and margins might have depended on whether a Staples store was proximate.

We considered four sets of products: The baseline models limited the analyses to products in the “consumable office supplies” category, which we defined as office supplies, copy paper, and ink/toner. We also considered three subsets of products for which competitive conditions may have been meaningfully different. First, we excluded copy paper, ink, and toner SKUs, since the degree of competition from mass merchants, club stores, and the Internet might

\textsuperscript{11} See Ashenfelter, et al. (2006) for a summary of the analyses that were conducted in Staples. The approach has the useful attribute of not requiring an a priori market definition. The set of stores included on the right-hand side need not be limited to those within any purported product market.

\textsuperscript{12} See Ashenfelter, et al. (2006) for a description of the relative strengths of these approaches.

\textsuperscript{13} Intuitively, there is likely meaningful interaction between the brick-and-mortar and online retail segments. While our analyses did not explicitly model this interaction, the potential effect of online competition nonetheless was captured in our reduced-form results. For example, if consumers viewed brick-and-mortar and online suppliers as highly substitutable, this would have been reflected in our results since margins and prices would be less responsive to the entry/exit of competing brick-and-mortar stores.
have been systematically different for these products. Second, we excluded SKUs that were identified by the parties’ documents as likely to be price-sensitive. Third, we excluded SKUs that were identified by the parties as being priced on a national basis.

A. Data

The data were primarily provided to us by the parties in conjunction with the FTC’s investigation. These included net sales and cost information at the store department/month level for the years 2008-2012, as well as net sales, units sold, and cost of goods sold (COGS) at the store/SKU/week level for the years 2008-2012. We also utilized data on store locations and entry/exit dates for the following firms: ODP, OMX, Staples, Wal-Mart, Target, Costco, Sam’s Club, and Best Buy.

In the SKU-level analyses, we aggregated the weekly store/SKU-level data up to 66 four-week periods.\(^\text{14}\) For each store/SKU/four-week period combination, we defined the unit price as the ratio of total net sales to total units sold, and unit cost as the ratio of total cost-of-good sold to total units sold.

In the margin analyses, we defined the margin using both the SKU-level data and the department-level data. The department-level data included additional fields that contained information on variable costs, and, therefore, were appropriate to include in the definition of margin. However, the department-level data did not contain the level of refinement in product categories that were observed in the SKU-level data.\(^\text{15}\) Therefore, we also constructed margins using the SKU-level data. This approach permitted an analysis of margins defined on a wide variety of product categories and sub-categories. However, the margins constructed from the SKU-level data likely understated variable costs because the data contain information on COGS, but not other components of variable cost. Because of the added potential for omitted variable

\(^{14}\) We aggregated the weekly SKU-level data for two reasons: First, our SKU-level analyses involved estimating tens of thousands of fixed-effects panel regression models under the time constraints imposed by the HSR Act. Aggregating to four-week periods significantly reduced the computational burden. Second, aggregating to four-week periods reduced the number of missing observations in the price/cost time series within SKU-store combinations. Of course, the aggregation may have made the estimated treatment effects less precise. In addition, the aggregation may have engendered a bias towards zero in our results since some prices from the post-entry/exit period may have been averaged into the pre-entry/exit period. However, since, as discussed below, we controlled for the four-week period that captured the entry/exit event, as well as the preceding four-week period, we believe that the likelihood of meaningful bias due to aggregating to the four-week period is minimal.

\(^{15}\) For example, we can analyze margins using only a single product category: office supplies, from which we cannot separate copy paper. Moreover, we cannot separately analyze margins for all office consumables, including ink/toner, because those products are not separated from other products in the technology department in the department level data.
bias, we limited the analyses using margins constructed from the SKU-level data to the panel data regression models.

B. Regression Models

Our regression models were similar to those estimated in Staples. Let $y_{kt}$ denote the logarithm of the margin (or price) for ODP(OMX) store $k$ in period $t$, and $N_{jkt}^d$ denote the number of stores of competitor $j$ within $d$ minutes from ODP(OMX) store $k$ in period $t$. We specified the panel data regression model based on 0-5, 5-15, and 15-30 minute drive-time thresholds around store $k$ as

\[ y_{kt} = \beta_k + \beta_t + \sum_{d \in D} \sum_{j \in J} \beta_j^d \left( N_{jkt}^d \right)^{1/2} + \sum_{j \in J} \gamma_j 1 \left[ N_{jkt}^3 \neq N_{jkt+1}^3 \text{ or } N_{jkt}^3 \neq N_{jkt-1}^3 \right] + \epsilon_{kt} \]

where $\beta_k$ denotes a fixed-effect for ODP store $k$, $\beta_t$ denotes a fixed-effect for period $t$, $J$ denotes the set \{OMX(ODP), Staples, Wal-Mart, Target, Costco, Sam’s Club, Best Buy\}, $D$ denotes the set \{5, 15, 30\}, and $\epsilon_{kt}$ denotes the error term of the regression model.\(^{16}\) The term $\beta_j^d \left( N_{jkt}^d \right)^{1/2}$ captures the effect of the number of stores of competitor $j$ within $d$ minutes of ODP(OMX) store $k$ in period $t$ on ODP(OMX) store $k$’s price (or margin).\(^{17,18}\) We also added an indicator variable for the period in which an entry/exit event occurs as well as the preceding period. This accounted for the possibility of promotional activities on the part of store $j$ about the time that a competing store enters or exits. We restricted the coefficient on this indicator variable, $\gamma_j$, to be equal for any entry/exit event up to 30 minutes from the store, but we did permit this coefficient to vary across competitors. Finally, the SKU-level price models also controlled for the average COGS.

Given the estimates of the model parameters, we estimated the predicted percent change in ODP price or margin under the hypothetical of closing all OMX stores by taking a weighted average of

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\(^{16}\) Throughout all of our analyses, we constructed standard errors and p-values of our estimates from an estimated covariance matrix that allows for arbitrary forms of correlation in the error term within stores, across time periods.

\(^{17}\) We also estimated regression models that specified a single marginal effect for entry/exit across a 30-minute threshold. However, the implied parameter restrictions were generally rejected by the data.

\(^{18}\) In Staples, the FTC’s econometric expert captured the effect of local competition using the natural log of the number of competitors, as opposed to the square root. Because the natural log is not defined at zero, an indicator variable was added for the outcome in which there were no local stores of a given competitor. However, there was no within-store variation in this indicator variable in some of our specifications. Under this circumstance, the effect of closing all OMX (ODP) stores on ODP (OMX) prices or margins could not be predicted. Since the square root function is defined at zero, it does not require this added indicator variable. Hence, we adopted the square root specification here.
\[
\exp\left\{-\sum_{d\in D} \hat{\beta}_{OMX}^d \left(N_{OMXkt}^d\right)^{1/2}\right\} - 1
\]

where the average was taken across ODP stores in the last year of the data, and the weights were based on store net sales. We included only ODP stores that would be affected under the hypothetical closure. That is to say, we excluded from the weighted average any ODP store \(k\) for which \(N_{OMXkt}^{30} = 0\) during the last year of the data.

We used two specifications in our cross-sectional analyses: First, we modified (1) by eliminating the store-level fixed effects and limiting the sample to the last three months of the data.\(^{19}\) We estimated the effect of OMX (ODP) closures on ODP (OMX) margins using two store populations: ODP (OMX) stores that had a Staples store within 30 minutes, and ODP (OMX) stores that did not have a Staples store within 30 minutes.

While this cross-sectional model was very similar to the model utilized in the panel studies, it did not provide a straightforward answer to the question of how ODP and OMX margins vary in the presence of one, two, and three different OSSs in a geographic area, controlling for the level of non-OSS competition. To address this question directly, we estimated a second cross-sectional model in which we transformed the explanatory variables for ODP, OMX, and Staples into indicator variables that were defined on whether there was at least one ODP (OMX, Staples) store within 30 minutes. In addition, in examining ODP margins, we interacted the OMX and Staples indicator variables, and used an analogous interaction in examining OMX margins. Hence, the question of how ODP and OMX margins varied in the presence of one, two, and three different OSSs in a geographic area, controlling for the level of non-OSS competition, could be answered directly from the regression coefficient estimates in this specification.

C. Results

Our panel study analyses produced no evidence of a systematic relationship between ODP (OMX) prices and margins and OMX (ODP) entry/exit events when all ODP (OMX) stores were included in the analysis, and when we excluded any ODP (OMX) store that did not experience any Staples or OMX (ODP) entry or exit over the sample period. However, our panel analyses initially did suggest that there may have been such a relationship for ODP and OMX

\(^{19}\) We also investigated larger time frames and found similar results.
stores that were not within 30 minutes of at least one Staples store. But further analysis revealed that these results were not robust, primarily because there were an extremely small number of closures by the merging parties for this set of stores. We discuss our results using the predicted effect of OMX closures on ODP margins as constructed from the SKU-level data for two product categories: all office consumables, and office consumables excluding copy paper, ink, and toner.

When all ODP stores were included, we found no meaningful relationship in either product category. When the sample was limited to ODP stores that did not have a Staples store within 30 minutes, we found an economically and statistically significant relationship in both product categories. Consistent with the intuition for excluding copy paper, ink, and toner SKUs, the predicted effect on ODP margins was larger when these SKUs are excluded.

However, further analysis revealed that this predicted effect was identified from a large number of treatment events that were all generated in a single large metropolitan area where only one of more than ten OMX stores closed. We also found that the results were highly sensitive to the omission of one of the treated ODP stores. When expanding the ODP store population to include stores that had a Staples store within 20-30 minutes, and dropping the aforementioned ODP store, we again found no meaningful relationship for all consumables, and found a significantly lower effect when excluding copy paper, ink, and toner SKUs, although the prediction was still economically significant.

Our SKU-level price regression analyses yielded similar results. However, the SKU-level analyses also revealed that results were largely driven by very large price increases for a modest number of SKUs that occurred several months after the OMX closure. Given the modest reduction in competition that resulted from this closure (one OMX store, out of more than ten), the estimated price effects seemed suspiciously large when compared to the estimated effects from other closures in markets with far fewer OMX stores.

Our conclusion was that, while there was a significant price increase for many SKUs at these ODP stores around the time of the closure, it was difficult to conclude that these predicted effects reflect a causal relationship between the number of OMX stores and ODP prices. Rather, it was more likely that the observed price changes were driven largely by an unobserved factor that was correlated with the number of OMX stores in that area.

Given the limited number of identifying entry/exit events and the instability of the panel study results, we turned to the cross-sectional analyses. As discussed in Ashenfelter, et al.
(2006), cross-sectional analyses may be useful particularly in cases in which there are few identifying events. However, cross-sectional analyses are more likely to suffer from omitted variable bias, and this may be particularly true when making comparisons across widely dispersed geographic areas, as is the case here.

With that caveat in mind, we analyzed a cross-sectional specification using ODP and OMX margins that were constructed from the department-level data as the dependent variable. This model directly estimated differences in ODP and OMX margins in the presence of one, two, and three different OSSs in a geographic area, controlling for the level of non-OSS competition. Consistent with our panel study results, we found no relationship between OMX margins and the extent of OSS competition. We also found that ODP margins were lower when either OMX or Staples was present; but conditional on the presence of one, adding the other did not meaningfully affect ODP margins. The cross-sectional results were also consistent with our panel study results insofar as we found some, although not robust, evidence that ODP margins responded to OMX entry/exit only if Staples was not close by.

Using the predicted percent changes in margins from this analysis, under the assumption of constant marginal cost, the predicted percent changes in price were estimated using the formula:

$$\% \Delta P = \% \Delta M \frac{M_0}{1 - M_1},$$

where $P$ denotes price and $M_0$ and $M_1$ denote the before-closure and after-closure margins, respectively. For instance, we employed this formula to generate a predicted price difference between ODP stores that did not have any OSS competitors within 30 minutes and ODP stores that had at least one OMX store within 30 minutes.\(^\text{20}\)

We concluded that despite the presence of some ambiguity in our results, they did not support a recommendation to the Commission to challenge the proposed merger. Given the lack of robustness in the results from the panel study analyses, and the aforementioned potential difficulties associated with drawing inferences from cross-sectional analyses, we concluded that our results did not provide a sufficient basis for deciding that the proposed merger was likely to be anticompetitive. We note also the contrast between these results, and the findings from

\(^\text{20}\) Note that we did not apply this formula to the predicted margin changes constructed from the SKU-level data since, as described above, those margin levels were likely measured with significant error.
In that case, the panel study and cross-sectional analyses yielded similar economically and statistically significant results, and were consistent with the other types of evidence.\textsuperscript{21}

Finally, we note that our results were based on the predictions of the likely effects of the hypothetical closure of all ODP (OMX) stores on the prices or margins of OMX (ODP). This approach, while useful for identifying the potential for concern that the proposed merger may be anticompetitive, is not a merger simulation. Hence, it does not predict what is likely to occur under the merger, and, absent evidence that the merged entity will likely close all stores of one banner or the other, these analyses may overstate the likely effects of the merger on prices and margins.

III. Quality Efficiencies Analysis in Health Care Markets

In recent years, we have described the Bureau of Economics’ approach to analyzing product markets and competitive effects in mergers of hospitals and health care providers.\textsuperscript{22} These analyses mostly focus on price; but in health care markets, the quality of patient care is also an important part of the complete competitive analysis. Clearly, the quality of care that is received by patients has a large impact on welfare in the health care sector. It has become common for merging health care providers to assert that the merger will improve quality. In this year’s discussion, we briefly describe the general framework underlying our analysis of efficiency justifications and quality improvement claims in health care provider mergers.

We then discuss in greater detail our efficiencies analysis in the FTC’s recent challenge of the acquisition of the Saltzer Medical Group by St. Luke’s Health System.\textsuperscript{23} The analysis of the St Luke’s case is extremely important because the merging parties’ defense of the transaction was that it was necessary to achieve integrated care, as promoted by the Affordable Care Act (ACA),\textsuperscript{24} including a move away from the traditional fee-for-service care model to a value-based care model. Since the District Court ruled that the transaction was anticompetitive, the parties, and many commentators, have complained that the federal government is providing conflicting

\textsuperscript{21}See Ashenfelter, et al. (2006). The econometric evidence in Staples was consistent with the parties’ documents with regard to pricing strategies, the parties’ marketing materials, and the testimony of non-OSS vendors.

\textsuperscript{22}See Farrell, et al. (2011) and Carlson, et al. (2013).


\textsuperscript{24}See Pate (2013).
signals to health care providers: encouraging greater coordination of patient care through the 
ACA, yet enforcing antitrust laws against firms’ efforts to improve care coordination through 
consolidation. We hope that this discussion demonstrates that there need be no conflict between 
health care reform and competition law, and that both are necessary to lower health care costs 
and improve patient care.\(^{25}\)

A. Key Factors in the Analysis of Quality Efficiencies

According to the 2010 DOJ-FTC Horizontal Merger Guidelines,\(^{26}\) the agencies will take 
into account efficiencies if and only if the claimed efficiencies are verifiable, non-speculative, 
and merger-specific. These criteria are the same whether or not the merger involves health care 
providers.

In mergers not involving health care providers, the asserted efficiencies usually involve 
reductions in production costs. In mergers involving health care providers, the parties frequently 
assert that the merger will improve the quality of patient care. However, evidence of the 
direction and magnitude of the association between costs and the quality of care is inconsistent.\(^{27}\) 
In addition, the evidence, both theoretical and empirical, does not find support for the notion that 
health care mergers, especially hospital mergers, lead to higher quality outcomes.\(^{28}\)

In general, a merger will lead to improved quality only if it leads to an increase in the 
profitability of producing quality. This can occur if the merger increases the revenue received 
from producing higher quality, or if the merger reduces the costs of producing quality. Only the 
latter is a valid efficiency argument under the merger guidelines.

Romano and Balan (2011) provide a detailed approach to analyzing efficiency and 
quality improvement claims of health care providers. They focus on hospital mergers, but the 
analysis can be applied to other provider combinations. In this section, we identify the two most 
likely sources of quality improvement, and discuss how to evaluate whether a merger is likely to 
create these improvements. A merger might improve quality if it extends a provider’s clinically 
superior quality to its merger partner, or if it helps the merged entity attain economies of scale 
that can lower the costs of producing quality.

\(^{27}\) See Hussey, et al. (2013).
A common efficiency justification for health care mergers is that the acquisition will allow a higher-quality acquirer to improve the quality of a poorly performing acquired provider. For this to be a credible efficiency claim, two things must be true: (1) one of the providers must have demonstrated practices or institutions that produce superior quality; and (2) these practices must be easily exported to the other provider to enable that provider to achieve these quality improvements more easily than it could have absent the merger.

The first step in the analysis of these claims is to establish whether one of the providers is actually clinically superior to the other, for if there are no differences in quality pre-merger, improvements are unlikely post-merger. Since numerous quality measures are extensively tracked by hospitals, ample empirical evidence can be evaluated to judge the likelihood of differences in provider quality. In most mergers, we look to see if one of the providers has significantly better measured quality, both on an absolute basis, and adjusting for patient population risks.

If we can establish the requisite difference in pre-existing quality, the analysis then proceeds to the second step: determining if the conditions exist for the higher-quality practices to be implemented by the lower-quality provider. The likelihood of an improvement resulting from a transmission of clinical superiority is greater when specific quality-improving measures have been adopted by the acquiring provider, and when there are concrete plans to export them following the merger. If there is evidence of quality improvements (leading to superior performance, not just relative quality gains) that have followed the adoption of specific practices or protocols, the efficiency justification is more likely to be verifiable and non-speculative. Similarly, if the acquiring firm has been able to improve the quality of other providers post-merger, this will be an important part of the analysis.

Once quality superiority is established, merger-specificity must still be demonstrated. In other words, it must be shown that the merger is necessary to achieve the improvements: i.e.,

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29 See Romano and Balan (2011) for the retrospective quality analysis performed by Dr. Romano as an expert for the FTC in its successful retroactive suit against the Evanston–Northwestern hospital merger: In re Evanston Northwestern Healthcare Corp. FTC No. 9315 (August 6, 2007). See also the prospective merger analysis in the FTC’s administrative complaint in Inova Health System Foundation–Prince William Health System, which asserted at ¶35: “Currently, the quality of PWHS’ services is comparable to, and at times superior to, the quality of Inova’s services, as measured by numerous objective quality criteria. Accordingly, Inova is unlikely to improve PWHS’ quality of service or to help generate other efficiencies sufficient to offset the Merger’s anticompetitive effects.” http://www.ftc.gov/sites/default/files/documents/cases/2008/05/080509admincomplaint.pdf.

30 See Romano and Balan (2011). It is important to look at both versions of statistics because differences or changes in coding of patient co-morbidities can make comparisons of risk-adjusted metrics misleading.
they could not be achieved (at the same cost) through other means (e.g., a contract that preserves competition between the parties). Quality standards and evidence-based best-practice guidelines are widely available, so evidence that links the specifics of the merger to projected improvements is critical.31 Once again, improvements that have resulted from past mergers can be valuable evidence of the specificity of likely efficiencies. For example, geographic proximity, which allowed the physical presence of personnel from the superior provider to improve care, might demonstrate the likelihood of merger specificity claims.

Potential merger efficiencies which result from economies of scale in the provision of services and quality can also be investigated directly. One source of scale efficiencies can come from the use of equipment that has such high fixed costs (and low marginal costs) that smaller providers might not utilize it, but a larger provider or system would (and that it would be uneconomic for the smaller providers separately to purchase the equipment services from a third party). It is possible that the merged firm could become large enough to invest in and utilize this equipment, or that the larger of the two firms could extend to the other the benefits of the existing investment. Greater provider size or utilization can have a large effect on quality only if the economies of scale are correspondingly large and if the interventions that provide large economies of scale are highly clinically important. A general claim that substantial patient volumes are necessary to reduce costs or improve care is not likely to be considered convincing evidence.

Scale economies sometimes can arise for surgical procedures that exhibit a volume–outcome relationship, such that repetition of the procedure generates better clinical outcomes for individual surgeons or facilities. Clinical evidence suggests that such scale effects appear to be strongest for certain high-risk, technically complex surgical procedures.32 By consolidating such procedures at fewer hospitals, or by sending experienced personnel from one hospital to another, a system potentially can reap the benefits of increased scale. However, if the consolidation is for a procedure that does not show improved outcomes that are associated with volume, or if individual surgeons continue to do the same number of procedures as before the merger, a merger that combines the service into the same facility is less likely to achieve the claimed cost efficiencies and quality benefits.

31 See, for example, the National Quality Forum’s endorsed quality measures for improving the quality of care.
32 See Halm, et al. (2002). Economists have also looked at this; see Ho, Town, and Heslin (2007), Gowrisankaran and Town (2003), and Gaynor, et al. (2005).
B. Application to a Specific Acquisition: St. Luke’s Health System

Many of these issues arose in the FTC’s recent challenge of a physician group by a health system in Idaho (Alphonsus Medical Center – Nampa, Inc., et al. v. St. Luke’s Health System, Ltd., 2014-1 Trade Cas. (CCH) P78,667). St. Luke’s proposed merger would have joined the largest health system in the state, already including seven hospitals and more than 400 employed physicians, with Saltzer, the largest multispecialty physician group in the state. The FTC’s complaint alleged that this combination would lead to a significant increase in concentration in the market for adult primary care services in Nampa, Idaho, and would provide St. Luke’s with power to raise prices for these services.

While it challenged the FTC’s definition of the relevant product market and the FTC’s claims about the merger’s likely competitive effects, St. Luke’s key defense was that the merger was necessary to provide integrated care and achieve the “triple aim” of better quality health, lower costs, and better population health. St. Luke’s asserted that the merger would improve its quality and reduce its costs by implementing evidence-based medicine through its entire system; by coordinating patient care using a single electronic medical record (“EMR”); and by enabling St. Luke’s to enter into full risk-based service contracts with payers. But at its core, St. Luke’s argument was that there was only one way to achieve integrated patient care: by employing Saltzer physicians and creating a fully financially and vertically integrated health system.

Notwithstanding St. Luke’s assertions, employing physicians is not the only way to change their incentives to provide high-quality integrated patient care. An integrated delivery system (IDS), especially a financially integrated one, does not guarantee integrated patient care. Instead, integrated care is provided by a continuum of collaborative arrangements by which health care providers seek to achieve specific shared goals or purposes through various economic, non-economic, and clinical relationships. The World Health Organization (WHO) has a working definition of integrated health care that simplifies the idea to “organization and management of health services so that people get the care they need, when they need it, in ways that are user-friendly; achieve the desired results and provide value for money.”

A broad range of financial arrangements and organizational structures can allow providers to satisfy these principles. At the one end of the organizational structure spectrum are

33 See Berwick et al. (2008).
the financially integrated models that St. Luke’s targeted, like Kaiser Permanente and the Mayo Clinic. But full financial integration does not guarantee highly integrated care, as the history of the Veteran’s Health system clearly shows.35 An example of a less financially integrated, but still very clinically integrated system is the Advocate Health System in Illinois, which includes a significant number of independent providers. Innovations in organizational structures that are aimed at producing integrated patient care are still evolving, as the multiplicity of forms and models of the ACA’s accountable care organizations (ACOs) show. The ACO evidence to date has not shown that a particular organizational structure of ACO – hospital based or otherwise – has proven the most successful at providing high-quality, cost-efficient patient care.36

St. Luke’s has experience working with independent, non-financially integrated physicians. St. Luke’s also uses independent physicians as some of its medical directors. These medical directors are responsible, in part, for improving the quality of care by implementing and developing evidence-based best practices and standardizing processes of care for the clinical areas for which they are responsible. More importantly, senior St. Luke’s executives testified that working with independent providers was necessary to achieve its integrated care vision.

However, St. Luke’s witnesses sought to deflect the necessity to work with non-financially integrated physicians by claiming that Saltzer was essential to developing a core group of primary care providers that would be the innovators of best practices that would be extended to wider use. Nonetheless, the witnesses did not agree on the number of core providers, and no empirical literature demonstrates how many are necessary. Since St. Luke’s has a significant number of existing employed physicians, the development of a core of providers was not a merger-specific efficiency.

There was also no evidence that there was a significant difference in the quality of care between Saltzer’s and St. Luke’s providers. No evidence was presented showing differences in prescribing or testing habits, or other differences in resource utilization. Had St. Luke’s demonstrated improvements in the many physician group practices it had recently acquired, this would have been a significant factor in the analysis. While the parties did not provide convincing evidence that financial integration would improve quality and costs, the FTC’s economic expert

36 See L&M Policy Research and Partners (2013). In the executive summary, the authors state that “The 8 (of 32) ACOs that reduced spending growth varied in geographic location, size, organizational structure, and average Medicare spending in their markets, suggesting that ACOs can achieve lower spending growth under a range of market conditions and organizational structures.”
(Professor David Dranove) analyzed this issue. He conducted a differences-in-differences expenditure analysis of previous St. Luke’s physician acquisitions, and found little evidence that past mergers had reduced health care spending. In addition, no evidence presented at trial suggested that St. Luke’s had superior quality that could be passed on to an integrated Saltzer. Thus, there was little evidence to support a merger-specific efficiency based on quality differences.

St. Luke’s also claimed that it would extend its Epic EMR system to Saltzer as a result of the merger. A single centralized EMR can help to coordinate patient care, but St. Luke’s claim that its ability to extend to Saltzer its Epic EMR was not an efficiency. Saltzer already had a different EMR, and switching to another EMR would likely yield disruption to workflow during a transition period. In addition, because St. Luke’s recognized that including more providers in its system could have improved patient care more widely in Idaho, it was developing an Affiliate EMR program to help independent practices get access to Epic. Saltzer could have taken advantage of that program if it wanted to switch to Epic. The merger would also not increase the speed of the Epic roll-out to all St. Luke’s providers, as some of the system hospitals were years away from transitioning.

Even the same EMR might not have been necessary to provide integrated care if there were another source of centralized patient care data. An easily accessible data warehouse or health information exchange can allow providers to share important data -- such as radiology and test results -- without providers’ being on the same EMR. The Health Information Technology for Economic and Clinical Health (HITECH) Act has provided the funding for local data exchange initiatives, including support for the Idaho Health Data Exchange (IHDE).

The IHDE’s development also weakens the efficiency claim. St. Luke’s has been a major sponsor of the IHDE, which is a way to connect providers throughout the state. But the real step to advance information sharing broadly is through greater interoperability of different EMRs, and this will be an important feature of most systems in the next few years.37

An important part of integrated patient care is not just having shared medical records, but having the analytical and decision tools to use the data that are contained in the medical records.

37 The HITECH Act includes an incentive program for providers’ meaningful use of electronic health records. Stage 2 meaningful use criteria include interoperability measures. See http://www.healthit.gov/providers-professionals/how-attain-meaningful-use.
St. Luke’s asserted that Saltzer would have been unable to gain access to its new data analytic tool absent the transaction.

However, the evidence did not support this efficiency. The tool was still in development and not actively utilized by any other health care system, and thus its effectiveness was not demonstrated. If Saltzer had wanted to integrate a data analytics tool into its existing EMR, there were a number of more widely used software packages available. For example, during the trial, the other major hospital in the area (and a private plaintiff), St. Alphonsus, demonstrated Explorys, which is another data analytical tool. It had the additional benefit of being widely used and therefore better suited to population health management, which is necessary to negotiate risk-based contracts.

St. Luke’s asserted that it needed to employ the Saltzer doctors to change their incentives from those in traditional fee-for-service medicine. Only by changing these incentives could Saltzer effectively practice the type of value-based medicine to enter full risk-based contracts with payers. However, this claimed efficiency was at odds with St. Luke’s current practice and its actual agreement with Saltzer. Under the professional services agreement, Saltzer doctors were to be paid for the volume of services provided. The Saltzer physicians, for the next two years at least, were going to earn more money in accordance with providing more services. The agreement between Saltzer and St. Luke’s did not detail any performance-based or risk-based compensation, despite the fact that movement in that direction was what the merger was supposed to facilitate. Furthermore, the evidence supported the notion that risk-based arrangements were in use in Idaho for provider groups of varying sizes.

In conclusion, the evidence was insufficient to conclude that St. Luke’s acquisition of Saltzer would create verifiable, non-speculative, and merger-specific quality efficiencies.

IV. Dalbey Education Institute
Economists in the Bureau’s Division of Consumer Protection frequently work with marketing researchers and attorneys to collect and analyze consumer behavior data in the course of investigations. The Federal Trade Commission’s case against Russell and Catherine Dalbey and the Dalbey Education Institute (DEI) provides an example of how such research is used in litigation. This matter is particularly interesting because the litigation team worked together to
examine a novel defense with roots in behavioral economics: the “unused gym membership” theory.

A. Case Background

DEI created and disseminated infomercials and direct mail advertisements for their signature product: “Winning in the Cash Flow Business.” The product consisted of a series of training materials that were designed to teach consumers how to locate and broker seller-financed promissory notes (“cash flow notes”), which are privately held mortgages or notes that are often secured by the home or land that is the subject of the loan. DEI advertised that consumers would quickly and easily earn substantial amounts of money through commissions from brokering these cash flow notes.

Approximately 949,000 consumers throughout the U.S. and Canada purchased this initial product, ranging in price from $40 to $160, from DEI. DEI also offered “up-sells”, such as additional training materials or coaching sessions, which ranged in price from hundreds to thousands of dollars. DEI’s revenues (less refunds and chargebacks) from 2006 to 2011 exceeded $330 million. DEI’s sole substantiation for the validity of the claims made in their advertisements was a list of 296 individuals (out of 949,000 customers) who had self-reported to DEI earning money from brokering notes.

B. FTC Evidence

FTC staff commissioned a survey in order to measure the success rates of DEI customers. DEI’s attorneys articulated a novel defense: the “unused gym membership” defense. The defendants’ attorneys argued that DEI customers may not be achieving their desired level of success due to present-bias or hyperbolic discounting. That is, for the same reasons that individuals frequently promise (themselves) to start their diets tomorrow or under-utilize gym memberships, consumers may have purchased DEI’s training materials but then not invested the necessary time or effort to achieve success (O’Donoghue and Rabin, 1999; DellaVigna and Malmendier, 2006).

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38 FTC v. Dalbey, No. 11-cv-01396-RBJ-KLM (D. Colo.) (Final Pretrial Order) (filed May 9, 2013, Stipulation #30).
39 FTC v. Dalbey, No. 11-cv-01396-RBJ-KLM (D. Colo.) (Final Pretrial Order) (filed May 9, 2013, Stipulation #39).
40 FTC v. Dalbey, No. 11-cv-01396-RBJ-KLM (D. Colo.) (Defendants’ Motion to Exclude Plaintiffs’ Experts Dr. Manoj Hastak and Dr. Frederica Conrey) (filed Nov. 6, 2012).
FTC staff obtained and examined DEI’s customer purchase database. To address the defendants’ novel defense, we tabulated customer expenditures and stratified the customers into two groups: individuals who spent less than $500 on DEI products and services (representing 86% of customers), and individuals who spent $500 or more. We stratified by customer expenditure under the theory that individuals who spent $500 or more signaled that they were likely to make an effort to locate and broker cash flow notes, and any lack of success would be unlikely to be attributable solely to a lack of effort.\footnote{We stratified at the $500 cutoff because: (1) given the pricing of DEI’s up-sells, spending more than $500 required purchasing at least one substantial additional training product or service; and (2) there was a sharp increase in the c.d.f. of customer expenditures around $500, naturally dividing customers into two distinct groups.} We then drew a random sample of 1,500 consumers from each of these two groups for a survey about their experiences and outcomes with DEI.

FTC staff conducted a mail survey to assess: (1) the frequency and magnitude of success of DEI consumers in earning money by brokering cash flow notes; and (2) the difference in success rates, if any, between customers that spent less than $500 versus those that spent $500 or more on DEI training materials. In addition, FTC staff commissioned a follow-up telephone survey that was designed to elicit the same information from the individuals who did not respond to the initial mail survey.

The surveys asked consumers how many hours per week they spent trying to broker notes in the first few months after their initial purchase from DEI; how many cash flow notes they brokered; and how much money they earned brokering notes. The results of the two surveys were clear: Although there was significant variation in the effort levels of the two expenditure groups, neither group achieved meaningful success in earning any money through the use of DEI’s materials.

For consumers spending less than $500 on DEI products, 0.8% reported ever brokering a note or earning any money. For consumers who spent $500 or more on DEI products, 2.7% reported ever brokering a note, and 1.9% reported earning any money from the transaction. Weighting the survey responses to account for the stratification and over-sampling of the high-expenditure customers implied that only 1.1% of respondents ever brokered a single note and 0.9% ever earned any money.

Given the disconnect between DEI’s advertising claims and the surveyed customers’ experiences, the FTC filed a complaint in 2011 that charged that defendants’ claims that
consumers would quickly and easily earn substantial revenue from brokering cash flow notes were false and unsubstantiated. The case settled in 2013 with an order that banned Dalbey and his wife from telemarketing, from marketing or selling business opportunities, and from producing or distributing infomercials. The settlement also contained a judgment for $330 million as equitable monetary relief.

In summary, analysis of the DEI customer database and the resulting survey of customer outcomes was an important component of demonstrating the falsity of DEI’s advertised claims. Specifically, an analysis that stratified customers based on observable measures of their investment helped refute the defendant’s claim that a behavioral economics phenomenon explained the low success rates of their clients.

V. Conclusion

FTC economists analyze a wide array of consumer and competition issues, as demonstrated in this article. Even as we address topics that have become familiar to us over the years, such as office supply retail mergers, healthcare consolidation, and alleged fraudulent behavior, we are constantly faced with new market realities and defense strategies that require us to advance and tailor our economic analyses. This is achieved not only through standard investigative techniques that uncover the most recent relevant information about the subjects of these investigations, but also by thinking hard about the underlying economics of the phenomena that we analyze and bringing to bear rigorous economic analysis that is informed by the best and most relevant scientific research in economics.

VI. References


Federal Trade Commission (FTC) filed action, seeking preliminary injunction under Federal Trade Commission Act to enjoin consumption of merger between office products superstores, pending final disposition of administrative proceedings to determine whether acquisition would substantially lessen competition in violation of Clayton Act and Federal Trade Commission Act. The District Court, Thomas F. Hogan, J., held that: (1) evidence of low cross-elasticity of demand between consumable office supplies sold by superstores and those sold by other retailers supported use of office supply superstore submarket as relevant product market; (2) FTC showed likelihood of success on merits and reasonable probability that proposed merger between office supply superstores would have anti-competitive effect in violation of antitrust laws; (3) evidence on whether barriers to entry existed and on alleged efficiencies from proposed merger did not rebut FTC’s evidence creating presumption that merger would substantially lessen competition; and (4) equities, both public and private, weighed in favor of granting preliminary injunction.

Preliminary injunction granted.

1. Monopolies ≅24(7.1)

In suit for preliminary relief, Federal Trade Commission (FTC) is not required to prove, nor is district court required to find, that proposed merger would in fact violate Clayton Act, which is question reserved for FTC; only question before court is whether FTC has made showing which justifies preliminary injunctive relief. Clayton Act, § 7, as amended, 15 U.S.C.A. § 18.

2. Monopolies ≅24(7.1)


3. Monopolies ≅24(7.1)

To obtain preliminary injunction pursuant to Federal Trade Commission Act, Federal Trade Commission (FTC) must show that there is reasonable probability that challenged transaction will substantially impair competition; although FTC need not prove to certainty that merger will have anti-competitive effect, which is question left to FTC after full administrative hearing, it is not enough for FTC to show merely that it has fair and tenable chance of ultimate success on merits. Clayton Act, § 7, as amended, 15 U.S.C.A. § 18; Federal Trade Commission Act, § 13(b), as amended, 15 U.S.C.A. § 53(b).

4. Monopolies ≅24(7.1)

In order to determine whether Federal Trade Commission (FTC) has met its burden with respect to showing its likelihood of success on merits, for purposes of obtaining preliminary injunction pursuant to Federal Trade Commission Act, district court must consider likely competitive effects of merger, if any, by determining line of commerce or product market in which to assess transaction, section of country or geographic market in which to assess transaction, and transaction’s probable effect on competition in product and geographic markets. Clayton Act, § 7, as amended, 15 U.S.C.A. § 18; Federal Trade Commission Act, § 13(b), as amended, 15 U.S.C.A. § 53(b).
5. Monopolies ⊆ 20(7)

Geographic market to be used in analysis of merger's probable effect on competition under Clayton Act is that geographic area to which consumers can practically turn for alternative sources of product and in which antitrust defendant faces competition. Clayton Act, § 7, as amended, 15 U.S.C.A. § 18.

6. Monopolies ⊆ 20(8)

General rule when determining relevant product market for purposes of analyzing potential merger under Clayton Act is that outer boundaries of product market are determined by reasonable interchangeability of use by consumers or cross-elasticity of demand between product itself and substitutes for it; court looks to whether there are other products offered to consumers which are similar in character or use to product or products in question, as well as how far buyers will go to substitute one commodity for another. Clayton Act, § 7, as amended, 15 U.S.C.A. § 18.

7. Monopolies ⊆ 20(8)


8. Monopolies ⊆ 20(8)

Evidence of low cross-elasticity of demand between consumable office supplies sold by superstores and those sold by other retailers, despite high degree of functional interchangeability of products, supported use of office supply superstore submarket as relevant product market in determining whether Federal Trade Commission (FTC) met burden of showing likelihood of success on merits of Clayton Act claim so as to support request for preliminary injunction under Federal Trade Commission Act; merging companies referred to markets without other office supply superstores as “non-competitive,” and were much more concerned with maintaining pricing parity with other office supply superstores than in undercutting other retailers. Clayton Act, § 7, as amended, 15 U.S.C.A. § 18; Federal Trade Commission Act, § 13(b), as amended, 15 U.S.C.A. § 53(b).

9. Monopolies ⊆ 20(8)

Unique combination of size, selection, depth and breadth of inventory offered by office supply superstores distinguished them from other retailers and supported use of office supply superstore submarket as relevant product market for purposes of determining whether Federal Trade Commission (FTC) met burden of showing likelihood of success on merits of Clayton Act claim so as to support request for preliminary injunction under Federal Trade Commission Act; other retailers devoted only fraction of their square footage to office supplies, and no one entering office supply superstore would mistake it for another type of retailer. Clayton Act, § 7, as amended, 15 U.S.C.A. § 18; Federal Trade Commission Act, § 13(b), as amended, 15 U.S.C.A. § 53(b).

10. Monopolies ⊆ 20(8)

Evidence that merging office supply superstores each considered other superstores as primary competition supported use of office supply superstore submarket as relevant product market for purposes of determining whether Federal Trade Commission (FTC) met burden of showing likelihood of success on merits of Clayton Act claim so as to support request for preliminary injunction under Federal Trade Commission Act; merging companies referred to markets without other office supply superstores as “non-competitive,” and were much more concerned with maintaining pricing parity with other office supply superstores than in undercutting other retailers. Clayton Act, § 7, as amended, 15 U.S.C.A. § 18; Federal Trade Commission Act, § 13(b), as amended, 15 U.S.C.A. § 53(b).

11. Monopolies ⊆ 24(7.1)

Federal Trade Commission (FTC) showed likelihood of success on merits and reasonable probability that proposed merger between office supply superstores would have anti-competitive effect in violation of Clayton Act, which thus supported FTC's request for preliminary injunction under Federal Trade Commission Act, in light of evidence of concentration statistics, Herfindahl-Hirschman Indexes (“HHIs”), and parties’ own pricing practices indicating that

12. Monopolies ██24(12)  
After Federal Trade Commission (FTC) established presumption that proposed merger would substantially lessen competition in violation of Clayton Act based on evidence that merger would lead to undue concentration in market for consumable office supplies sold by office superstores in geographic markets agreed upon, for purposes of FTC’s request for preliminary injunction under Federal Trade Commission Act, burden shifted to merging parties to produce evidence that market-share statistics gave inaccurate prediction of proposed acquisition’s probable effect on competition. Clayton Act, § 7, as amended, 15 U.S.C.A. § 18.

13. Monopolies ██24(7.1)  
Federal Trade Commission’s (FTC) showing that proposed merger of office supply superstores would substantially lessen competition, for purposes of FTC’s request for preliminary injunction under Federal Trade Commission Act, was not rebutted by parties’ evidence of isolated examples of lower product prices in specific competitive markets, nor by general and limited evidence on other factors which could affect pricing in different markets such as sales volume, product mixes, marketing costs, and distribution costs. Clayton Act, § 7, as amended, 15 U.S.C.A. § 18; Federal Trade Commission Act, § 13(b), as amended, 15 U.S.C.A. § 53(b).

14. Monopolies ██24(7.1)  
Evidence concerning existence of barriers to entry into submarket of consumable office supplies sold by office supply superstores did not rebut Federal Trade Commission’s (FTC) claim that proposed merger between office superstores would have anti-competitive effects in violation of Clayton Act and, thus, did not preclude issuance of preliminary injunction against merger under Federal Trade Commission Act; although merging parties presented evidence that other retailers had plans or ability to sell more office products, number of office superstore chains had fallen from 23 to 3 in recent years, new superstore would need nationwide outlets to achieve economies of scale, and other retailers had not been able to expand sales of office supplies sufficiently to constrain superstore pricing. Clayton Act, § 7, as amended, 15 U.S.C.A. § 18; Federal Trade Commission Act, § 13(b), as amended, 15 U.S.C.A. § 53(b).

15. Monopolies ██24(7.1)  
Evidence on alleged efficiencies from proposed merger between office supply superstores did not rebut Federal Trade Commission’s (FTC) evidence creating presumption that merger would substantially lessen competition in violation of Clayton Act and, thus, did not preclude preliminary injunction of merger under Federal Trade Commission Act; merging companies estimated that merger would save combined company about $5 billion and that 2/3 of savings would be passed on to consumers, but savings figures presented to boards of directors when they approved merger were 50% lower, estimate was not verified by necessary documentation, estimate included product cost savings that companies would likely have realized without merger, and companies had historically passed through only 15–17% of efficiency savings to customers. Clayton Act, § 7, as amended, 15 U.S.C.A. § 18; Federal Trade Commission Act, § 13(b), as amended, 15 U.S.C.A. § 53(b).

16. Monopolies ██24(7.1)  

17. Monopolies ██24(7.1)  
In balancing equities on whether to grant preliminary injunction under Federal Trade Commission Act to block merger, it is important for court to consider that, although private equities are important, when Federal Trade Commission (FTC) demonstrates like-

18. Monopolies <=24(7.1)

Weighing of public and private equities favored granting preliminary injunction under Federal Trade Commission Act to prevent proposed merger of office supply superstores; consolidation plans of combined company would preclude effective division later if merger was determined to violate antitrust laws, and lack of injunction would put consumers at risk of higher prices than if companies pursued pre-merger plans to expand aggressively into each other's markets, but companies asserted that injunction would preclude greater product selection and expansion into foreign markets, that injunction would inflict losses on merging company's shareholders, and that anticipation for merger has weakened company's ability to exist as stand alone company. Clayton Act, § 7, as amended, 15 U.S.C.A. § 18.

George Cary, Melvin Orlans, Bureau of Competition, Washington, DC, for F.T.C.

J. Mark Gidley, Christopher M. Curran, Francis A. Vasquez, Jr., White & Case, Washington, DC, for Staples, Inc.

Donald Kempf, Mark L. Kovner, Kirkland & Ellis, Washington, DC, for Office Depot.

REDACTED MEMORANDUM OPINION

THOMAS F. HOGAN, District Judge.

Plaintiff, the Federal Trade Commission ("FTC" or "Commission"), seeks a preliminary injunction pursuant to Section 13(b) of the Federal Trade Commission Act, 15 U.S.C. § 53(b), to enjoin the consummation of any acquisition by defendant Staples, Inc., of defendant Office Depot, Inc., pending final disposition before the Commission of administrative proceedings to determine whether such acquisition may substantially lessen competition in violation of Section 7 of the Clayton Act, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45. The proposed acquisition has been postponed pending the Court's decision on the motion for a preliminary injunction, which is now before the Court for decision after a five-day evidentiary hearing and the filing of proposed findings of fact and conclusions of law. For the reasons set forth below, the Court will grant the plaintiff's motion. This Memorandum Opinion constitutes the Court's findings of fact and conclusions of law.

BACKGROUND

The FTC is an administrative agency of the United States organized and existing pursuant to the Federal Trade Commission Act, 15 U.S.C. §§ 41–77. The Commission is responsible, inter alia, for enforcing federal antitrust laws particularly Section 7 of the Clayton Act and Sections 5 and 13(b) of the Federal Trade Commission Act.

Defendants are both corporations which sell office products—including office supplies, business machines, computers and furniture—through retail stores, commonly described as office supply superstores, as well as through direct mail delivery and contract stationer operations. Staples is the second largest office superstore chain in the United States with approximately 550 retail stores located in 28 states and the District of Columbia, primarily in the Northeast and California. In 1996 Staples' revenues from those stores were approximately $4 billion through all operations. Office Depot, the largest office superstore chain, operates over 500 retail office supply superstores that are located in 38 states and the District of Columbia, primarily in the South and Midwest. Office Depot's 1996 sales were approximately $6.1 billion. OfficeMax, Inc., is the only other office supply superstore firm in the United States.

On September 4, 1996, defendants Staples and Office Depot, and Marlin Acquisition Corp. ("Marlin"), a wholly-owned subsidiary of Staples, entered into an "Agreement and Plan of Merger" whereby Marlin would merge with and into Office Depot, and Office Depot would become a wholly-owned subsidiary of Staples. According to the Agreement and Plan of Merger, the transaction would be structured as a pooling of interests, in which each share of Office Depot common stock would be exchanged for 1.14 shares of Sta-
Pursuant to the Hart–Scott–Rodino Improvements Act of 1976, 15 U.S.C. § 18a, Staples and Office Depot filed a Premerger Notification and Report Form with the FTC and Department of Justice on October 2, 1996. This was followed by a seven month investigation by the FTC. The FTC issued a Second Request for Information on November 1, 1996, to both Staples and Office Depot. The Commission further initiated a second Second Request on January 10, 1997. In addition to the hundreds of boxes of documents produced to the FTC during this time, the FTC took depositions of 18 Staples and Office Depot officers and employees. The FTC also undertook extensive ex parte discovery of third-party documents and, in lieu of subpoenas, obtained at least 36 declarations from third parties.

On March 10, 1997, the Commission voted 4–1 to challenge the merger and authorized commencement of an action under Section 13(b) of the Federal Trade Commission Act, 15 U.S.C. § 53(b), to seek a temporary restraining order and a preliminary injunction barring the merger. Following this vote, the defendants and the FTC staff negotiated a consent decree that would have authorized the merger to proceed on the condition that Staples and Office Depot sell 63 stores to OfficeMax. However, the Commission voted 3–2 to reject the proposed consent decree on April 4, 1997. The FTC then filed this suit on April 9, 1997, seeking a temporary restraining order and preliminary injunction against the merger pursuant to Section 13(b) of the Federal Trade Commission Act, 15 U.S.C. § 53(b), pending the completion of an administrative proceeding pursuant to Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45, and Sections 7 and 11 of the Clayton Act, 15 U.S.C. §§ 12, 21.

Because of the urgency of this matter, the Court authorized expedited discovery and held a five-day evidentiary hearing beginning on May 19, 1997. Closing arguments were heard on June 5, 1997. In the meantime, the defendants agreed to postpone the merger pending the Court’s decision on the motion for a preliminary injunction, thus making the plaintiff’s motion for a temporary restraining order moot. At the hearing, the FTC called a number of live witnesses, including three industry witnesses and two economic experts, Dr. Frederick R. Warren–Boulton and Dr. Orley Ashenfelter. Defendants offered testimony from eight live witnesses, including one economic expert, Dr. Jerry Hausman, as well as an expert in retailing, Maurice Segall. In addition to these live witnesses, the plaintiff and the defendants combined submitted over six thousand exhibits including declarations from consumers, industry analysts, economic experts, suppliers, and other sellers of office supplies. Following the conclusion of the hearing, nine states filed a joint amicus brief in support of the FTC’s motion.1

DISCUSSION

I. Section 13(B) Standard for Preliminary Injunctive Relief

[1] Section 7 of the Clayton Act, 15 U.S.C. § 18, makes it illegal for two companies to merge “where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.” Whenever the Commission has reason to believe that a corporation is violating, or is about to violate, Section 7 of the Clayton Act, the FTC may seek a preliminary injunction to prevent a merger pending the Commission’s administrative adjudication of the merger’s legality. See Section 13(b) of the Federal Trade Commission Act, 15 U.S.C. § 53(b). However, in a suit for preliminary relief, the FTC is not required to prove, nor is the Court required to find, that the proposed merger would in fact violate Section 7 of the Clayton Act. FTC v. Alliant Techsystems Inc., 808 F.Supp. 9, 19 (D.D.C.1992), was submitted to the Court following the hearing. Thus, neither party had the opportunity for meaningful cross-examination of Dr. Greer. In fairness to the parties, therefore, the Court wishes to make it clear that the Court did not use or rely on Dr. Greer’s declaration in reaching this decision.

1. The amicus brief filed by the states was unusual due to its inclusion of a declaration of an expert witness employed by the states. The Court read and considered the states’ amicus brief. However, the Court did not rely on the declaration of Douglas F. Greer in any way in reaching its decision. Dr. Greer’s declaration
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Cite as 970 F.Supp. 1066 (D.D.C. 1997)

FTC v. PPG Indus., 628 F.Supp. 881, 888, n. 3 (D.D.C.), aff'd in part rev'd in part, 798 F.2d 1500 (D.C.Cir.1986). The determination of whether the acquisition actually violates the antitrust laws is reserved for the Commission and is, therefore, not before this Court. See Alliant, 808 F.Supp. at 19. The only question before this Court is whether the FTC has made a showing which justifies preliminary injunctive relief.

Section 13(b) of the Federal Trade Commission Act, 15 U.S.C. § 53(b), provides that “[u]pon a proper showing that, weighing the equities and considering the Commission’s likelihood of ultimate success, such action would be in the public interest, and after notice to the defendant, a temporary restraining order or a preliminary injunction may be granted without bond.” Courts have interpreted this to mean that a court must engage in a two-part analysis in determining whether to grant an injunction under section 13(b). (1) First, the Court must determine the Commission’s likelihood of success on the merits in its case under Section 7 of the Clayton Act, and (2) Second, the Court must balance the equities. See FTC v. Freeman Hospital, 69 F.3d 260, 267 (8th Cir. 1996), FTC v. University Health, Inc., 995 F.2d 1206, 1217–18 (11th Cir.1991), FTC v. Warner Communications Inc., 742 F.2d 1156, 1160 (9th Cir.1984); FTC v. Occidental Petroleum Corp., 1986–1 Trade Cases ¶ 67,071, 1986 WL 952 (D.D.C.1986).

A. Likelihood of Success on the Merits

[2] Likelihood of success on the merits in cases such as this means the likelihood that the Commission will succeed in proving, after a full administrative trial on the merits, that the effect of a merger between Staples and Office Depot “may be substantially to lessen competition, or to tend to create a monopoly” in violation of Section 7 of the Clayton Act. The Commission satisfies its burden to show likelihood of success if it “raises questions going to the merits so serious, substantial, difficult, and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the Commission in the first instance and ultimately by the Court of Appeals.” FTC v. University Health, Inc., 995 F.2d 1206, 1218 (11th Cir. 1991) (“To show a likelihood of ultimate success, the FTC must ‘raise[]’ questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals.”), FTC v. Warner Communications, Inc., 742 F.2d 1156, 1162 (9th Cir.1984) (“The Commission meets its burden if it ‘raise[s]’ questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals.”), FTC v. National Tea Co., 603 F.2d 694, 698 (8th Cir.1979) (same language); FTC v. Alliant Techsystems Inc., 808 F.Supp. 9, 19 (D.D.C.1992) (same language). See also FTC v. Beatrice Foods Company, 587 F.2d 1225 (D.C.Cir. 1978).3

2. The traditional “irreparable harm” element is absent from the Section 13(b) standard. In this respect, the section 13(b) standard is “lesser” than that which courts normally impose on private litigants seeking a preliminary injunction.

3. The only time the D.C. Circuit has addressed the FTC’s burden under Section 13(b) was in Beatrice Foods where Judges MacKinnon and Robb wrote:

The appropriate definition of the Commission’s burden under Section 13(b) was articulated in FTC v. Lancaster Colony Corp., 434 F.Supp. 1088, 1090 (S.D.N.Y.1977), where the court held that “the FTC meets its burden on the likelihood of success issue if it shows preliminarily, by affidavits or other proof, that it has a ‘fair and tenable chance of ultimate success on the merits.’” It amplified this standard by stating that, if the FTC makes the requisite showing on the equities a preliminary injunction should issue if the FTC has raised questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals. Id. at 1229 (emphasis added).

Defendants argued in their briefs that the Court may not rely on Beatrice Foods as precedent because it is a memorandum opinion appended to the statements of Judges MacKinnon and Robb explaining their votes on a motion for rehearing en banc. Judge Revercomb reached this same conclusion in FTC v. Occidental Petroleum Corp., 1986–1 Trade Cases ¶ 67,071, 1986 WL 952 (D.D.C.1986), vacated, No. 86–5254 (D.C.Cir. Oct. 23, 1986), where he found that
[3] It is not enough for the FTC to show merely that it has a “fair and tenable chance” of ultimate success on the merits as has been argued and rejected in other cases. See FTC v. Freeman Hospital, 69 F.3d 260, 267 (8th Cir. 1995) (rejecting the Commission’s argument that it need only show a “fair and tenable chance of ultimate success on the merits” in order to qualify for injunctive relief because such a standard would run contrary to Congressional intent and reduce the judicial function to a mere “rubber stamp” of the FTC’s decisions.) See also FTC v. National Tea Co., 603 F.2d 694, 698 (8th Cir. 1979) (reaching the same conclusions under the same reasoning). However, the FTC need not prove to a certainty that the merger will have an anti-competitive effect. That is a question left to the Commission after a full administrative hearing. Instead, in a suit for a preliminary injunction, the government need only show that there is a “reasonable probability” that the challenged transaction will substantially impair competition. FTC v. University Health, 993 F.2d 1206, 1218 (11th Cir. 1993) (“[T]he government must show a reasonable probability that the proposed transaction would substantially lessen competition in the future”), Fruheau Corp. v. FTC, 603 F.2d 345, 351 (2d Cir. 1979) (“There must be ‘the reasonable probability’ of a substantial impairment of competition to render a merger illegal”). See also United States v. Penn-Olin Chemical Co., 378 U.S. 158, 171, 84 S.Ct. 1710, 1717, 12

Beatrice Foods could not be cited as precedent under the Local Rules, and, in fact, the FTC agrees that the opinion is technically “unpublished” even though it appears in the Federal Reporter, 2d Series. For these reasons, the Court has not relied on Beatrice Foods as precedent. Instead, the Court cites it only because it contains language identical to that from other circuits, and the discussion would be incomplete without mention of the case.

4. It is clear that the defendants’ primary objection to the Beatrice Foods case is the “fair and tenable chance” language contained in that opinion. For the reasons expressed in the Freeman and National Tea opinions, the Court finds that the defendants are correct that a “fair and tenable chance” of ultimate success on the merits is not the proper burden in this case. In addition, there is no case identified by either party which specifically holds that a “fair and tenable chance” of ultimate success on the merits is the proper standard. It is not clear that Beatrice Foods even supports such a conclusion. The L.Ed.2d 775 (1964) (“The requirements of Section 7 are satisfied when a tendency toward monopoly of the reasonable likelihood of a substantial lessening of competition in the relevant market is shown”). FTC v. Great Lakes Chemical Corp., 528 F.Supp. 84, 86 (N.D.Ill. 1981) (“The government must prove not that the merger in question may possibly have an anti-competitive effect, but rather that it will probably have such an effect.”).

[4] In order to determine whether the Commission has met its burden with respect to showing its likelihood of success on the merits, that is, whether the FTC has raised questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals and that there is a “reasonable probability” that the challenged transaction will substantially impair competition, the Court must consider the likely competitive effects of the merger, if any. Analysis of the likely competitive effects of a merger requires determinations of (1) the “line of commerce” or product market in which to assess the transaction, (2) the “section of the country” or geographic market in which to assess the transaction, and (3) the transaction’s probable effect on competition in the product and geographic markets. See United States v. Marine Bancorporation, 458 U.S. 691, 722, 102 S.Ct. 3380, 73 L.Ed.2d 1035 (1982). The FTC’s argument with respect to the “fair and tenable chance” language in Beatrice Foods, and that the FTC did not in fact argue that a “fair and tenable chance” was the appropriate burden in this case. Rather, the FTC’s citation of Beatrice Foods was to the later part of that argument in which Judges MacKinnon and Robb wrote that a preliminary injunction should issue if the FTC has “raised questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals.”
II. The Geographic Market

One of the few issues about which the parties to this case do not disagree is that metropolitan areas are the appropriate geographic markets for analyzing the competitive effects of the proposed merger. A geographic market is that geographic area "to which consumers can practically turn for alternative sources of the product and in which the antitrust defendant faces competition." Morganestern v. Wilson, 29 F.3d 1291, 1296 (8th Cir.1994), cert. denied, 513 U.S. 1150, 115 S.Ct. 1300, 190 L.Ed.2d 1068 (1995). In its first amended complaint, the FTC identified forty-two such metropolitan areas as well as future areas which could suffer anti-competitive effects from the proposed merger. Defendants have not challenged the FTC's geographic market definition in this proceeding. Therefore, the Court will accept the relevant geographic markets identified by the Commission.

III. The Relevant Product Market

In contrast to the parties' agreement with respect to the relevant geographic market,

5. According to the FTC, the proposed merger would have an anti-competitive effect in the following geographic markets:

1. in Salinas, California, San Diego, California, Visalia--Tulare--Porterville, California, Lakeport--Winter Haven, Florida, Ocala, Florida, Tampa--St. Petersburg--Clearwater, Florida, Fort Pierce--Port St. Lucie, Florida, Champaign--Urbana, Illinois, Louisville, Kentucky, Baltimore, Maryland, Greensville, North Virginia, Florence, South Carolina, Charlottesville, Virginia, Washington, D.C., and Spokane, Washington, where the number of office superstore firms would drop from two to one.

2. In Los Angeles, California, Sacramento, California, San Francisco--Oakland--San Jose, California, Stockton--Lodi, California, Orlando, Florida, Sarasota--Bradenton, Florida, West Palm Beach--Boca Raton, Florida, Evansville, Indiana, Indianapolis, Indiana, South Bend, Indiana, Springfield, Illinois, Kalamazoo--Battle Creek, Michigan, Detroit--Ann Arbor--Flint, Michigan, Grand Rapids--Muskegon--Holland, Michigan, Middlesex County, New Jersey, Passaic County, New Jersey, Nassau--Suffolk, New York, the Commission and the defendants sharply disagree with respect to the appropriate definition of the relevant product market or line of commerce. As with many antitrust cases, the definition of the relevant product market in this case is crucial. In fact, to a great extent, this case hinges on the proper definition of the relevant product market.

The Commission defines the relevant product market as "the sale of consumable office supplies through office superstores," with "consumable" meaning products that consumers buy recurrently, i.e., items which "get used up" or discarded. For example, under the Commission's definition, "consumable office supplies" would not include capital goods such as computers, fax machines, and other business machines or office furniture, but does include such products as paper, pens, file folders, post-it notes, computer disks, and toner cartridges. The defendants characterize the FTC's product market definition as "contrived" with no basis in law or fact, and counter that the appropriate product market within which to assess the likely competitive consequences of a Staples--Office Depot combination is simply the overall sale of office products, of which a combined Staples--Office Depot accounted for 5.5% of total sales in North America in 1996. In addition, Greensborough--Winston Salem--High Point, North Carolina, Raleigh--Durham, North Carolina, Cleveland, Ohio, Cincinnati--Hamilton, Ohio, Portland--Vancouver, Oregon--Washington, Pittsburgh, Pennsylvania, Columbus, South Carolina, Chattanooga, Tennessee, Nashville, Tennessee, and Salt Lake City--Ogden, Utah, where the number of superstore firms will be reduced from three to two.

6. Metropolitan areas where Staples and Office Depot would have competed in the future include Bergen County, New Jersey, Fayetteville, North Carolina, Albany--Schenectady--Troy, New York, and Fredericksburg, Virginia, where Office Depot plans to open stores in Staples markets before the end of 1997. In addition, Staples predicted that it would face competition from Office Depot in 76% of its markets by the year 2000, compared to the 46% overlap between the two companies in 1996.

7. The Commission also offered an alternative product market, that of the sale of consumable office supplies through retail stores to small businesses and individuals with home offices.
the defendants argue that the challenged combination is not likely "substantially to lessen competition" however the product market is defined. After considering the arguments on both sides and all of the evidence in this case and making evaluations of each witness's credibility as well as the weight that the Court should give certain evidence and testimony, the Court finds that the appropriate relevant product market definition in this case is, as the Commission has argued, the sale of consumable office supplies through office supply superstores.

[6] The general rule when determining a relevant product market is that "[t]he outer boundaries of a product market are determined by the reasonable interchangeability of use [by consumers] or the cross-elasticity of demand between the product itself and substitutes for it." *Brown Shoe v. United States*, 370 U.S. 294, 325, 82 S.Ct. 1502, 1523-24, 8 L.Ed.2d 510 (1962); *see also United States v. E.I. du Pont de Nemours and Co.*, 351 U.S. 377, 395, 76 S.Ct. 994, 1007-08, 100 L.Ed. 1264 (1956). Interchangeability of use and cross-elasticity of demand look to the availability of substitute commodities, i.e. whether there are other products offered to consumers which are similar in character or use to the product or products in question, as well as how far buyers will go to substitute one commodity for another. *E.I. du Pont de Nemours*, 351 U.S. at 398, 76 S.Ct. at 1006. In other words, the general question is "whether two products can be used for the same purpose, and if so, whether and to what extent purchasers are willing to substitute one for the other." *Hayden Pub. Co. v. Cox Broadcasting Corp.*, 730 F.2d 64, 70 n.8 (2d Cir.1984).

[7] Whether there are other products available to consumers which are similar in character or use to the products in question may be termed "functional interchangeability." *See, e.g., E.I. du Pont de Nemours*, 351 U.S. at 399, 76 S.Ct. at 1009 (recognizing "functional interchangeability" between cellophane and other flexible wrappings). *United States v. Archer-Daniels-Midland Co.*, 866 F.2d 242, 246 (8th Cir.1988) (discussing "functional interchangeability" between sugar and high fructose corn syrup), *cert. denied*, 483 U.S. 809, 110 S.Ct. 51, 107 L.Ed.2d 20 (1989). This case, of course, is an example of perfect "functional interchangeability." The consumable office products at issue here are identical whether they are sold by Staples or Office Depot or another seller of office supplies. A legal pad sold by Staples or Office Depot is "functionally interchangeable" with a legal pad sold by Wal-Mart. A post-it note sold by Staples or Office Depot is "functionally interchangeable" with a post-it note sold by Viking or Quill. A computer disk sold by Staples--Office Depot is "functionally interchangeable" with a computer disk sold by CompUSA. No one disputes the functional interchangeability of consumable office supplies. However, as the government has argued, functional interchangeability should not end the Court's analysis.

The Supreme Court did not stop after finding a high degree of functional interchangeability between cellophane and other wrapping materials in the *E.I. du Pont de Nemours* case. Instead, the Court also found that "an element for consideration as to cross-elasticity of demand between products is the responsiveness of the sales of one product to price changes of the other." *Id.* at 400, 76 S.Ct. at 1010. For example, in that case, the Court explained, "[i]f a slight decrease in the price of cellophane causes a considerable number of customers of other flexible wrappings to switch to cellophane, it would be an indication that a high cross-elasticity of demand exists between [cellophane and other flexible wrappings], [and therefore] that the products compete in the same market." *Id.* Following that reasoning in this case, the Commission has argued that a slight but significant increase in Staples--Office Depot's prices will not cause a considerable number of Staples--Office Depot's customers to purchase consumable office supplies from other non-superstore alternatives such as Wal-Mart, Best Buy, Quill, or Viking. On the other hand, the Commission has argued that an increase in price by Staples would result in consumers turning to another office superstore, especially Office Depot, if the consumers had that option. Therefore, the Commission concludes that the sale of consumable office supplies by
office supply superstores is the appropriate relevant product market in this case, and products sold by competitors such as Wal-Mart, Best Buy, Viking, Quill, and others should be excluded.

The Court recognizes that it is difficult to overcome the first blush or initial gut reaction of many people to the definition of the relevant product market as the sale of consumable office supplies through office supply superstores. The products in question are undeniably the same no matter who sells them, and no one denies that many different types of retailers sell these products. After all, a combined Staples-Office Depot would only have a 5.5% share of the overall market in consumable office supplies. Therefore, it is logical to conclude that, of course, all these retailers compete, and that if a combined Staples-Office Depot raised prices after the merger, or at least did not lower them as much as they would have as separate companies, that consumers, with such a plethora of options, would shop elsewhere.

The Court acknowledges that there is, in fact, a broad market encompassing the sale of consumable office supplies by all sellers of such supplies, and that those sellers must, at some level, compete with one another. However, the mere fact that a firm may be termed a competitor in the overall marketplace does not necessarily require that it be included in the relevant product market for antitrust purposes. The Supreme Court has recognized that within a broad market, “well-defined submarkets may exist which, in themselves, constitute product markets for antitrust purposes.” Brown Shoe Co. v. United States, 370 U.S. 294, 325, 82 S.Ct. 1502, 1524, 8 L.Ed.2d 510 (1962), see also Roteiny Storage & Van Co. v. Atlas Van Lines, Inc., 792 F.2d 210, 218 (D.C.Cir.1986) (Bork, J.), cert. denied, 479 U.S. 1033, 107 S.Ct. 880, 93 L.Ed.2d 834 (1987). With respect to such submarkets, the Court explained “[b]ecause Section 7 of the Clayton Act prohibits any merger which may substantially lessen competition ‘in any line of commerce,’ it is necessary to examine the effects of a merger in each such economically significant submarket to determine if there is a reasonable probability that the merger will substantially lessen competition. If such a probability is found to exist, the merger is proscribed.” Id. There is a possibility, therefore, that the sale of consumable office supplies by office superstores may qualify as a submarket within a larger market of retailers of office supplies in general.

The Court in Brown Shoe provided a series of factors or “practical indicia” for determining whether a submarket exists including “industry or public recognition of the submarket as a separate economic entity, the product’s peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors.” Id. Since the Court described these factors as “practical indicia” rather than requirements, subsequent cases have found that submarkets can exist even if only some of these factors are present. See, e.g., Beatrice Foods Co. v. FTC, 540 F.2d 393 (7th Cir.1976) (finding submarket based on industry recognition, peculiar characteristics of the product, and differences in production methods and prices). International Telephone and Telegraph Corp. v. General Telephone & Electronics Corp., 518 F.2d 913, 932 (9th Cir.1975) (explaining that Brown Shoe’s practical indicia were meant as “practical aids rather than with the view that their presence or absence would dispose, in talismanic fashion, of the submarket issue”).

The Commission discussed several of the Brown Shoe “practical indicia” in its case, such as industry recognition, and the special characteristics of superstores which make them different from other sellers of office supplies, including distinct formats, customers, and prices. Primarily, however, the FTC focused on what it termed the “pricing evidence,” which the Court finds corresponds with Brown Shoe’s “sensitivity to price changes” factor. First, the FTC presented evidence comparing Staples’ prices in geographic markets where Staples is the only office superstore, to markets where Staples competes with Office Depot or OfficeMax, or both. Based on the FTC’s calculations, in markets where Staples faces no Office superstore competition at all, something which was termed a one firm market during the hear-
ing, prices are 13% higher than in three firm markets where it competes with both Office Depot and OfficeMax. The data which underly this conclusion make it compelling evidence. Prices were compared as of January 1997, which, admittedly, only provides data for one specific point in time. However, rather than comparing prices from only a small sampling or “basket” of goods, the FTC used an office supply sample accounting for 90% of Staples’ sales and comprised of both price sensitive and non price sensitive items. The FTC presented similar evidence based on Office Depot’s prices of a sample of 500 items, also as of January 1997. Similarly, the evidence showed that Office Depot’s prices are significantly higher—well over 5% higher, in Depot-only markets than they are in three firm markets.

Other pricing evidence presented by the FTC is less convincing on its own, due to limitations in the underlying data. For example, relatively small samplings or “baskets” of goods may have been used or it may not be clear how many stock keeping units (“SKUs”) of supplies were included. For example, the FTC also presented evidence comparing Staples’ prices in Staples-only markets with Staples’ prices in three-firm markets for four different time periods, August 1994, January 1995, August 1995, and May 1996. The result is startlingly similar to that found in the first two examples. Where Staples does not compete with other office superstores, it charges prices well over 5% higher than where it does so compete. While having the advantage of showing a trend over time, the Court recognizes that this evidence has some problems. These particular calculations were made based on a “basket” or sample of supplies comprised of supplies used by Staples to price check against Office Depot. The number of SKUs in the sample was not provided to the Court,

and it appears that the components of the baskets may have changed over time. Therefore, the Court would not give much weight to this evidence standing alone. However, since additional evidence supports the same conclusion, the Court credits this evidence as confirmation of the general pricing trend.

The FTC also pointed to internal Staples documents which present price comparisons between Staples’ prices and Office Depot’s prices and Staples’ prices and OfficeMax’s prices within different price zones. The comparisons between Staples and Office Depot were made in August 1994, January 1995, August 1996, and May 1996. Staples’ prices were compared with OfficeMax’s prices in August 1994, July 1995, and January 1996. For each comparison, Staples calculations were based on a fairly large “basket” or sample of goods, approximately 2000 SKUs containing both price sensitive and non-price sensitive items. Using Staples’ data, but organizing it differently to show which of those zones were one, two, or three firm markets, the FTC showed once again that Staples charges significantly higher prices, more than 5% higher, where it has no office superstore competition than where it competes with the two other superstores.

The FTC offered similar price comparison evidence for Office Depot, comparing Office Depot’s prices across Staples’ zones. The comparisons were made in August 1994, January 1995, August 1995, and May 1996. Again, a large sample, approximately 2000 SKUs, was considered. The results of this analysis are slightly less favorable to the FTC’s position. Price differentials are significantly smaller and there are even a few instances where Office Depot’s prices appear to be higher in one of its three firm markets than prices in its two firm markets and at least one point where prices in one of the

8. The analytical framework set forth in the Merg-
er Guidelines approaches the inquiry regarding the reasonable interchangeability of use or cross-
elasticity of demand by asking whether a “hypo-
thetical monopolist would profitably impose at
least a ‘small but significant and nontransitory’
[price] increase.” Merger Guidelines at § 111.
The Merg er Guidelines use 5% of the usual ap-
proximation of a “small but significant and non-
transitory price increase.” Id. For this reason,

the Court’s analysis will often refer to this 5% number.

9. It was established at the hearing that Staples and Office Depot do not maintain nationally uni-
form prices in their stores. Instead, both com-
npanies currently organize their stores into price
zones which are simply groups of one or more
stores that have common prices.
Depot-only zones were lower than prices in one of the three firm markets. On average, however, this evidence shows that Office Depot’s prices are highest in its one firm markets, and lowest in its three firm markets.

This evidence all suggests that office superstore prices are affected primarily by other office superstores and not by non-superstore competitors such as mass merchandisers like Wal-Mart, Kmart, or Target, wholesale clubs such as BJ’s, Sam’s, and Price Costco, computer or electronic stores such as Computer City and Best Buy, independent retail office supply stores, mail orders firms like Quill and Viking, and contract stations. Though the FTC did not present the Court with evidence regarding the precise amount of non-superstore competition in each of Staples’ and Office Depot’s one, two, and three firm markets, it is clear to the Court that these competitors, albeit in different combinations and concentrations, are present in every one of these markets. For example, it is a certainty that the mail order competitors compete in all of the geographic markets at issue in this case. Office products are available through the mail in all 50 states, and have been for approximately 30 years. Despite this mail order competition, however, Staples and Office Depot are still able to charge higher prices in their one firm markets than they do in the two firm markets and the three firm markets without losing a significant number of customers to the mail order firms. The same appears to be true with respect to Wal-Mart. Bill Long, Vice President for Merchandising at Wal-Mart Stores, testifying through declaration, explained that price-checking by Wal-Mart of Staples’ prices in areas where both Staples and Wal-Mart exist showed that, on average, Staples’ prices were higher where there was a Staples and a Wal-Mart but no other superstore than where there was a Staples, a Wal-Mart, and another superstore.10

The evidence with respect to the wholesale club stores is consistent. Mike Atkinson, Vice President, Division Merchandise Man-

10. As the defendants pointed out and criticized during the hearing, Mr. Long submitted several declarations and/or revised declarations in which he modified portions of his declaration. However, his testimony remained unchanged on this particular issue. Therefore, the Court credited this particular testimony.
zones when faced with entry of another superstore, but do not do so for other retailers. For example, Staples changed its price zone for Cincinnati to a lower priced zone when Office Depot and OfficeMax entered that area. New entry by Staples and OfficeMax caused a decrease in prices at Office Depot’s Greensboro stores. In July 1996, after OfficeMax entered Jackson, Michigan, Staples moved its Jackson store to a new zone, cutting prices by 6%. There are numerous additional examples of zones being changed and prices falling as a result of superstore entry. There is no evidence that zones change and prices fall when another non-superstore retailer enters a geographic market.

[8] Though individually the FTC’s evidence can be criticized for looking at only brief snapshots in time or for considering only a limited number of SKUs, taken together, however, the Court finds this evidence a compelling showing that a small but significant increase in Staples’ prices will not cause a significant number of consumers to turn to non-superstore alternative for purchasing their consumable office supplies. Despite the high degree of functional interchangeability between consumable office supplies sold by the office superstores and other retailers of office supplies, the evidence presented by the Commission shows that even where Staples and Office Depot charge higher prices, certain consumers do not go elsewhere for their supplies. This further demonstrates that the sale of office supplies by non-superstore retailers are not responsive to the higher prices charged by Staples and Office Depot in the one firm markets. This indicates a low cross-elasticity of demand between the consumable office supplies sold by the superstores and those sold by other sellers.

Turning back to the other Brown Shoe “practical indicia” of submarkets that the Commission offered in this case, the Commission presented and the Court heard a great deal of testimony at the hearing and through declarations about the uniqueness of office superstores and the differences between the office superstores and other sellers of office supplies such as mass merchandisers, wholesale clubs, and mail order firms as well as the special characteristics of office superstore customers. In addition, the Court was asked to go and view many of the different types of retail formats. That evidence shows that office superstores are, in fact, very different in appearance, physical size, format, the number and variety of SKU’s offered, and the type of customers targeted and served than other sellers of office supplies.

The Court has observed that office supply superstores look far different from other sellers of office supplies. Office supply superstores are high volume, discount office supply chain stores averaging in excess of 20,000 square feet, with over 11,000 of those square feet devoted to traditional office supplies, and carrying over 5,000 SKUs of consumable office supplies in addition to computers, office furniture, and other non-consumables. In contrast, stores such as Kmart devote approximately 210 square feet to the sale of approximately 250 SKUs of consumable office supplies. Kinko’s devotes approximately 50 square feet to the sale of 150 SKUs. Target sells only 400 SKUs. Both Sam’s Club and Computer City each sell approximately 200 SKUs. Even if these SKU totals are low estimates as the defendants have argued, there is still a huge difference between the superstores and the rest of the office supply sellers.

In addition to the differences in SKU numbers and variety, the superstores are different from many other sellers of office supplies due to the type of customer they target and attract. The superstores' customer base overwhelmingly consists of small businesses with fewer than 20 employees and consumers with home offices. In contrast, mail order customers are typically mid-sized companies with more than 20 employees. Another example is contract stationers who focus on serving customers with more than 100 employees. While the Court accepts that some small businesses with fewer than 20 employees as well as home office customers do choose other sellers of office supplies, the superstores' customers are different from those of many of the purported competitors.
It is difficult to fully articulate and explain all of the ways in which superstores are unique. As the plaintiff and defendant requested, the Court viewed some of the various sellers of office supplies located in the Rockville, Maryland area, including Staples, Office Depot, CompUSA, Best Buy, CVS, Kmart, Giant Food, and Wal-Mart. Based on the Court’s observations, the Court finds that the unique combination of size, selection, depth and breadth of inventory offered by the superstores distinguishes them from other retailers. Other retailers devote only a fraction of their square footage to office supplies as opposed to Staples or Office Depot. The evidence shows that the typical club, mass merchant, or computer store offers only 210 to 2000 square feet of office supplies, compared to over 11,182 square feet at a typical Staples. This was evident to the Court when visiting the various stores. Superstores are simply different in scale and appearance from the other retailers. No one entering a Wal-Mart would mistake it for an office superstore. No one entering Staples or Office Depot would mistakenly think he or she was in Best Buy or CompUSA. You certainly know an office superstore when you see one. Cf. Bow-Ton Stores, Inc. v. May Department Stores, 881 F.Supp. 860, 870 (W.D.N.Y.1994) (“Customers know a department store when they see it.”)


The Commission offered abundant evidence on this factor from Staples’ and Office Depot’s documents which shows that both Staples and Office Depot focus primarily on competition from other superstores. The documents reviewed by the Court show that the merging parties evaluate their “competition” as the other office superstore firms, without reference to other retailers, mail order firms, or independent stationers. In document after document, the parties refer to, discuss, and make business decisions based upon the assumption that “competition” refers to other office superstores only. For example, Staples uses the phrase “office superstore industry” in strategic planning documents. PX 15 at 3186. Staples’ 1996 Strategy Update refers to the “Big Three” and “improved relative competitive position” since 1993 and states that Staples is “increasingly recognized as [the] industry leader.” PX 15 at 3153. A document analyzing a possible acquisition of OfficeMax referenced the “[b]enefits from pricing in [newly] non-competitive markets,” and also the fact that there was “a potential margin lift overall as the industry moves to 2 players.” PX 33 at 8393, 8399.

When assessing key trends and making long range plans, Staples and Office Depot focus on the plans of other superstores. In addition, when determining whether to enter a new metropolitan area, both Staples and Office Depot evaluate the extent of office superstore competition in the market and the number of office superstores the market can support. When selecting sites and markets for new store openings, defendants repeatedly refer to markets without office superstores as “non-competitive,” even when the new store is adjacent to or near a warehouse club, consumer electronics store, or a mass merchandiser such as Wal-Mart. In a monthly report entitled “Competitor Store Opening/Closing Report” which Office Depot circulates to its Executive Committee, Office Depot notes all competitor store closings and openings, but the only competitors referred to for its United States stores are Staples and OfficeMax. PX 75 at 1309.

While it is clear to the Court that Staples and Office Depot do not ignore sellers such as warehouse clubs, Best Buy, or Wal-Mart, the evidence clearly shows that
Staples and Office Depot each consider the other superstores as the primary competition. For example, Office Depot has a Best Buy zone and Staples has a warehouse club zone. However, each still refers to its one firm markets with no other office superstore as “non-competitive” zones or markets. In addition, it is clear from the evidence that Staples and Office Depot price check the other office superstores much more frequently and extensively than they price check other retailers such as BJ’s or Best Buy, and that Staples and Office Depot are more concerned with keeping their prices in parity with the other office superstores in their geographic areas than in undercutting Best Buy or a warehouse club.

For the reasons set forth in the above analysis, the Court finds that the sale of consumable office supplies through office supply superstores is the appropriate relevant product market for purposes of considering the possible anti-competitive effects of the proposed merger between Staples and Office Depot. The pricing evidence indicates a low cross-elasticity of demand between consumable office products sold by Staples or Office Depot and those same products sold by other sellers of office supplies. This same evidence indicates that non-superstore sellers of office supplies are not able to effectively constrain the superstores prices, because a significant number of superstore customers do not turn to a non-superstore alternative when faced with higher prices in the one firm markets. In addition, the factors or “practical indicia” of Brown Shoe support a finding of a “submarket” under the facts of this case, and “submarkets,” as Brown Shoe established, may themselves be appropriate product markets for antitrust purposes. 370 U.S. at 325, 82 S.Ct. at 1523–24.11

This Court is not the first to find a narrower submarket or relevant product market within a larger market. Judge Larimer found one in Bon-Ton Stores, Inc. v. May Department Stores Co., 881 F.Supp. 860 (W.D.N.Y.1994), when he defined the relevant product market in that case as “traditional department stores including J.C. Penney’s.” Defendants had argued that the “traditional department stores” definition was underinclusive because it overlooked numerous businesses that compete with department stores. Id. at 865. Under the defendants’ view, the relevant product market should have included all stores selling general merchandise, apparel, and furniture. Id. The court acknowledged that, in a broad sense, traditional department stores do compete in a vast marketplace encompassing retailers in general. Id. at 868. However, applying the Brown Shoe “practical indicia,” the court found that there were qualitative differences between traditional department stores and other retailers, including the physical appearance and layout of the stores, distinctive customers, the wide range of brand-name merchandise, and service. Id. at 869–72. Additionally, the court found that testimony at the hearing as well as internal company documents indicated that the department stores themselves recognize each other as competitors different from other retailers. Id. at 873. The court found that this evidence established that “traditional department stores including J.C. Penney’s” constituted a proper submarket under the Brown Shoe criteria. Id. at 874. The court enjoined the merger. Id. at 878.

A similar, though not as detailed, analysis was undertaken in State of California v. American Stores Co., 697 F.Supp. 1125 (C.D.Ca.1988), aff’d in part and rev’d in part on other grounds, 872 F.2d 837 (9th Cir. 1989), rev’d on other grounds, 495 U.S. 271, 110 S.Ct. 1853, 109 L.Ed.2d 240 (1990). In that case, the State of California brought an action to enjoin the merger of two supermarket chains. Id. at 1127. The State defined the relevant product market as “supermarkets—full line grocery stores with more than

11. As other courts have noted, use of the term “submarket” may be confusing. See Allen–Myland v. IBM Corp., 33 F.3d 194, 208 n. 16 (3rd Cir.1994) (finding it less confusing to speak in terms of the relevant product market rather than the submarket), cert. denied, 513 U.S. 1066, 115 S.Ct. 684, 130 L.Ed.2d 615 (1994). Olin Corp. v. FTC, 986 F.2d 1295, 1299 (9th Cir.1993) (“Every market that encompasses less than all products is, in a sense, a submarket”), cert. denied, 510 U.S. 1110, 114 S.Ct. 1051, 127 L.Ed.2d 373 (1994). Whatever term is used—market, submarket, relevant product market—the analysis is the same.
10,000 square feet.” Id. at 1129. In contrast, defendants contended that the relevant product market included retail grocery purchases from “mom and pop” retail grocery stores, convenience stores, and non-grocery stores such as department stores, gasoline service stations, eating and drinking places, drug stores, and liquor stores. Id. The court credited evidence which showed that shoppers as well as the supermarkets themselves did not consider these other retailers as competition. Id. Thereafter, the court defined the relevant product market as the State had defined it. Id.

The Court is aware that litigants have not always been successful in proving submarkets similar to the one found by the Court in this case. See Thurman Industries, Inc. v. Pay ‘N Pak Stores, Inc., 875 F.2d 1369 (9th Cir.1989) (concluding that plaintiff failed to show that home centers were submarkets for purposes of its restraint of trade and monopolization claims). In addition, when the supermarket case went up on appeal, the Ninth Circuit did not set aside the relevant product market definition, but did express some reservations about it. See State of California v. American Stores, 872 F.2d 837, 841 (9th Cir. 1989) (“Were we to evaluate independently the evidence of the relevant product market, we might reach a different conclusion”). However, each of those cases is distinguishable on its facts. None, including Bon-Tom, possessed the compelling pricing evidence submitted to the Court in this case.

IV. Probable Effect on Competition

After accepting the Commission’s definition of the relevant product market, the Court next must consider the probable effect of a merger between Staples and Office Depot in the geographic markets previously identified. One way to do this is to examine the concentration statistics and HHIs within the geographic markets.12 If the relevant product market is defined as the sale of consumable office supplies through office supply superstores, the HHIs in many of the geographic markets are at problematic levels even before the merger. Currently, the least concentrated market is that of Grand Rapids–Muskegon–Holland, Michigan, with an HHI of 3,597, while the most concentrated is Washington, D.C. with an HHI of 6,944. In contrast, after a merger of Staples and Office Depot, the least concentrated area would be Kalamazoo–Battle Creek Michigan, with an HHI of 5,003, and many areas would have HHIs of 10,000. The average increase in HHI caused by the merger would be 2,715 points. The concentration statistics show that a merged Staples–Office Depot would have a dominant market share in 42 geographic markets across the country. The combined shares of Staples and Office Depot in the office superstore market would be 100% in 15 metropolitan areas. It is in these markets the post-merger HHI would be 10,000. In 27 other metropolitan areas, where the number of office superstore competitors would drop from three to two, the post-merger market shares would range from 45% to 94%, with post-merger HHIs ranging from 5,003 to 9,049. Even the lowest of these HHIs indicates a “highly concentrated” market.

[11] According to the Department of Justice Merger Guidelines, a market with an HHI of less than 1000 in “unconcentrated.” An HHI between 1000 and 1800 indicates a “moderately concentrated” market, and any market with an HHI over 1800 qualifies as “highly concentrated.” See FTC v. PPG Industries, Inc., 708 F.2d 1500, 1503 (D.C.Cir.1986) (citing the U.S. Department of Justice and Federal Trade Commission Horizontal Merger Guidelines) (hereinafter “Merger Guidelines”). Further, according to the Merger Guidelines, unless mitigated by other factors which lead to the conclusion that the merger is not likely to lessen competition, an increase in the HHI is excess of 50 points in a post-merger highly concentrated market may raise significant competitive concerns. In cases where the post-merger HHI is less

12. Market power or the lack of it is often determined by the Herfindahl–Hirschmann Index (“HHI”). The HHI is calculated by squaring the individual market shares of all the firms in the market and adding up the squares. The HHI takes into account the relative size and distribution of the firms in a market, increasing both as the number of firms in the market decreases and as the disparity in size among those firms increases.
than 1,800, but greater than 1,000, the *Merger Guidelines* presume that a 100 point increase in the HHI is evidence that the merger will create or enhance market power. The *Merger Guidelines*, of course, are not binding on the Court, but, as this Circuit has stated, they do provide "a useful illustration of the application of the HHI," *Id. at 1503 n. 4*, and the Court will use that guidance here. In addition, though the Supreme Court has established that there is no fixed threshold at which an increase in market concentration triggers the antitrust laws, see, e.g., *United States v. Philadelphia National Bank*, 374 U.S. 321, 363-65, 83 S.Ct. 1715, 1741-43, 10 L.Ed.2d 915 (1963), this is clearly not a borderline case. The pre-merger markets are already in the "highly concentrated" range, and the post-merger HHIs show an average increase of 2,715 points. Therefore, the Court finds that the plaintiff's have shown a likelihood of success on the merits. With HHIs of this level, the Commission certainly has shown a "reasonable probability" that the proposed merger would have an anti-competitive effect.  

The HHI calculations and market concentration evidence, however, are not the only indications that a merger between Staples and Office Depot may substantially lessen competition. Much of the evidence already discussed with respect to defining the relevant product market also indicates that the merger would likely have an anti-competitive effect.  

The Court is also persuaded by the Commission's HHI calculations for its alternate relevant product market, that of the sale of consumable office supplies through retail stores to small businesses and individuals with home offices. In response to the defendants' arguments regarding the variety of competition in this larger office supply market, the Commission presented HHI calculations which included additional competitors. Besides Staples, Office Depot, and Office-Max, the Commission included Price Costco, Sam's Club, BJ's, Best Buy, Wal-Mart, Kmart, Target, Circuit City, Computer City, CompUSA, and independent office supply dealers in this alternate HHI calculation. The result showed Sacramento, California as the least concentrated market post-merger with an HHI of 1,793, and Greenville, North Carolina as the most concentrated market post-merger with an HHI of 5,047. Overall, the HHIs increased by an average of 861 points post-merger, an increase that is still problematic according to the *Merger Guidelines* given that all the post-merger markets were in the "moderately" or "highly concentrated" range.

The evidence of the defendants' own current pricing practices, for example, shows that an office superstore chain facing no competition from other superstores has the ability to profitably raise prices for consumable office supplies above competitive levels. The fact that Staples and Office Depot both charge higher prices where they face no superstore competition demonstrates that an office superstore can raise prices above competitive levels. The evidence also shows that defendants also change their price zones when faced with entry of another office superstore, but do not do so for other retailers. Since prices are significantly lower in markets where Staples and Office Depot compete, eliminating this competition with one another would free the parties to charge higher prices in those markets, especially those in which the combined entity would be the sole office superstore. In addition, allowing the defendants to merge would eliminate significant future competition. Absent the merger, the firms are likely, and in fact have planned, to enter more of each other's markets, leading to a deconcentration of the market and, therefore, increased competition between the superstores.

In addition, direct evidence shows that by eliminating Staples' most significant, and in many markets only, rival, this merger would allow Staples to increase prices or otherwise maintain prices at an anti-competitive level.

Therefore, for this reason as well, the Court finds that the Commission has shown a "reasonable probability" that the merger would have an anti-competitive effect.

There has been tremendous argument regarding whether the FTC actually contends that prices will go up after the merger. The Court understands that is not precisely the Commission's contention. Rather, the Commission argues that the merger will have an anti-competitive effect such that the combined firm's prices will be higher after the merger than they would be absent the merger. This does not necessarily mean that prices would rise from the levels they are now. Instead, according to the Commission, prices would simply not decrease as much as they would have on their own absent the merger. It is only in this sense that the Commission has contended that prices would go up—prices would go up compared to where they would have been absent the merger. It is only in this sense that consumers would be faced with "higher"...
The merger would eliminate significant head-to-head competition between the two lowest cost and lowest priced firms in the superstore market. Thus, the merger would result in the elimination of a particularly aggressive competitor in a highly concentrated market, a factor which is certainly an important consideration when analyzing possible anti-competitive effects. See, e.g., FTC v. Food Town Stores, Inc., 539 F.2d 1339, 1345 (4th Cir. 1976) (enjoining merger when merging firms had been “aggressive competitors in the past,” by opening stores in each other’s markets and increasing sales by greater than the industry’s sales average). It is based on all of this evidence as well that the Court finds that the Commission has shown a likelihood of success on the merits and a “reasonable probability” that the proposed transaction will have an anti-competitive effect.

[121] By showing that the proposed transaction between Staples and Office Depot will lead to undue concentration in the market for consumable office supplies sold by office supermarkets in the geographic markets agreed upon by the parties, the Commission establishes a presumption that the transaction will substantially lessen competition. See United States v. Citizens & Southern Nat’l Bank, 422 U.S. 86, 95 S.Ct. 2099, 45 L.Ed.2d 41 (1975). United States v. Philadelphia Nat’l Bank, 374 U.S. 321, 325, 83 S.Ct. 1715, 10 L.Ed.2d 915 (1963). Once such a presumption has been established, the burden of producing evidence to rebut the presumption shifts to the defendants. See, e.g., United States v. Marine Bancorporation, 418 U.S. 602, 631, 94 S.Ct. 2856, 2874-75, 41 L.Ed.2d 978 (1974); United States v. General Dynamics Corp., 415 U.S. 486, 496-504, 94 S.Ct. 1186, 1192-97, 39 L.Ed.2d 530 (1974). To meet this burden, the defendants must show that the market-share statistics give an inaccurate prediction of the proposed acquisition’s probable effect on competition. See United States v. Baker Hughes, Inc., 908 F.2d 981, 991 (D.C.Cir.1990) (rejecting argument that a defendant should be required to “clearly” disprove future anti-competitive effects, because that would impermissibly shift the ultimate burden of persuasion). See also Marine Bancorporation, 418 U.S. at 631, 94 S.Ct. at 2874-75 (finding presumption may be overcome by a showing that the statistics do not accurately reflect the probable effect of the proposed merger on competition). In order to rebut the FTC’s showing with respect to the likely anti-competitive effects of a merger, defendants challenged the FTC’s market-share statistics in this case in various ways, such as criticizing the Commission’s definition of the relevant product market and introducing evidence to counter the FTC’s pricing information. Defendants also made allegations of “cherry-picking” on the part of the Commission, pointing to data which tend to show the opposite from the Commission’s contentions. Finally, the defendants argued that the price differentials between one, two, and three firm markets shown by the Commission do not accurately reflect market power because the Commission failed to take into account factors such as the differences in marketing costs between stores.

[13] In their criticism of the Commission’s pricing evidence, the defendants accused the FTC of “cherry-picking” its data and pointed to specific examples which contradict the Commission’s conclusions. For example, the defendants focused on the FTC’s comparison prices on manila folders in two Ohio towns, Columbus which has two supermarkets and Cincinnati which has all three supermarket chains. For 1995-96, the prices of those manila folders were shown to be, on average, 51% higher in the two firm market than in the three firm market.15 The defendants argued that in contrast to the Ohio example, a comparison of two Indiana towns, Kokomo with two firms and Elkhart/South Bend with all three firms, shows the opposite. In fact, the defendants’ com-

15. The FTC also presented comparison prices in Columbus and Cincinnati for perforated pads (86% higher in Columbus), envelopes (68% higher), computer paper (26% higher), hammermill paper (14% higher), and generic paper (12% higher).
parison of the average prices of manila folders for 1996 in Kokomo and Elkhart/South Bend shows that the prices in Kokomo, the two firm market, were 30% lower than in the three firm market.

The Court acknowledges that there is some evidence of this type in the record, and the Court has considered all of it. However, the fact that there may be some examples with respect to individual items in individual cities which contradict the FTC’s evidence does not overly concern the Court. A few examples of isolated products simply cannot refute the power of the FTC’s evidence with respect to the overall trend over time, which is that Staples’ and Office Depot’s prices are lowest in three firm markets and highest where they do not compete with another office superstore. Neither does the fact that some two superstore areas have lower prices than some three firm markets. In addition, a closer examination of the price comparison study done by the defendants for Kokomo and Elkhart/South Bend shows that for four of the six products compared, the prices were actually higher in Kokomo. Moreover, when Staples’ total of price sensitive and non-price sensitive items are examined, Kokomo’s prices are between 3 and 5% higher than Elkhart, which reconfirms the Commission’s result rather than refuting it.

Defendants also argued that the regional price differences set forth in the FTC’s pricing evidence do not reflect market power, because the reason for those differentials is not solely the presence or absence of other superstore competition. Instead, argued the defendants, these differentials are the result of a host of factors other than superstore competition. As examples of other factors which cause differences in pricing between geographic markets, the defendants offered sales volume, product mix, marketing or advertising costs, and distribution costs. Defendants also argued that there are differences in wages and rent which cause the differences in pricing between certain stores. The Court, however, cannot find that the evidence submitted by the defendants with respect to other reasons for the differences in pricing between one, two, and three firm markets is sufficient to rebut the Commission’s evidence.

The Court generally accepts that per-store advertising costs, such as those incurred for a newspaper insert, will likely be lower in markets where Staples or Office Depot has a larger number of stores as those costs may be spread over a larger number of stores, and the defendants have provided some concrete evidence that the price differentials shown by the FTC may be somewhat affected by marketing costs. Donna Rosenberg, Vice President of Marketing Strategy at Staples, testified by declaration that Staples has the lowest average marketing costs per store in Staples/Office Depot areas and the highest marketing costs per store in Staples only areas. Exhibit H to her declaration shows, more specifically, that in 1996 Staples stores in three firm areas had an average marketing expense of 202,112. In Staples/Office Depot areas, Staples’ stores had an average marketing expense of 185,905. Staples stores in Staples/OfficeMax areas paid an average of 218,500, and the stores in Staples only markets had an average marketing expense of 243,763. These numbers do suggest a correlation between the prices charged by Staples and marketing costs as average marketing costs are higher in the one firm markets than the three firm markets. However, the marketing cost evidence also shows that marketing costs are lower in Staples/Depot areas than in Staples/OfficeMax areas and, in fact, that costs are higher in Staples/OfficeMax areas than in the three firm markets, which does not correspond with the pricing trend. Staples generally charges lower prices where it competes with Office Depot than where it competes with OfficeMax and generally charges lower prices in three firm markets than in Staples/OfficeMax areas. In addition, the differences in marketing costs are not so large that they alone could account for the significant price differentials shown by the FTC.

16. The Defendants also paralleled the FTC’s evidence with respect to perforated pads (8% lower in Kokomo), envelopes (5% higher), computer paper (8% higher), hammermill paper (1% higher), and generic paper (1% lower).
As the Court has already noted, the defendants, of course, point to other factors besides marketing costs. However, unlike the comparison of average marketing costs between one, two, and three firm markets, the defendants produced no concrete evidence in support of these other factors. For example, the Court believes that it is probably true that distribution costs are higher for stores which are the farthest from either company’s distribution centers. Yet, the defendants introduced no evidence to show that the one-firm markets are, in fact, the farthest from distribution centers or that in the three firm markets, the stores are the closest to the distribution centers. Nor did the defendants introduce any evidence showing the actual differences in distribution costs based on a store’s distance from a distribution center. The only evidence that the Court heard on this point was the testimony of Thomas Stemberg, Chairman and CEO of Staples, who testified at the hearing that “typically the smaller markets are further away from the distribution hubs. It costs you a lot more to haul freight up to Bangor, Maine, than it does from Hagerstown to Washington.” The Court cannot find that the FTC’s pricing evidence is seriously undermined by such a general statement.

The defendants’ evidence is similar with respect to sales volume, rent and wages. For example, Steven Mandel, Senior Managing Director of Tiger Management Corporation, testified at the hearing that single store markets are typically smaller markets. He continued by explaining that even though the costs of rent and labor may be lower in a smaller market, they would be higher as a percentage of sales because the volume of sales are also typically lower in these smaller markets. Therefore, in order to come out with a decent return on investment, it will be necessary to have a modestly higher gross margin in those markets. While this seems logical to the Court, again, the only evidence presented on the point is very general and the Court cannot give it much weight. For example, Mr. Mandel testified that “typically” one firm areas are in smaller markets but offered no concrete evidence relating specifically to Staples’ or Office Depot’s one firm market stores. Also, the Court has heard evidence that Bangor, Maine, a one firm store in a smaller market, actually has an extremely high volume of sales which directly contradicts Mr. Mandel’s testimony. Mr. Mandel is not employed by either Staples or Office Depot, and while he may be generally knowledgeable about the broader office supply industry, the Court questions his level of knowledge with respect to individual Staples and Office Depot stores. Finally, Mr. Mandel’s testimony regarding the fact that he would generally expect higher gross margins in smaller one firm markets is contradicted by other evidence submitted by the defendants in their DX 1968 which states that in 1996, Staples’ lowest gross margins were in the one superstore areas. For these reasons, the Court cannot find that the defendants’ evidence regarding the different costs attributed to sales volume, rent, and wages shows that the Commission’s evidence gives an inaccurate prediction of the proposed acquisition’s probable effect on competition.

The defendants also argued that the variations in product mix between different stores account for some of the differences in prices between one, two, and three firm markets. For example, defendants argued that Staples’ mix of general office supplies is highest in three superstore towns (37.23% of retail sales), lower in Staples/Office Depot areas (36.14%), lower yet in Staples/OfficeMax areas, and lowest in Staples-only areas (26.68%). On the other hand, defendants argue, computer mix is highest in Staples-only areas (30.36%), and lowest in three superstore areas (13.62%). Computer sales make up 40% of store sales in Bangor, Maine, for example, but only 10% in Los Angeles. Pointing to evidence showing that Staples’ sale of computers in 1996 generated a net loss of 10.6%, defendants argued that stores with higher computer sales must have higher margins on their other products to generate sufficient total returns. Therefore, defendants explained that the higher prices of consumable office supplies in these areas are a result of economic costs and do not imply that Staples has more market power in Staples-only markets. The Court cannot agree. While the higher percentage of computer sales in a one firm market such as
Bangor, Maine, may be one of the reasons that Staples chooses to charge higher prices for consumable office supplies in that location, it does not change the fact that Staples is able to charge those higher prices. The primary reason that computer sales generate a very small or even negative return is the competition among sellers of computers. Individual competitors are effectively constrained from raising prices on computers. The fact that Staples can raise its prices for consumable office supplies in order to offset the low or negative returns on the sale of computers shows the opposite—that Staples is not constrained by non-superstore competitors from raising prices on consumable office supplies.

The above discussion covers some of the ways in which the defendants have challenged the FTC’s market-share statistics in this case, including the highly debated issue of the relevant product market definition as well as the defendants’ allegations of “cherry-picking” on the part of the Commission, and the defendants’ argument that regional price differentials do not reflect market power because of the other factors such as marketing costs involved. However, in addition to attempting to discredit the Commission’s evidence with respect to the combined company’s market share and ability to raise prices, the defendants focused specifically on two other areas in an attempt to rebut the presumption that the proposed transaction will substantially lessen competition—entry into the market and efficiencies.

V. Entry Into the Market

[14] “The existence and significance of barriers to entry are frequently, of course, crucial considerations in a rebuttal analysis [because] [i]n the absence of significant barriers, a company probably cannot maintain supra-competitive pricing for any length of time.” Baker Hughes, Inc., 908 F.2d at 987. Thus, the Court must consider whether, in this case, “entry into the market would likely avert anticompetitive effects from [Staples’] acquisition of [Office Depot].” Id. at 989. If the defendants’ evidence regarding entry showed that the Commission’s market-share statistics give an incorrect prediction of the proposed acquisition’s probable effect on competition because entry into the market would likely avert any anti-competitive effect by acting as a constraint on Staples–Office Depot’s prices, the Court would deny the FTC’s motion. The Court, however, cannot make such a finding in this case.

The defendants argued during the hearing and in their briefs that the rapid growth in overall office supply sales has encouraged and will continue to encourage expansion and entry. One reason for this, according to Dr. Hausman’s declaration, is that entry is more attractive when an industry is growing, because new entrants can establish themselves without having to take all of their sales away from existing competitors. In addition, the defendants’ impressive retailing expert, Professor Maurice Segall, testified at the hearing that there are “no barriers to entry in retailing,” and defendants pointed to the fact that all office superstore entrants have entered within the last 11 years.

In addition to this general testimony regarding entry, defendants emphasized specific examples of recent or planned entry. For example, defendants offered testimony from John Ledecky, Chairman and CEO of U.S. Office Products, regarding U.S. Office Products’ acquisition of Mailboxes, Etc., an acquisition that was coincidentally announced the night before Mr. Ledecky’s testimony in this case. Through this acquisition, U.S. Office Products, an organization or co-op of approximately 165 contract stationers located throughout the country, will acquire the 3300-unit Mailboxes, Etc., franchise operation. Defendants also offered testimony regarding Wal-Mart’s plans to revamp and expand the office supply section in its stores. According to the deposition testimony of William Long, Vice President for Merchandizing at Wal-Mart, and David Glass, President and CEO of Wal-Mart, Wal-Mart will modify its office supplies department, called “Department 3,” beginning in May 1997 and continuing through the summer. Though Mr. Long was not certain of the exact number of SKUs of office supplies Wal-Mart’s new Department 3 will offer, he estimated the range to
be 2,600 to 3,000 SKUs. Finally, defendants offered testimony regarding the general ability of mass merchandisers, computer superstores, and warehouse clubs to change store configurations and shift shelf space to accommodate new demands or popular products.

There are problems with the defendants' evidence, however, that prevent the Court from finding in this case that entry into the market by new competitors or expansion into the market by existing firms would likely avert the anti-competitive effects from Staples' acquisition of Office Depot. For example, while it is true that all office superstore entrants have entered within the last 11 years, the recent trend for office superstores has actually been toward exiting the market rather than entering. Over the past few years, the number of office superstore chains has dramatically dropped from twenty-three to three. All but Staples, Office Depot, and OfficeMax have either closed or been acquired. The failed office superstore entrants include very large, well-known retail establishments such as Kmart, Montgomery Ward, Ames, and Zayre. A new office superstore would need to open a large number of stores nationally in order to achieve the purchasing and distribution economies of scale enjoyed by the three existing firms. Sunk costs would be extremely high. Economies of scale at the local level, such as in the costs of advertising and distribution, would also be difficult for a new superstore entrant to achieve since the three existing firms have saturated many important local markets. For example, according to the defendants' own saturation analyses, Staples estimates that there is room for less than two additional superstores in the Washington, D.C. area and Office Depot estimates that there is room for only two more superstores in Tampa, Florida.

The Commission offered Office 1 as a specific example of the difficulty of entering the office superstore arena. Office 1 opened its first two stores in 1991. By the end of 1994, Office 1 had 17 stores, and grew to 35 stores operating in 11 Midwestern states as of October 11, 1996. As of that date, Office 1 was the fourth largest office supply superstore chain in the United States. Unfortunately, also as of that date, Office 1 filed for Chapter 11 bankruptcy protection. Brad Zenner, President of Office 1, testified through declaration, that Office 1 failed because it was severely undercapitalized in comparison with the industry leaders, Staples, Office Depot, and OfficeMax. In addition, Mr. Zenner testified that when the three leaders ultimately expanded into the smaller markets where Office 1 stores were located, they seriously undercut Office 1's retail prices and profit margins. Because Office 1 lacked the capitalization of the three leaders and lacked the economies of scale enjoyed by those competitors, Office 1 could not remain profitable.

For the reasons discussed above, the Court finds it extremely unlikely that a new office superstore will enter the market and thereby avert the anti-competitive effects from Staples' acquisition of Office Depot. The defendants, of course, focused their entry argument on more than just the entry of additional superstores, pointing also to the expansion of existing companies such as U.S. Office Products and Wal-Mart. The Court also finds it unlikely that the expansions by U.S. Office Products and Wal-Mart would avert the anti-competitive effects which would result from the merger.

The problems with the defendants' evidence regarding U.S. Office Products are numerous. In contrast to Staples and Office Depot, U.S. Office Products is a company which is focused on a contract stationers business servicing primarily the medium corporate segment. The Mailboxes stores recently acquired by U.S. Office Products carry only 50–200 SKUs of office supplies in stores of approximately 1,000–4,000 square feet with no more than half of that area devoted to consumable office supplies. In addition to their small size and limited number of SKUs, the Mailboxes stores would not actually be new entrants. U.S. Office Products is acquiring existing stores, and, besides Mr. Ledecky's plans to put a U.S. Office Products catalogue in every Mailboxes store, there was no testimony regarding plans to expand the
number of SKUs available in the retail stores themselves or to increase the size of the average Mailboxes store. Finally, though Mr. Ledecky testified that if Staples and Office Depot were to raise prices after the merger he would look on that as an opportunity to take business away from the combined entity, he later clarified that statement by explaining that he meant in the contract stationer field.

The defendants’ evidence regarding Wal-Mart’s expansion of Department 3 has similar weaknesses. While the total number of SKUs expected to be carried by the new Department 3 is impressive, Mr. Glass estimated it to be between 2,600 to 3,000 SKUs, the evidence shows that this is only an increase of approximately 400 SKUs. The Court has already found that Wal-Mart’s sales of office supplies are outside the relevant product market in this case primarily because the pricing evidence shows that Wal-Mart does not presently effectively constrain the superstores’ prices. The Court cannot conclude that an addition of 400 SKUs and reconfigured shelf space will significantly change Wal-Mart’s ability to constrain Staples’ and Office Depot’s prices. The superstores will continue to offer significantly more SKUs of consumable office supplies. For these reasons, the Court cannot find that Wal-Mart’s expansion through Department 3 is likely to avert anti-competitive effects resulting from Staples’ acquisition of Office Depot. 18

The defendants’ final argument with respect to entry was that existing retailers such as Sam’s Club, Kmart, and Best Buy have the capability to reallocate their shelf space to include additional SKUs of office supplies. While stores such as these certainly do have the power to reallocate shelf space, there is no evidence that they will in fact do this if a combined Staples–Office Depot were to raise prices by 5% following a merger. In fact, the evidence indicates that it is more likely that they would not. For example, even in the superstores’ anti-competitive zones where either Staples or Office Depot does not compete with other superstores, no retailer has successfully expanded its consumable office supplies to the extent that it constrains superstore pricing. Best Buy attempted such an expansion by creating an office supplies department in 1994, offering 2000 SKUs of office supplies, but found the expansion less profitable than hoped for and gave up after two years. For these reasons, the Court also cannot find that the ability of many sellers of office supplies to reconfigure shelf space and add SKUs of office supplies is likely to avert anti-competitive effects from Staples’ acquisition of Office Depot. The Court will next consider the defendants’ efficiencies defense.

VI. Efficiencies

[15] Whether an efficiencies defense showing that the intended merger would create significant efficiencies in the relevant market, thereby offsetting any anti-competitive effects, may be used by a defendant to rebut the government’s prima facie case is not entirely clear. The newly revised efficiencies section of the Merger Guidelines recognizes that, “mergers have the potential to generate significant efficiencies by permitting a better utilization of existing assets, enabling the combined firm to achieve lower costs in producing a given quality and quantity than either firm could have achieved without the proposed transaction.” See Merger Guidelines § 4. This coincides with the view of some courts that “whether an acquisition would yield significant efficiencies in the relevant market is an important consideration in predicting whether the acquisition would substantially lessen competition… Therefore, … an efficiency defense to the government’s prima facie case in section 7 challenges is appropriate in certain circumstances.” FTC v. University Health, 938 F.2d 1206, 1222 (11th Cir.1991). The Supreme Court, however, in FTC v. Procter & Gamble Co., 386 U.S. 568, 579, 87 S.Ct. 1224, 1230, 18 L.Ed.2d 303 (1967), stated that “[p]ossible economies cannot be used as a defense to illegality in section 7 merger cases.” There has been great disagreement regarding the meaning of this precedent and whether an efficiencies defense is permitted. Compare RSR Corp. v. FTC, 602 F.2d 1317,
1325 (9th Cir.1979) (finding that the efficiencies argument has been rejected repeatedly),
cert. denied, 445 U.S. 927, 100 S.Ct. 1313, 63
L.Ed.2d 760 (1983) with University Health,
938 F.2d at 1222 (recognizing the defense).
Neither the Commission or the defendants
could point to a case in which this Circuit
has spoken on the issue. But see FTC v.
Coca-Cola Co., 641 F.Supp. 1128, 1141
(D.D.C.1986) (Gesell) (finding that Congress
recognized as desirable efficiencies that ben-
efit consumers, but that they were to be
“developed by dominant concerns using
their brains, not their money by buying out
troubling competitors. The Court has no
authority to move in a direction neither
Congress nor the Supreme Court has ac-
etted”), vacated as moot, 829 F.2d 191
(D.C.Cir.1987). Assuming that it is a viable
defense, however, the Court cannot find in
this case that the defendants’ efficiencies
evidence rebuts the presumption that the
merger may substantially lessen competition
or shows that the Commission’s evidence
gives an inaccurate prediction of the pro-
posed acquisition’s probable effect.

The Court agrees with the defendants that
where, as here, the merger has not yet been
consummated, it is impossible to quantify
precisely the efficiencies that it will generate.
In addition, the Court recognizes a difference
between efficiencies which are merely specu-
lative and those which are based on a predic-
tion backed by sound business judgment.
Nor does the Court believe that the defen-
dants must prove their efficiencies by “clear
and convincing evidence” in order for those
efficiencies to be considered by the Court.
That would saddle Section 7 defendants with
the nearly impossible task of rebutting a
possibility with a certainty, a burden which
was rejected in United States v. Baker
Hughes, Inc., 908 F.2d 981, 992 (D.C.Cir.
1990). Instead, like all rebuttal evidence in
Section 7 cases, the defendants must simply
rebut the presumption that the merger will
substantially lessen competition by showing
that the Commission’s evidence gives an in-
accurate prediction of the proposed acquisi-
tion’s probable effect. See id. at 991. De-
fendants, however, must do this with credible
evidence, and the Court with respect to this
issue did not find the defendants’ evidence to
be credible.

Defendants’ submitted an “Efficiencies
Analysis” which predicated that the com-
bined company would achieve savings of be-
tween $4.9 and $6.5 billion over the next five
years. In addition, the defendants argued
that the merger would also generate dynamic
efficiencies. For example, defendants ar-
gued that as suppliers become more efficient
due to their increased sales volume to the
combined Staples–Office Depot, they would
be able to lower prices to their other retail-
ers. Moreover, defendants argued that two-
thirds of the savings realized by the com-
bined company would be passed along to
consumers.

Evaluating credibility, as the Court must
do, the Court credits the testimony and Re-
port of the Commission’s expert, David
Painter, over the testimony and Efficiencies
Study of the defendants’ efficiencies witness,
Shira Goodman, Senior Vice President of In-
tegration at Staples. Mr. Painter’s testimo-
yry was compelling, and the Court finds,
based primarily on Mr. Painter’s testimony,
that the defendants’ cost savings estimates
are unreliable. First, the Court notes that
the cost savings estimate of $4.947 billion
over five years which was submitted to the
Court exceeds by almost 500% the figures
presented to the two Boards of Directors in
September 1996, when the Boards approved
the transaction. The cost savings claims
submitted to the Court are also substantially
greater than those represented in the defen-
dants’ Joint Proxy Statement/Prospectus “re-
flexing the best currently available estimate
of management,” and filed with the Securi-
ties and Exchange Commission on January
23, 1997, or referenced in the “fairness op-
ions” rendered by the defendants’ investment
bankers which are contained in the Proxy
Statement.

The Court also finds that the defendants’
projected “Base Case” savings of $5 billion
are in large part unverified, or at least the
defendants failed to produce the necessary
documentation for verification. One example
of this is the estimated cost savings from the
Goods and Services category which projects
cost savings of $553 million, about 10% of the
total cost savings attributed to the merger by the defendants. Ms. Goodman admitted that the entire backup, source, and the calculations of the Goods and Services' cost savings were not included in the Efficiencies Analysis. In addition, Ms. Goodman was unable to explain the methods used to calculate many of the cost savings. Similarly, the projected distribution cost savings, $88.3 million or 17% of the projected total cost savings, are problematic. Defendants' consultant A.T. Kearney estimated the savings, and Ms. Goodman admitted the Efficiency Analysis did not show that Kearney had deducted the projected Staples stand-alone savings from the new Hagerstown and Los Angeles full line distribution centers.

As with the failure to deduct the Staples stand-alone savings from the new Hagerstown and Los Angeles full line distribution centers from the projected distribution cost savings, the evidence shows that the defendants did not accurately calculate which projected cost savings were merger specific and which were, in fact, not related to the merger. For example, defendants' largest cost savings, over $2 billion or 40% of the total estimate, are projected as a result of their expectation of obtaining better prices from vendors. However, this figure was determined in relation to the cost savings enjoyed by Staples at the end of 1996 without considering the additional cost savings that Staples would have received in the future as a stand-alone company. Since Staples has continuously sought and achieved cost savings on its own, clearly the comparison that should have been made was between the projected future cost savings of Staples as a stand-alone company, not its past rate of savings, and the projected future cost savings of the combined company. Thus, the calculation in the Efficiencies Analysis included product cost savings that Staples and Office Depot would likely have realized without the merger. In fact, Mr. Painter testified that, by his calculation, 48% of the estimated savings are savings that Staples and Office Depot would likely have achieved as stand-alone entities.

There are additional examples of projected savings, such as the projected savings on employee health insurance, which are not merger specific, but the Court need not discuss every example here. However, in addition to the non-merger specific projected savings, Mr. Painter also revealed problems with the defendants' methodology in making some of the projections. For example, in calculating the projected cost savings from vendors, Staples estimated cost savings for a selected group of vendors, and then extrapolated these estimated savings to all other vendors. Mr. Painter testified that, although Hewlett Packard is Staples' single largest vendor, it was not one of the vendors used for the savings estimate. In addition, the evidence shows that Staples was not confident that it could improve its buying from Hewlett Packard. Yet, Staples' purchases and sales of Hewlett Packard products were included in the "all other" vendor group, and defendants, thereby, attributed cost savings in the amount of $207 million to Hewlett Packard even though Staples' personnel did not believe that they could, in fact, achieve cost savings from Hewlett Packard.

In addition to the problems that the Court has with the efficiencies estimates themselves, the Court also finds that the defendants' projected pass through rate—the amount of the projected savings that the combined company expects to pass on to customers in the form of lower prices—is unrealistic. The Court has no doubt that a portion of any efficiencies achieved through a merger of the defendants would be passed on to customers. Staples and Office Depot have a proven track record of achieving cost savings through efficiencies, and then passing those savings to customers in the form of lower prices. However, in this case the defendants have projected a pass through rate of two-thirds of the savings while the evidence shows that, historically, Staples has passed through only 15-17%. Based on the above evidence, the Court cannot find that the defendants have rebutted the presumption that the merger will substantially lessen competition by showing that, because of the efficiencies which will result from the merger, the Commission's evidence gives an inaccurate prediction of the proposed acquisition's probable effect. Therefore, the only remaining issue for the Court is the balancing of the equities.
VII. The Equities

Where, as in this case, the Court finds that the Commission has established a likelihood of success on the merits, a presumption in favor of a preliminary injunction arises. FTC v. PPG Indus., Inc., 798 F.2d 1500, 1507 (D.C.Cir.1986); FTC v. Alliant Techsystems, Inc., 808 F.Supp. 9, 22–23 (D.D.C.1992). Despite this presumption, however, once the Court has determined the FTC's likelihood of success on the merits, it must still turn to and consider the equities. The D.C. Circuit has held that in cases such as the one now before the Court, a judge is obligated "to exercise independent judgment on the propriety of issuance of a temporary restraining order or preliminary injunction." FTC v. Weyerhaeuser Co., 665 F.2d 1072, 1082 (D.C.Cir.1981) (quoting H.R. Rep. No. 624 at 31). "Independent judgment is not exercised when a court responds automatically to the agency's threshold showings. To exercise such judgment, the court must take genuine amount of the equities." Id.

[16–18] There are two types of equities which the Court must consider in all Section 13(b) cases, private equities and public equities. In this case, the private equities include the interests of the shareholders and employees of Staples and Office Depot. The public equities are the interests of the public, either in having the merger go through or in preventing the merger. An analysis of the equities properly includes the potential benefits, both public and private, that may be lost by a merger blocking preliminary injunction. Id. at 1083. In addition, the Court notes that in balancing the equities, it is important to keep in mind that while private equities are important, "[w]hen the Commission demonstrates a likelihood of ultimate success, a counter showing of private equities alone would not suffice to justify denial of a preliminary injunction barring the merger." Id. at 1083. After examining the evidence in this case, the Court finds that in light of the public equities advanced by the plaintiff, the equities, both public and private, set forth by the defendants are insufficient to overcome the presumption in favor of granting a preliminary injunction.

The strong public interest in effective enforcement of the antitrust laws weighs heavily in favor of an injunction in this case, as does the need to preserve meaningful relief following a full administrative trial on the merits. "Unscrambling the eggs" after the fact is not a realistic option in this case. Both the plaintiff as well as the defendants introduced evidence regarding the combined company's post-merger plans, including the consolidation of warehouse and supply facilities in order to integrate the two distribution systems, the closing of 40 to 70 Office Depot and Staples stores, changing the name of the Office Depot stores, negotiating new contracts with manufacturers and suppliers, and, lastly, the consolidation of management which is likely to lead to the loss of employment for many of Office Depot's key personnel. As a result, the Court finds that it is extremely unlikely, if the Court denied the plaintiff's motion and the merger were to go through, that the merger could be effectively undone and the companies divided if the agency later found that the merger violated the antitrust laws. It would not simply be a matter of putting the old Office Depot signs back on the stores. Office Depot would have lost its name, many of its stores, its distribution centers, and key personnel. It would also be behind in future plans to open new stores and expand on its own.

More importantly, in addition to the practical difficulties in undoing the merger, consumers would be at risk of serious anti-competitive harm in the interim. Without an injunction, consumers in the 42 geographic markets where superstore competition would be eliminated or significantly reduced face the prospect of higher prices than they would have absent the merger. These higher charges could never be recouped even if the administrative proceeding resulted in a finding that the merger violated the antitrust laws. Failure to grant a preliminary injunction also would deny consumers the benefit of any new competition that would have occurred, absent the merger, between Staples and Office Depot as those stores continued to enter and compete in each other's markets. Both parties had aggressive expansion plans before the merger, many of which have been put on hold pending the outcome of this case.
The public equities raised by the defendants simply do not outweigh those offered by the FTC. In addition, given some of the Court's earlier findings, several of the public equities submitted by the defendants are without factual support. For example, the defendants argued that the public equities favor the merger because prices will fall for all products, in all markets, following the merger. Since the Court has already found that the Commission has shown a likelihood of success on the merits with respect to proving that the proposed merger will have anti-competitive effects, the Court cannot give any weight to this particular public equity advanced by the defendants. In addition, as the Court has previously explained, the fact that prices might be lower than current prices after the merger does not mean that the merger will not have an anti-competitive effect. Consumers would still be hurt if prices after the merger did not fall as far as they would have absent the merger. Similarly, the Court has already determined the defendants' efficiencies evidence to be unconvincing. On the public equities issue as it relates to efficiencies, Dr. Hausman testified that the merger will result in huge efficiencies to the U.S. economy, and that the cost savings realized as a result of those efficiencies will result in the creation of additional jobs. While the Court believes that there would be some efficiencies realized by the merger, though not at the level argued by the defendants, the Court cannot find that those efficiencies would result in the creation of so many additional jobs that the public equity would outweigh those argued by the plaintiff.

Finally, according to the defendants, the public equities also include the benefits consumers will derive from even greater product selection and the benefits the U.S. economy will derive from increased international trade as the combined company through its increased efficiencies and improved distribution system will be poised for a dramatic expansion into foreign markets. Defendants, however, have provided no specific evidence regarding the probable increase in product selection or the likelihood that a combined Staples–Office Depot will expand overseas. In addition, the Court is not convinced that this is an appropriate equity which the Court may consider in this case. The Court, therefore, cannot find that the public equities regarding increased product selection for consumers and expansion into foreign markets overcome the public equities set forth by the FTC.

Turning finally to the private equities, the defendants have argued that the principal private equity at stake in this case is the loss to Office Depot shareholders who will likely lose a substantial portion of their investments if the merger is enjoined. The Court certainly agrees that Office Depot shareholders may be harmed, at least in the short term, if the Court granted the plaintiff's motion and enjoined the merger. This private equity alone, however, does not suffice to justify denial of a preliminary injunction.

The defendants have also argued that Office Depot itself has suffered a decline since the incipiency of this action. It is clear that Office Depot has lost key personnel, especially in its real estate department. This has hurt this year's projected store openings. The defendants argue, therefore, that Office Depot, as a separate company, will have difficulty competing if the merger is enjoined. While the Court recognizes that Office Depot has indeed been hurt or weakened as an independent stand-alone company, the damage is not irreparable. The evidence shows that Office Depot, which of the three superstores has been the low-priced aggressive maverick of the group, would continue generating sales volume and turning a substantial profit. In reaching this conclusion, the Court credits one of the defendants' own expert witnesses, Steven Mandel, who testified that, in his opinion, Office Depot would be fine even if the merger did not go through. He described Office Depot as a very strong and well-run company, and said that it would certainly have a little bit of a hole to dig out of if the merger were enjoined. However, his ultimate conclusion was that the company would recover. Certainly Office Depot is in a better position to recover and move forward now if the Court grants the plaintiff's motion than it would be if the merger was allowed to go forward and
then later the two companies were ordered to separate.

**CONCLUSION**

Thomas Stemberg pioneered the office supply superstore concept in 1985. He created a deep discount chain selling a broad array of office supplies primarily to small businesses which theretofore were undeniably "paying through the nose" for office supplies. Staples was to be a high volume chain operating at low gross margins, with higher volume leading to still lower costs for consumers. Staples' pricing as well as the pricing of other office supply superstores which soon followed Staples' lead, revolutionized the office products industry, impacting all channels of office products retailing. By selling office products at 30 to 60% off list price, Staples and the other superstores worked as a catalyst that forced everyone else in the industry to focus on cutting their prices. In a relatively short period of time, the office supply superstores caused a general decrease in the price of office products across the board. That decrease continued as the superstores have increased their buying power, forcing manufacturers and suppliers to implement efficiencies in their own businesses in order to compete in the sale of their products.

In light of the undeniable benefits that Staples and Office Depot have brought to consumers, it is with regret that the Court reaches the decision that it must in this case. This decision will most likely kill the merger. The Court feels, to some extent, that the defendants are being punished for their own successes and for the benefits that they have brought to consumers. In effect, they have been hoisted with their own petards. See William Shakespeare, *Hamlet*, act 3, sc 4. In addition, the Court is concerned with the broader ramifications of this case. The superstore or "category killer" like office supply superstores are a fairly recent phenomenon and certainly not restricted to office supplies. There are a host of superstores or "category killers" in the United States today, covering such areas as pet supplies, home and garden products, bed, bath, and kitchen products, toys, music, books, and electronics. Indeed, such "category killer" stores may be the way of retailing for the future. It remains to be seen if this case is *sui generis* or is the beginning of a new wave of FTC activism. For these reasons, the Court must emphasize that the ruling in this case is based strictly on the facts of this particular case, and should not be construed as this Court's recognition of general superstore relevant product markets.

Despite the Court's sympathy toward the plight of the defendants in this case, the Court finds that the Commission has shown a "reasonable probability" that the proposed merger between Staples and Office Depot may substantially impair competition and likewise has "raised questions going to the merits so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instances and ultimately by the Court of Appeals." Therefore, the Court finds that the Commission has shown a likelihood that it will succeed in proving, after a full administrative trial on the merits, that the effect of the proposed merger between Staples and Office Depot "may be substantially to lessen competition" in violation of Section 7 of the Clayton Act. In addition, the Court has weighed the equities and finds that they tip in favor of granting a preliminary injunction. A preliminary injunction is, therefore, found to be in the public interest. The FTC's motion for a preliminary injunction shall be granted.

The Court once again commends counsel on both sides for their excellent performances in this matter and the tremendous efforts made on both sides. Though this was an extremely complex matter, the issues were clearly presented to the Court by counsel possessing superior advocacy skills. Counsel also exhibited a high degree of professionalism in their ability to resolve peripheral matters so that the Court could focus on the important issues presented by this action.

An appropriate order accompanies this Memorandum Opinion.
Statement of the Federal Trade Commission
Concerning the Proposed Merger of Office Depot, Inc. and OfficeMax, Inc.
FTC File No. 131-0104
November 1, 2013

The Commission has unanimously decided to close its seven-month investigation of Office Depot, Inc.’s proposed merger with OfficeMax, Inc., a transaction that aims to combine the country’s second and third largest chains of office supply superstores (OSS). 1 Although sixteen years ago the Commission blocked a proposed merger between Staples, Inc. and Office Depot, the nation’s two largest OSS, our current investigation has shown that the market for the sale of consumable office supplies has changed significantly in the intervening years. For the reasons discussed below, we conclude that Office Depot and OfficeMax should be permitted to move forward with their proposed transaction. In reaching this conclusion, we assessed the proposed merger’s competitive effects in two distinct lines of commerce: the sale of office supplies to retail and contract customers. We discuss each in turn.

I. Retail Channel

In the 1997 Staples case, 2 the Commission successfully argued that the relevant product market was the sale of consumable office supplies through OSS and that the proposed merger of two of the three OSS would lead to competitive harm. 3 In finding an OSS-only market, the Staples court relied principally on qualitative and empirical evidence that OSS prices were set according to the number of competing OSS in a local area. Company documents revealed the merging parties’ intense competitive focus on other OSS and general lack of concern with non-OSS rivals. The evidence also showed that the defendants grouped their stores into price zones specifically based on the number of nearby OSS, resulting in higher prices in local markets with fewer OSS, even if non-OSS competitors were present.

The current competitive dynamics are very different. The Commission’s investigation shows that today’s market for the sale of consumable office supplies is broader, due mainly to two significant developments. One is that customers now look beyond OSS for office supply products and rely more heavily on non-OSS brick-and-mortar retailers. Mass merchants like Wal-Mart and Target and club stores like Costco and Sam’s Club have proliferated and expanded their product offerings and sales of office supplies. The result is that fewer consumers today shop OSS as a destination. Instead, consumers place a greater premium on convenience, preferring in many cases to purchase supplies at retailers that also offer other products that office supply customers purchase.

The other is the explosive growth of online commerce, which has had a major impact on this market. Online retailers stock a vast array of office supply products and can deliver them quickly anywhere in the country at nominal cost. Company documents show that OSS are

1 The Attorneys General of several states joined in the Commission’s investigation.
3 “Consumable office supplies” refers to non-durable products that consumers use up, discard, and purchase on a recurrent basis. Examples included pens, paper, file folders, Post-it notes, and ink and toner cartridges. Id. at 1080.
acutely aware of, and feel threatened by, the continued growth of online competitors, most notably Amazon. OSS have lost, and continue to lose, substantial in-store sales to online competitors. This increased competition from online retailers has caused OSS to respond with new pricing practices and other strategies. For example, because online prices are often lower than in-store prices, and because many customers compare shop in-store prices against online prices, OSS are often pressured to match these lower online prices in their stores. And, in-store and online channel boundaries are blurring as OSS seek to create a seamless customer experience by offering in-store pickup for online orders and using in-store Internet kiosks to order products online.

The merging parties’ pricing policies and practices reflect these changes in customer behavior and now specifically factor in non-OSS competition. Price zones and retail pricing are no longer dictated by the number of local OSS. In fact, a majority of products sold by the merging parties are priced nationally, and the products priced locally take into account competition from non-OSS retailers. OSS closely monitor, and respond competitively to, other non-OSS retailers. This competitive interaction includes price-checking, price matching, and advertising and promotion designed specifically to compete effectively with non-OSS retailers.

The econometric analysis reflects the new competitive dynamics in the industry and shows that the proposed merger is unlikely to result in anticompetitive price effects. Commission staff replicated the type of econometric work performed in *Staples* and conducted an extensive amount of additional econometric analysis, including comparisons of prices in markets with varying numbers of OSS and “events studies” analyzing the impact of OSS store closings on the prices charged by remaining OSS in local areas. All of the econometrics, none of which assumed or depended on any particular definition of a relevant product or geographic market, indicate that the merger is unlikely to lead to anticompetitive price increases.

Altogether, the overwhelming evidence supports the conclusion that OSS today face significant competition and demonstrates that the proposed merger is unlikely to substantially lessen competition in the retail sale of consumable office supplies.

II. Contracting Channel

The Commission also examined the potential for competitive harm in the sale of consumable office supplies to businesses and other customers on a contract basis, a channel not at issue in *Staples*. Many businesses and public entities purchase office supplies under a contract. Unlike retail purchasers, contract customers typically receive discounted pricing based on actual or anticipated purchase volume. These contracts allow customers to order office products at previously negotiated prices. Because there are dozens, if not hundreds, of office suppliers that compete effectively to serve small and medium-sized businesses, the investigation focused on contracts for large multi-regional or national customers, which typically have the most demanding purchasing requirements and, as a result, fewer potential suppliers capable of meeting their needs.

A substantial body of evidence indicates that the merger is unlikely to substantially lessen competition or harm large contract customers. First, large customers use a variety of tools to ensure that they receive competitive pricing such as ordering certain products (like ink and toner)
directly from manufacturers and sourcing (or threatening to source) certain categories of office supply products from multiple firms. Second, the merging parties’ documents show that they are rarely each other’s closest competitor for most large customers and that non-OSS competitors take business from the parties in a substantial number of contracting opportunities. Third, the parties will continue to face strong competition for such customers from Staples and a host of non-OSS competitors, such as W.B. Mason Co., Inc. Non-OSS competitors are growing in number and strength and have demonstrated the ability to win large multi-regional and national customer contracts. In particular, regional office supply competitors have developed and utilized various strategies to compete successfully for large national accounts, including working with office supply wholesalers and joining cooperatives of independent office supply dealers to create a distribution network capable of meeting the needs of large multi-regional and national customers. Finally, potential competitors in adjacent product categories, such as janitorial and industrial products, have existing contractual relationships with large office supply customers and can leverage those relationships to enter the office supply distribution market.

In light of the foregoing, there was little concern from contract customers about the proposed merger, and even the largest customers believe the merger would be either pro-competitive or competitively neutral. We therefore find that the proposed merger is unlikely to result in competitive harm in the contract channel.¹

III. Conclusion

Analyzing the likely competitive effects of a proposed transaction is always a fact-specific exercise that must take into account the evolving nature of markets. Our decision highlights that yesterday’s market dynamics may be very different from the market dynamics of today. In this case, significant developments in the market for consumable office supplies have led us to approve a merger when we had blocked a similar merger sixteen years ago. In so finding, we emphasize that our decision, including our view of the competitive interaction between brick-and-mortar retailers and Internet sellers, is limited to the facts before us in this particular matter.

¹ We also assessed the potential for coordinated effects, but found that market conditions, including the number and diversity of competing firms, the complexity of contract terms, and the lack of transparency into the identity of bidders and terms of contracts and bids, would render post-merger coordination or market allocation difficult.
MEMORANDUM OPINION

I. Introduction

Drawing an analogy to the fate of penguins whose destinies appear doomed in the face of uncertain environmental changes, Defendant Staples Inc. ("Staples") and Defendant Office Depot, Inc. ("Office Depot") (collectively "Defendants") argue they are like "penguins on a melting iceberg," struggling to survive in an increasingly digitized world and an office-supply industry soon to be revolutionized by new entrants like Amazon Business. Prelim. Inj. Hrg Tr. ("Hrg Tr." ) 60:15 (Opening Statement of Diane Sullivan, Esq.). Charged with enforcing antitrust laws for the benefit of American consumers, the Federal Trade Commission ("FTC") and its co-plaintiffs, the Commonwealth of Pennsylvania
and the District of Columbia, commenced this action in an effort to block Defendants’ proposed merger and alleged that the merger would “eliminate direct competition between Staples and Office Depot” resulting in “significant harm” to large businesses that purchase office supplies for their own use. Compl., Docket No. 3 at ¶ 4. The survival of Staples’ proposed acquisition of Office Depot hinges on two critical issues: (1) the reliability of Plaintiffs’ market definition and market share analysis; and (2) the likelihood that the competition resulting from new market entrants like Amazon Business will be timely and sufficient to restore competition lost as a result of the merger.

Subsequent to Defendants’ announcement in February 2015 of their intent to merge, the FTC began an approximate year-long investigation into the $6.3 billion merger and its likely effects on competition. Defs.’ Proposed Findings of Fact and Conclusions of Law (“Defs.’ FOF”) ¶ 58. On December 7, 2015, by a unanimous vote, the FTC Commissioners found reason to believe that the proposed merger would substantially reduce competition in violation of Section 7 of the Clayton Act and Section 5 of the FTC Act. Compl. ¶ 34. That same day, Plaintiffs commenced this action seeking a preliminary injunction pursuant to Section 13(b) of the FTC Act, 15 U.S.C. § 53 (b) to enjoin the proposed
merger until the FTC’s administrative proceedings are complete. Pls. ’ Mot. Prelim. Inj., Docket No. 5 at 1.

This antitrust case involved an extraordinary amount of work. As a result of the FTC’s investigation and seven weeks of discovery, more than fifteen million pages of documents were produced, more than seventy depositions around the country were taken, and five expert reports were completed. Defs.’ FOF ¶ 60. The Court presided over an evidentiary hearing and heard testimony from ten witnesses from March 21, 2016 to April 5, 2016. Id. Nearly 4,000 exhibits were admitted into evidence. Id. ¶ 61. Despite onerous time constraints created by the nature of this unique litigation, lawyers for the parties and non-parties completed this work with civility and professionalism while demonstrating the highest level of sophistication and competency in their written and oral advocacy. The Court commends the lawyers and the paralegals for their outstanding work.  

1 Defendants requested an expedited decision by no later than a date certain so that financing could be secured to hold their deal together. December 17, 2015 Tr., Docket 107 at 39. The Court committed to ruling on the merits of this controversy by no later than May 10, 2016. Id.

2 As the Court stated during the hearing: “Let me extend my appreciation to [the paralegals]. They’re the unsung heroes and never get the credit that they deserve. I know how hard you work to make us look good, I know that. So on behalf of everyone, thank you very much.” Hrg Tr. 158:8-13.
At the conclusion of Plaintiffs' case, Defendants chose not to present any fact or expert witnesses, arguing that Plaintiffs failed to establish their prima facie case. Hrg Tr. 2889:20-25 (Ms. Sullivan: "It’s going to be the defendants’ position that we’re going to rest on the record as it exists, so there’ll be no need for additional evidence or rebuttal."). And, although entitled to a trial on the merits before an Administrative Law Judge at the FTC, Defendants indicated that they will not proceed with the merger if Plaintiffs’ motion is granted. Hrg Tr. at 3034:18-22; Defs.’ FOF ¶ 17.³

Upon consideration of the evidence presented during the hearing, the parties’ proposed findings of fact and conclusions of law, and the relevant legal authority, the Court concludes that the Plaintiffs have established their prima facie case by demonstrating that Defendants’ proposed merger is likely to reduce competition in the Business to Business ("B-to-B") contract space for office supplies. Defendants’ response relies

³ As the Court expressed many times during these proceedings, the lack of meaningful appellate review on the merits is an unfortunate reality of antitrust statutes. Because the administrative process before the FTC is so time consuming, most corporations, like Defendants in this case, cannot secure financing to keep the deal together pending the administrative trial on the merits. See, e.g. FTC v. Sysco Corporation, 113 F. Supp. 3d 1, 15 (2015) (noting that the Defendants announced that they will not proceed with the merger if the Court grants the requested injunction.)
in large part on the prospect that Amazon Business will replace any competition lost because of the merger. Although Amazon Business may transform how some businesses purchase office supplies, the evidence presented during the hearing fell short of establishing that Amazon Business is likely to restore lost competition in the B-to-B space in a timely and sufficient manner. For the reasons discussed in Section IV infra, Plaintiffs' Motion for Preliminary Injunction is GRANTED.

In Section II of this Memorandum Opinion, the Court sets forth important background information, including many critical findings of fact underpinning the Court's analysis. Section III establishes the relevant legal standard pursuant to the Clayton Act. The Court's analysis in Section IV proceeds as follows:

(A) legal principles considered when defining a relevant market;
(B) application of legal principles to Plaintiffs' market definition; (C) Defendants' arguments in opposition to Plaintiffs' alleged market; (D) conclusions regarding the relevant market; (E) analysis of the Plaintiffs' arguments

4 The Court appreciates the tremendous amount of time, money and effort Defendants put into this case, and understands that they genuinely believe this merger would be best for their companies, the industry and the public. While the Court's decision is surely a great disappointment to Defendants, the Court is optimistic that Defendants will find ways to innovate, evolve and remain relevant in the rapidly changing office supply industry.
relating to the probable effects on competition based on market share calculations; (F) Defendants’ arguments in opposition to Plaintiffs’ market share calculations; (G) conclusions regarding Plaintiffs’ market share; (H) Plaintiffs’ evidence of additional harm; (I) Defendants’ response to Plaintiffs’ prima facie case; and (J) weighing the equities. In Section V, the Court concludes that the proposed merger must be enjoined due to the likelihood of anticompetitive effects that would result were the merger to be consummated.

II. Background

A. Overview

Every day millions of employees throughout the United States utilize office supplies in the course of their daily work. To sustain employees’ use of pens, Post-it notes and paperclips, large companies purchase more than two billion dollars of office supplies from Defendants annually. Hrg Tr. 10:23-24, (Opening Statement of Tara Reinhart, Esq.). Companies that purchase office supplies for their own use operate in what the industry refers to as the B-to-B space. B-to-B customers prefer to work with one vendor that can meet all of the companies’ office supply needs. Hrg Tr. at 204:1-20 (Gregg O’Neill, Category Manager for Workplace Services at American Electric Power (“AEP”) testifying that because the company spends two million dollars on office supplies, its leverage with
one vendor is greater than it would be if it utilized twenty vendors); Id. at 1617:1-1618:4 (Leo J. Meehan, III, CEO of WB Mason testifying about the benefits of utilizing one primary vendor, including lower prices, growth rebates, assistance with controlling leakage, etc.).

To establish a primary vendor relationship, companies in the B-to-B space request proposals from national suppliers like Staples and Office Depot. See e.g., Hrg Tr. (AEP) 194:10-195:16. The request for proposal ("RFP") process typically results in a multi-year contract with a primary vendor that guarantees prices for specific items, includes an upfront lump-sum rebate, and a host of other services. Pls.' Proposed Findings of Fact and Conclusions of Law ("Pls.' FOF") ¶¶ 41-46. Because the office supplies consumed by large companies are voluminous, such companies typically pay only half the price for basic supplies as compared to the average retail consumer. Plaintiffs' Exhibit ("PX") 06100, Pls.' Expert Dr. Carl Shapiro's Report ("Shapiro Report") at 019.5

5 Dr. Shapiro, Plaintiffs' expert economist, is a Professor of Business Strategy at the Haas School of Business at the University of California at Berkeley. Shapiro Expert Report ("Shapiro Report"), PX06100-003. In addition to teaching, Dr. Shapiro has served in government in various capacities during his professional career, including as a member of the President's Council of Economic Advisers from 2011 to 2012, and as an advisor at the Department of Justice from 1995 to 1996 and again from 2009 to 2011. Id. Dr. Shapiro testifies for Plaintiffs and Defendants in antitrust matters. Id.
B. Defendants Staples and Office Depot

Established as big-box retail stores in the 1980s, Defendants are the primary B-to-B office supply vendors in the United States today. Hrg Tr. 59. Plaintiffs allege that Defendants sell and distribute upwards of seventy-nine percent of office supplies in the B-to-B space. Hrg Tr. 20-21. Since the 2013 merger of Office Depot and Office Max, Defendants consistently engage in head-to-head competition with each other for B-to-B contracts. See, e.g., PX04322 Staples ("SPLS") 001 (identifying only Office Depot as "Key Competitor[1]").

Staples and Office Depot are publicly traded corporations. Compl. ¶¶ 29 and 30. Staples is the largest office supplier of consumable office supplies to large B-to-B customers in the United States and operates in three business segments: (1) North American stores and online sales; (2) North American commercial; and (3) international operations. Id. ¶ 29. In fiscal year 2014, Staples generated $22.5 billion in sales, with more than half of all sales coming from office supplies. Id. In fiscal year 2013, 34.8 percent of Staples' total revenue came from the North American commercial segment. Id.

Office Depot is the second largest office supplier of consumable office supplies to large B-to-B customers in the United States. Id. ¶ 30. Like Staples, Office Depot operates in similar business segments: (1) North America retail; (2) North
American business solutions; and (3) an international division. Id. In fiscal year 2014, Office Depot made $16.1 billion in revenue, with nearly half of those sales coming from office supplies and 37.4 percent of overall sales from B-to-B business. Id.

Staples’ “commercial” and Office Depot’s “business solutions” segments focus on the B-to-B contracts at issue in this case. While both companies serve businesses of all sizes, this case focuses on large B-to-B customers, defined by Plaintiffs as those that spend $500,000 or more per year on office supplies. Hrg Tr. 30:4-6. Approximately 1200 corporations in the United States are included in this alleged relevant market. Hrg Tr. 2473:17-18.

C. FTC Investigation

On February 4, 2015, Defendants entered into a merger agreement in which Staples would acquire Office Depot for a combination of cash and Staples’ stock. Compl. ¶ 32. Shortly after the merger was announced, the FTC launched an investigation into the competitive effects of the proposed merger. Defs.’ FOF ¶ 58. Ultimately, the FTC commissioners filed an administrative complaint before an FTC Administrative Law Judge (“ALJ”) and also authorized the Plaintiffs to seek a preliminary injunction to prevent the Defendants from consummating the merger to maintain the status quo pending a
full hearing on the merits. Compl. ¶ 34. Plaintiffs filed this suit the same day. Pls.’ Mot. Prelim. Inj.

D. Regional and local vendors

Regional and local office supply vendors exist throughout the country. Hrg Tr. 84:2. However, they typically do not bid for large B-to-B contracts. Hrg Tr. 907:7-14 (James Moise, Senior Vice President and Chief Sourcing Officer for Fifth Third Bank testifying that regional suppliers Office Essentials and WB Mason declined to bid on their RFP); Hrg Tr. 1941:18-20 (Leonard Allen Wright, Vice President of Strategic Sourcing for Health Trust Purchasing Group (“HPG”) noting that neither WB Mason nor MyOfficeProducts could meet HPG’s needs nationwide). When regional office supply vendors compete for large RFPs, they are rarely awarded the contract. PX02138 (Sears (Realogy) Dep. 156:15-21, 191:6-17) ("... I was concerned about [WB Mason’s] ability to service the entire country..."").

WB Mason is a regional supplier that targets its business to thirteen northeastern states plus the District of Columbia (known in the industry as “Masonville”). Id. WB Mason “ranks a distant third” behind Staples and Office Depot. PX03021-002, Meehan Decl. ¶ 6. In fiscal year 2015, WB Mason generated approximately $1.4 billion in total revenue. Id. WB Mason has no customers in the Fortune 100 and only nine in the Fortune 1000. Hrg Tr. 1611:21-1611:24. According to WB Mason’s CEO, Leo
Meehan, "Staples and Office Depot are the only consumable office supplies vendors that meet the needs of most large B2B customer[s] across the entire country, or even most of it." Meehan Decl. ¶ 19.

WB Mason recently abandoned a plan to expand nationwide. Hrg Tr. 1672 (Mr. Meehan: "And then I just got cold feet about it.") When asked during the hearing if WB Mason would accept a divestiture of cash assets from the Defendants to cover the expenses of nationwide expansion, Mr. Meehan would not commit to accepting such a proposal. Id. 1790 (Mr. Meehan: "I don't know if I would. That's a big challenge.").

E. Amazon Business

marketplace for selling a variety of products, including office supplies to business customers. Hrg Tr. 524:3-4.


[redacted] Hrg Tr. 573:3-574:24.

Although in its infancy, Amazon’s vision is for Amazon Business to be the “preferred marketplace for all professional, business and institutional customers worldwide.” DX00030 at 1. Amazon Business has several undisputed strengths: tremendous brand recognition, a user-friendly marketplace, cutting edge technological innovation, and global reach.6 Hrg Tr. 663:13 (Vice President of Amazon Business, Prentis Wilson: “We actually don’t

6 Amazon’s marketplace is an online shopping experience where customers can browse for items and make online purchases. Hrg Tr. 552. Amazon makes approximately half of all sales through the marketplace. Id. Millions of other companies—“third-party sellers,”—make the remaining sales through the marketplace. Id.
worry a lot about our competitors. Our focus has been on serving our customers."). Amazon Business also has several weaknesses with regard to its entry into the B-to-B space. One weakness is that Amazon Business is inexperienced in the RFP process. Amazon Business has not bid on many RFPs and has yet to win a primary vendor contract. Hrg Tr. 551:11-13 ("Q: Has Amazon Business ever won an RFP for the role as primary supplier of office supplies? A: No."). Amazon Business' marketplace model is also at odds with the B-to-B industry because half of the sales made through the marketplace are from independent third-party sellers over whom Amazon Business has no control. Hrg Tr. 843: 7-9 ("Q: You have no plans to force the third parties to offer particular prices? A: No, we'll never do that. No.").

III. Legal Standards

A. The Clayton Act

Section 7 of the Clayton Act prohibits mergers or acquisitions "the effect of [which] may be substantially to lessen competition, or to tend to create a monopoly," in any "line of commerce or in any activity affecting commerce in any section of the country." 15 U.S.C. § 18. When the FTC has "reason to believe that a corporation is violating, or is about to violate, Section 7 of the Clayton Act," it may seek a preliminary injunction under Section 13(b) of the FTC Act to "prevent a merger pending the Commission's administrative

B. Section 13(b) Standard for Preliminary Injunction

The standard for a preliminary injunction under Section 13(b) requires plaintiffs to show: (1) a likelihood of success on the merits; and (2) that the equities tip in favor of injunctive relief. FTC v. Cardinal Health, 12 F. Supp. 2d 34, 44 (D.D.C. 1998). To establish a likelihood of success on the merits, the government must show that “there is a reasonable probability that the challenged transaction will substantially impair

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7 In contrast, the typical preliminary injunction standard requires a plaintiff to show: (1) irreparable harm; (2) probability of success on the merits; and (3) a balance of equities favoring the plaintiff. FTC v. Sysco Corporation, 113 F. Supp. 3d 1, 22 (2015) (citing Heinz, 246 F.3d at 714)).

The Court's task, therefore, is to "measure the probability that, after an administrative hearing on the merits, the Commission will succeed in proving that the effect of the [proposed] merger 'may be substantially to lessen competition, or tend to create a monopoly' in violation of Section 7 of the Clayton Act.'" Heinz, 246 F.3d at 714 (quoting 15 U.S.C. § 18). This standard is satisfied if the FTC raises questions going to the merits "so serious, substantial, difficult and doubtful as to make them fair ground for thorough investigation, study, deliberation and determination by the FTC in the first instance and ultimately by the Court of Appeals." Id. at 714-15 (citations omitted) (internal quotation marks omitted). As reflected by this standard, Congress' concern regarding potentially anticompetitive mergers was with "probabilities, not certainties." Brown Shoe Co., 370 U.S. at 323 (other citations omitted).

In sum, the Court "must balance the likelihood of the FTC's success against the equities, under a sliding scale." F.T.C. v.
Whole Foods Market, Inc., 548 F.3d 1028, 1035 (D.C. Cir. 2008). The equities or “public interest” in the antitrust context include: “(1) the public interest in effectively enforcing antitrust laws, and (2) the public interest in ensuring that the FTC has the ability to order effective relief if it succeeds at the merits trial.” Sysco, 113 F. Supp. 3d at 86.

Nevertheless, “[t]he issuance of a preliminary injunction prior to a full trial on the merits is an extraordinary and drastic remedy.” FTC v. Exxon Corp., 636 F.2d 1336, 1343 (D.C. Cir. 1980) (citations omitted) (internal quotation marks omitted). The government must come forward with rigorous proof to block a proposed merger because “the issuance of a preliminary injunction blocking an acquisition or merger may prevent the transaction from ever being consummated.” Id.

C. Baker Hughes Burden-Shifting Framework

In United States v. Baker Hughes, Inc., 908 F.2d 981, 982-83 (D.C. Cir. 1990), the U.S. Court of Appeals for the D.C. Circuit established a burden-shifting framework for evaluating the FTC’s likelihood of success on the merits. See Heinz, 246 F.3d at 715. The government bears the initial burden of showing the merger would result in “undue concentration in the market for a particular product in a particular geographic area.” Baker Hughes, 908 F.2d at 982. Showing that the merger would result in a single entity controlling such a large percentage of the
relevant market so as to significantly increase the concentration of firms in that market entitles the government to a presumption that the merger will substantially lessen competition. Id.

The burden then shifts to the defendants to rebut the presumption by offering proof that "the market-share statistics [give] an inaccurate account of the [merger's] probable effects on competition in the relevant market." Heinz, 246 F.3d at 715 (quoting United States v. Citizens & S. Nat'l Bank, 422 U.S. 86 (1975) (alterations in original)). "The more compelling the prima facie case, the more evidence the defendant must present to rebut it successfully." Baker Hughes, 908 F.2d at 991. "A defendant can make the required showing by affirmatively showing why a given transaction is unlikely to substantially lessen competition, or by discrediting the data underlying the initial presumption in the government's favor." Id.

"If the defendant successfully rebuts the presumption, the burden of producing additional evidence of anticompetitive effect shifts to the government, and merges with the ultimate burden of persuasion, which remains with the government at all times." Id. at 983. "[A] failure of proof in any respect will mean the transaction should not be enjoined." Arch Coal, 329 F. Supp. 2d at 116. The court must also weigh the equities, but if
the FTC is unable to demonstrate a likelihood of success on the merits, the equities alone cannot justify an injunction. Id.

IV. Discussion

The Court’s analysis proceeds as follows: (A) legal principles considered when defining a relevant market; (B) application of legal principles to Plaintiffs’ market definition; (C) Defendants’ arguments in opposition to Plaintiffs’ alleged market; (D) conclusions regarding the relevant market; (E) analysis of the Plaintiffs’ arguments relating to the probable effects on competition based on market share calculations; (F) Defendants’ arguments in opposition to Plaintiffs’ market share calculations; (G) conclusions regarding Plaintiffs’ market share; (H) Plaintiffs’ evidence of additional harm; (I) Defendants’ response to Plaintiffs’ prima facie case; and (J) weighing the equities.

A. Legal principles considered when defining a relevant market

As discussed supra, the burden is on the Plaintiffs to show that the merger would result in a single entity controlling such a large percentage of the relevant market that concentration is significantly increased and competition is lessened. See e.g. Baker Hughes, 908 F.2d at 982. To consider whether the proposed merger may have anticompetitive effects, the Court must first define the relevant market based on evidence proffered at the evidentiary hearing. See United States v. Marine Bancorp., 418
U.S. 602, 618 (1974) (Market definition is a "‘necessary predicate’ to deciding whether a merger contravenes the Clayton Act.”). Examination of the particular market, including its structure, history and probable future, is necessary to "provide the appropriate setting for judging the probable anticompetitive effects of the merger." FTC v. Arch Coal, Inc., 329 F. Supp. 2d at 116 (quoting Brown Shoe at 322 n. 28); see also United States v. General Dynamic, 415 U.S. 486, 498 (1974). “Defining the relevant market is critical in an antitrust case because the legality of the proposed merger [] in question almost always depends on the market power of the parties involved.” Cardinal Health, Inc., 12 F. Supp. 2d at 45.

Two components are considered when defining a relevant market: (1) the geographic area where Defendants compete; and (2) the products and services with which the defendants' products compete. Arch Coal, Inc., 329 F. Supp. 2d. at 119. The parties agree that the United States is the relevant geographic market. Hrg Tr. (Shapiro) 2151:23-2152:4; see also Orszag Dep. 155:15-19.8 The parties vigorously disagree, however, about how the relevant product market should be defined.

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8 Defendants' economic expert, Johnathan Orszag, produced several expert reports for Defendants but was not called to testify.
The Supreme Court in *Brown Shoe* established the basic rule for defining a product market: "The outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it." *Brown Shoe*, 370 U.S. at 325. In other words, a product market includes all goods that are reasonable substitutes, even where the products are not entirely the same. Two factors contribute to an analysis of whether goods are "reasonable substitutes": (1) functional interchangeability; and (2) cross-elasticity of demand. See e.g., *Sysco*, 113 F. Supp. 3d at 25-26.

As the following discussion demonstrates, the concepts of cluster and targeted markets are critical to defining the market in this case.

**a. Consumable office supplies as cluster market**

Cluster markets allow items that are not substitutes for each other to be clustered together in one antitrust market for analytical convenience. Shapiro Report at 007 (noting that cluster markets are "commonly used by antitrust economists.") The Supreme Court has made clear that "[w]e see no barrier to combining in a single market a number of different products or services where that combination reflects commercial realities." *United States v. Grinnell Corp.*, 384 U.S. 563, 572 (1966).
Here, Plaintiffs allege that items such as pens, file folders, Post-it notes, binder clips, and paper for copiers and printers are included in this cluster market. Compl. ¶¶ 36-37. Although a pen is not a functional substitute for a paperclip, it is possible to cluster consumable office supplies into one market for analytical convenience. ProMedica Health Sys., Inc. v. FTC, 749 F.3d 559, 565-68 (6th Cir. 2014). Defining the market as a cluster market is justified in this case because “market shares and competitive conditions are likely to be similar for the distribution of pens to large customers and the distribution of binder clips to large customers.” Shapiro Report at 007; see also PX02167 (Orszag Dep. 91:11-15) (“So, for example, pens may not often be substitutes for notebooks in the context of this case, but a cluster market would be the aggregation of those two and then the analysis of those together for, as we talked about earlier, analytical simplicity.”).

b. Large B-to-B customers as target market

Another legal principle relevant to market definition in this case is the concept of a “targeted” or “price discrimination” market. According to the Merger Guidelines:

When examining possible adverse competitive effects from a merger, the Agencies consider whether those effects vary significantly for different customers purchasing the same or similar products. Such differential impacts are possible when sellers can discriminate, e.g., by profitably raising price to certain targeted customers but not to others. [...]
When price discrimination is feasible, adverse competitive effects on targeted customers can arise, even if such effects will not arise for other customers. A price increase for targeted customers may be profitable even if a price increase for all customers would not be profitable because too many other customers would substitute away.


Defining a market around a targeted consumer, therefore, requires finding that sellers could “profitably target a subset of customers for price increases . . .” See Sysco, 113 F. Supp. 3d at 38 (citing Merger Guidelines Section 4.1.4.). This means that there must be differentiated pricing and limited arbitrage. Dr. Shapiro concluded that arbitrage is limited here because “it is not practical or attractive for a large customer to purchase indirectly from or through smaller customers.” Id.

B. Application of relevant legal principles to Plaintiffs’ market definition

The concepts of cluster and targeted markets inform the Court’s critical consideration when defining the market in this case: the products and services with which the Defendants’ products compete. Arch Coal, Inc., 329 F. Supp. 2d. at 119. The

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9 Although the Merger Guidelines are not binding on this Court, the D.C. Circuit has relied on them for guidance in other merger cases. Sysco, 113 F. Supp. 3d at 38 (citing Heinz, 246 F.3d at 716 n.9).
parties vigorously disagree on how the market should be defined. As noted supra, Plaintiffs argue that the relevant market is a cluster market of “consumable office supplies” which consists of “an assortment of office supplies, such as pens, paper clips, notepads and copy paper, that are used and replenished frequently.” Compl. ¶¶ 36-37. Plaintiffs’ alleged relevant market is also a targeted market, limited to B-to-B customers, specifically large B-to-B customers who spend $500,000 or more on office supplies annually. Hrg Tr. 30:4-6.10

Defendants, on the other hand, argue that Plaintiffs’ alleged market definition is wrong because it is a “gerrymandered and artificially narrow product market limited to some, but not all, consumable office supplies sold to only the most powerful companies in the world.” Defs.’ FOF ¶ 4 (emphasis in original). In particular, Defendants insist that ink and toner must be included in a proper definition of the relevant product market. Id. ¶ 101. Defendants also argue that no

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10 In Plaintiffs’ complaint, they alleged that the relevant market was limited to large B-to-B customers, including, but not limited to “those that buy $1 million annually of consumable office supplies for their own use.” Id. ¶¶ 41, 45. For analytical purposes, Dr. Shapiro drew the line at large B-to-B’s that spend $500,000 or more on office supplies. Hrg Tr. 2154:16-2155:14 (Dr. Shapiro noting that 90 percent of Enterprise customers spend at least $500,000 on office supplies and that there is no “magic place that’s the right place” to draw the line, but necessary for practical analytical purposes).
evidence supports finding sales to large B-to-B customers as a distinct market. Id. ¶ 77.

1. Brown Shoe "Practical Indicia"

The Brown Shoe practical indicia support Plaintiffs’ definition of the relevant product market. The Brown Shoe "practical indicia" include: (1) industry or public recognition of the market as a separate economic entity; (2) the product's peculiar characteristics and uses; (3) unique production facilities; (4) distinct customers; (5) distinct prices; (6) sensitivity to price changes; and (7) specialized vendors. Brown Shoe, 370 U.S. at 325. Courts routinely rely on the Brown Shoe factors to define the relevant product market. See, e.g. Staples, 970 F. Supp. at 1075-80; Cardinal Health, 12 F. Supp. 2d at 46-48; FTC v. Swedish Match, 131 F. Supp. 2d 151, 159-64 (D.D.C. 2000); FTC v. CCC Holdings, 605 F. Supp. 2d 26, 39-44 (D.D.C. 2009); United States v. H & R Block, 833 F. Supp. 2d 36, 51-60 (D.D.C. 2011). ¹¹

¹¹ The Court is aware of the academic observation that "the rationale for market definition in Brown Shoe was very different from and at odds with the rationale for market definition in horizontal merger cases today." Phillip E. Areeda and Herbert Hovenkamp, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION at 237 (CCH, Inc. 2015).

Today the concern is that the post-merger firm might be able to raise prices without causing too much output to be lost to its rivals. In contrast, the Brown Shoe concern was that by reducing its price (or improving quality at the same price), the post-merger firm could
The most relevant Brown Shoe indicia in this case are:

(a) industry or public recognition of the market as a separate economic entity; (b) distinct prices and sensitivity to price changes; and (c) distinct customers that require specialized vendors that offer value-added services, including:

(i) sophisticated information technology (IT) services;
(ii) high quality customer service; and (iii) expedited delivery.

a. Industry or public recognition of the alleged market as a separate economic entity

Vendors in the office supply industry identify customers according to how much they spend annually and recognize B-to-B customers as a distinct group. Shapiro Report 006-008. For example, Staples defines "Enterprise" customers as those who spend over $1 million per year, "Commercial" customers as those who spend between $100,000 and $1 million per year, and "mid-market" customers as those who spend between $6,000 and $100,000 per year. PX04062 (SPLS) at 009; PX04088 (SPLS) at 23. Office Depot maintains similar categories. PX02002 (Calkins, Office Depot ("ODP") IH 85:16-86:7). According to Staples, the $500,000
deprive rivals of output, thus forcing them out altogether or relegating them to niche markets.

Id. at 240. Nevertheless, the Court finds the Brown Shoe factors a useful analytical tool, and as Judge Amit P. Mehta recognized in Sysco, "Brown Shoe remains the law, and this court cannot ignore its dictates." Sysco, 113 F. Supp. 3d at n 2.

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spend mark is a "threshold" that requires "closer attention" be paid to the customer. PX02153 (Mutschler (SPLS) Dep. 56:11-20).

These examples demonstrate that the industry recognizes large B-to-B customers as a separate economic entity.

b. Distinct prices and a high sensitivity to price changes

Large B-to-B customers solicit RFPs, requests for information ("RFI"), requests for quote ("RFQ"), or similar processes to select their primary office supply vendor. See e.g., Hrg Tr. (AEP) 194:10-195:16; Hrg Tr. (HPG) 1883, 1915:13-1916:18. Through these competitive processes, large B-to-B customers enter into multi-year contracts that typically last for three to five years. Hrg Tr. at 70, 92. Large B-to-B customers generally request prices for all items on their core list of office supplies, particularly those purchased in high volume. Hrg Tr. (AEP) 207:19-208:10; (Select Medical) 1012:18-25; 1112:14-18. The volume of consumable office supplies purchased by large B-to-B customers allows them to purchase office supplies for half the price paid by the average retail consumer. Shapiro Report at 019.

Multi-year contracts with a primary office supply vendor allow large B-to-B customers to avoid regional price differences and to lock in prices on core items for several years. Hrg Tr. (Select Medical) 1023:3-7; (HPG) 1929:8-1931:19. B-to-B
contracts are not exclusive, which means that B-to-B customers can buy office supplies off contract at any time without penalty. See e.g. Hrg Tr. at 411:7-20; 412:9-12; 919:20-25; 1898:24-1900:23. B-to-B customers may seek to amend the items on their core list and re-negotiate the price for those items. PX02100 (Heisroth (SPLS) Dep. 92:1-16). B-to-B customers typically receive a flat percentage discount off published prices for non-core items. Pls.' FOF ¶ 52. Upfront payments and volume discounts also reduce costs for large B-to-B customers. Hrg Tr. (AEP) 173:1-23; (Meester (Best Buy)) 1320:4-10.

In addition to price, other services are also evaluated, including delivery and information technology capabilities, customer service, and more. Hrg Tr. (AEP) 208:12-22; (HPG) 1914:15-1915:10. After evaluating all proposals and selecting finalists, intense competition between the top two or three bidders ensues. Hrg Tr. (AEP) 209:17-210:3. Vendors naturally seek to charge B-to-B customers the highest price possible, while the B-to-B customers' interest in obtaining the lowest possible price is served by the head-to-head competition among vendors. PX02002 (Calkins (ODP) IH 305:7-306:8). Large B-to-B customers possess a tremendous amount of bargaining power. See e.g. Hrg Tr. 404:3-16; 940:20-941:12.

The bargaining power of large B-to-B customers is enhanced by their ability to pit Defendants against each other. For
example, in 2015, Staples was in "a dog fight" with Office Depot for [redacted]'s business, so it offered an additional 1.5 percent volume rebate. PX04064. In November 2014, Staples offered a $[redacted] upfront payment to win a contract with [redacted], beating Office Depot's offer of $[redacted]. PX04034 (SPLS) at 001. In 2014, Office Depot offered [redacted] a retention incentive of $[redacted] per year for three years. PX05266 (ODP) at 001. These examples demonstrate that large B-to-B customers are extremely price sensitive.

c. Large B-to-B customers are distinct

In addition to wanting the best price, large B-to-B customers also want the best service. PX02003 (Ringel (SPLS) IH 127:9-11) ("It's not always about the company wanting the lowest price, they want the best service, they want the best services, they want a competitive price, and they want good representation."). This includes sophisticated IT capabilities, personalized customer service, and expedited delivery capabilities. See e.g. Hrg Tr. (HPG) 1914:15-1915:10; PX02119 (O’Neill (AEF) Dep.) 262:16-263:5; PX 07006 ( [redacted] ) at 012.

i. Sophisticated IT capabilities

Sophisticated IT capabilities include customizable product catalogs, electronic procurement systems, and punch-out sites. See e.g., Hrg Tr. (McDonalds) 375:25-376:13; (PDME) 1391:7-23.
Customized catalogs allow large B-to-B customers to limit the products their employees can purchase in accordance with the specific high-volume items for which they have negotiated the lowest price from their vendor. See e.g., Hrg Tr. (Select Medical) 1067:16-25; 1069:3-1070:4. The “punch out” IT interface enables companies to control ordering, approval, payment and invoicing. Hrg Tr. (WB Mason) 1624:3-1625:20. Such IT capabilities are expensive and are therefore offered by only a select few nationwide vendors. PX03032 (Pfizer Decl. ¶ 9). These capabilities are critical, however, to invoicing in such a way that reduces the administrative burden of processing a high volume of invoices. Hrg Tr. 1624.

In addition to detailed invoicing, large B-to-B customers require utilization reports. See e.g., Hrg Tr. (AEP) 182:1-9; (McDonalds) 376:14-377:9. These reports include data on the products ordered by employees (whether they are core or non-core), the quantity, unit price and delivery location. Id. (Best Buy) 1237:7-1238:4. The reports also identify the product purchased by employees at the stock keeping unit (“SKU”) level. Id. This detailed reporting allows B-to-B customers to track spending and make necessary adjustments in order to decrease off-contract spend and save money. Id.
ii. Personalized, high quality customer service

Dedicated customer service experts are another unique feature demanded by large B-to-B contract customers. See e.g., (WB Mason) 1631:18-1633:9. Large B-to-B customers demand an office supply vendor that provides a dedicated account manager. Id. (BestBuy) Hrg 1241:14-18; (HPG) 1938:7-13. Account managers for large B-to-B customers are expected to understand the customers' office supply needs. Id. (AEP) 187:19-18:14.

According to Staples' CEO Ron Sargent, large B-to-B customers require "more high-touch hand holding" from dedicated sales experts. PX02012.

iii. Next day and desktop delivery

The sale and distribution of consumable office supplies to large B-to-B customers, many of whom have locations nationwide, requires the warehousing, sale, and distribution of a wide range of office supplies. Hrg Tr. (HPG) 1907:24-25. Nationwide delivery to dispersed geographic locations is critical for large B-to-B customers. See e.g., Hrg Tr. (Fifth Third Bank) 895:24-896:13. Large B-to-B customers require reliable next-day delivery because they have limited storage space for office supplies. Id. (Select Medical) 1082:1-1083:24. Large B-to-B customers also prefer a vendor with the ability to make desktop deliveries because such a service eliminates the need to hire employees to make internal deliveries. Hrg Tr. (Fifth Third
Defendants are the only two office supply vendors that provide nation-wide desktop delivery. Id. (WB Mason) 1695:25-1696:5. Defendants tout their nationwide distribution capabilities to differentiate themselves among other office supply vendors. PX 02002 (Calkins (ODP) IH 118:21-119:2); PX04321 (SPLS) at 001; PX04469 (SPLS) at 014; PX05380 (ODP) at 044; PX04320 (SPLS) at 001; PX04338 (SPLS) at 004.

In sum, the evidence shows that the Brown Shoe factors support Plaintiffs' alleged market definition because there is: (a) industry or public recognition of the market as a separate economic entity; (b) B-to-B customers demand distinct prices and demonstrate a high sensitivity to price changes; and (c) B-to-B customers require specialized vendors that offer value-added services, including: (i) sophisticated information technology (IT) services; (ii) high quality customer service; and (iii) expedited delivery. These factors support viewing large B-to-B customers as a target market.

2. Expert testimony of Dr. Carl Shapiro and the Hypothetical Monopolist Test

In addition to the Brown Shoe factors, the Court must consider the expert testimony offered by Plaintiffs in this case. The parties agree that the main test used by economists to determine a product market is the hypothetical monopolist test. ("HMT"). Shapiro Report at 014; see Orszag Dep., at 89:6-8. This
test queries whether a hypothetical monopolist who has control over the products in an alleged market could profitably raise prices on those products. Defs.' FOF ¶ 31 ("The key question is whether a hypothetical monopolist in the alleged market profitably could impose a small but significant and non-transitory increase in price ("SSNIP")") (citing United States v. Oracle Corp., 331 F. Supp. 2d 1098 at 1111-12 (N.D. Cal. 2004). If so, the products may comprise a relevant product market. See H & R Block, 833 F. Supp. 2d at 51-52. The HMT is explained in the Merger Guidelines.

The test requires that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future seller of those products ... likely would impose at least a small but significant and non-transitory increase in price ("SSNIP") on at least one product in the market, including at least one product sold by one of the merging firms.

Merger Guidelines § 4.1.1 The SSNIP is generally assumed to be "five percent of the price paid by customers for the products or services to which the merging firms contribute value." Merger Guidelines § 4.1.2.

Dr. Shapiro's HMT analysis emphasizes that the proposed or "candidate" market consisting of the sale and distribution of consumable office supplies includes all methods of procuring office supplies by large companies, i.e. procurement through a primary vendor relationship, off contract purchases, online and retail buys. Shapiro Report at 014. "Since the hypothetical
monopolist, by definition, controls all sources of supply to large customers, it would not have to worry that raising prices would cause large customers to switch to other suppliers of consumable office supplies: by definition, there are none." Id.

Dr. Shapiro also points out that Staples and Office Depot's head-to-head competition "tells us that a monopoly provider of consumable office supplies would charge significantly more to large customers than Staples and Office Depot today charge these same customers." Id. Dr. Shapiro also highlights the record evidence that demonstrates Defendants compete "fiercely" for business in the large B-to-B space. Id. Dr. Shapiro concludes that such competition implies that "the elimination of competition would lead to a significant price increase to large customers, which in turn implies that the HMT is satisfied." Id.

Dr. Shapiro's conclusions are supported by the testimony presented during the hearing. For example, Mr. O'Neil, who testified on behalf of AEP, noted that the company was able to get a lower price because of competition between Staples and Office Depot. Hrg Tr. 340. Mr. Jason Cervone, Sourcing Manager of indirect procurement at McDonalds, acknowledged the same. Id. at 492 ("So in our definition of what we need in terms of vendor in this space [with Staples and Office Depot] you have more chance of lowering prices or maintaining pricing than you would with just one player there."); see also Hrg Tr. 1890:15-24 (Mr.
Wright for HPG: “Without competition, we can’t secure best-in-class price and best-in-class terms for our members and that’s really part of our operating model.”).

In sum, Dr. Shapiro’s expert report and testimony, as well as the testimony of the corporate representatives, supports Plaintiffs’ definition of the relevant market as the sale and distribution of consumable office supplies to large B-to-B customers.

C. Defendants’ arguments in opposition to Plaintiffs’ alleged market

Defendants make two primary arguments in response to Plaintiffs’ alleged market. First, although Defendants do not explicitly discuss the Brown Shoe practical indicia, they argue that exclusion of ink and toner, as well as “beyond office supplies” or “BOSS” products from the alleged market, is error. Defs.’ FOF ¶ 6 and 72. Second, Defendants argue that no evidence supports Plaintiffs’ contention that large B-to-B customers should be treated as a separate market. Defs.’ FOF ¶ 77.

1. Exclusion of ink, toner and BOSS from alleged market is proper

Defendants’ principal challenge to Plaintiffs’ alleged market centers on the exclusion of ink, toner and BOSS from the alleged relevant market. Defendants advance three arguments, none of which are persuasive. First, Defendants argue that
exclusion of these products from the alleged market is a "made for litigation market," that is inconsistent with commercial realities. Defs.' FOF ¶ 6. Second, Defendants argue that Plaintiffs' market definition is inconsistent with the one used by the FTC in 1997 and 2013. Id. Finally, Defendants seize on Dr. Shapiro's admission that the FTC made the decision to exclude ink and toner from the proposed market prior to his independent determination that doing so was proper. Id. These arguments are addressed in turn.

a. Defendants' argument for inclusion of ink and toner fails because they are not subject to the same competitive conditions as general office supplies

Defendants' fundamental legal argument for inclusion of ink, toner and BOSS products in the alleged market is that "a well-defined product market must correspond to the commercial realities of the industry and be economically significant."Defs.' FOF ¶ 32 (citing Brown Shoe, 370 U.S. at 336-37). Defendants argue that the dispositive "commercial reality" is that many large B-to-B customers include ink, toner and other BOSS products in the bundle of goods they contract for with their primary vendor. Defs.' FOF ¶ 74. Many large businesses include these adjacent items in their primary vendor bundle. Hrg Tr. 2641:3-9 (Professor Shapiro agreed that BOSS products are included in customer contracts and RFPs "the overwhelming majority of the time."); see also id. at 235:19-236:25; 342:13-
(AEP testifying that "office supplies" includes pens, pencils, paper, binder clips, folders, ink and toner, [janitorial and sanitation "jan/san"] materials, break room supplies, furniture, and technology); see also id, at 397:11-398:22 (McDonald's testifying that "office supplies" includes traditional office supplies, toner, and copy paper, as well as break room supplies and some technology items). However, Defendants do not address the critical question that must be answered when determining whether a particular product should be included in a cluster market: are the items subject to the same competitive conditions? ProMedica Health, 749 F.3d at 566 (holding that "the competitive conditions across the markets for primary and secondary services are similar enough to justify clustering of those markets when analyzing the merger's competitive effects."); see also Hrg Tr. (Shapiro) 2123:3-2124:21, 2313:19-2314:8.

Competition for the sale of ink and toner has increased due to the "recent and rapid" rise of Managed Print Services ("MPS"). Pls.' FOF ¶ 26. MPS vendors like Xerox, Hewlett-Packard, Lexmark, and Ricoh provide a bundle of services that includes sale of ink and toner in addition to service and maintenance of printers and copiers. See e.g., Hrg Tr. (Select Medical) 1018:18-1019:3; (WB Mason) 1604:14-20. There is ample record evidence to show that ink, toner, and other adjacent BOSS
items are properly excluded from the relevant market because they are subject to distinct competitive conditions. For example, some large companies are shifting all of their ink and toner business to an MPS. See e.g., Hrg Tr. 357-358; 503 (McDonalds noting that in November 2015 it changed from Office Depot to an MPS to procure its ink and toner and that the number of companies capable of providing ink and toner is larger than those that provide office supplies). Other large companies are disaggregating ink and toner purchases between their primary vendor and an MPS. Id. (AEP) 236 (noting that AEP buys some ink and toner from Office Depot and some from Xerox). Many companies hold separate sourcing events for ink and toner. See e.g., Hrg Tr. 166-170 (AEP confirming that it runs a separate sourcing event for office furniture, jan/san and ink and toner); id. at 1019:13-1020:3 (Select Medical noting five vendors submitted bids during its 2013 RFP for MPS. Select Medical ultimately contracted with MPS Total Print); id. at 1316-18 (Best Buy confirming purchases of BOSS items from Kimberly-Clark and ink and toner through MPS contract with Hewlett-Packard). The same is true of other BOSS items. Hrg Tr. 168 (AEP: "... most of our commercial, if not all of our commercial jan san is part of a janitorial contract that also provides labor.").

Moreover, the authority relied on by Defendants is readily distinguished. Defendants rely on Brown Shoe to support a focus
on the "commercial realities of the industry." However, Defendants rely on Brown Shoe's discussion of the proper geographic boundaries of a market, which is distinct from Brown Shoe's discussion of the relevant product market. Brown Shoe 370 U.S. at 336-37 ("The geographic market selected must, therefore both 'correspond to the commercial realities of the industry' and be economically significant."). To the extent that the "commercial realities of the industry" are important in this case, the Court agrees with Plaintiffs that the commercial realities are "that Defendants are the largest and second-largest office supplies vendors in the country; they are each other's closest competitor for large business customers; bid data show that they lose bids most often to each other; and large customers currently benefit greatly from their head-to-head competition." Pls.' FOF ¶ 288.

Defendants also rely on PepsiCo, Inc. v. Coca Cola Co., a case brought by PepsiCo under Section 2 of the Sherman Act alleging that Coca Cola had monopolized, or attempted to monopolize, the market of fountain syrup distributed by independent food service entities. 114 F. Supp. 2d 243 (S.D.N.Y. 2000). PepsiCo is distinguishable for a number of reasons. First, the critical question before the Court in PepsiCo was whether the evidence supported a finding that the distribution channel of fountain syrup through independent foodservice
distributors should be recognized as a relevant market. Id. at 249-50. The Court rejected PepsiCo’s proposed relevant market because the evidence showed that “while customers view fountain syrup delivered through independent foodservice distributors as preferential and advantageous, they view fountain syrup delivered through other means as acceptable.” Id.

Here, the record evidence shows that large B-to-B customers do not view any alternative sources for bulk procurement of basic office supplies that would retain the current competitive conditions of the market. Hrg Tr. 349 (AEP) (“I think our team would be very good at finding alternatives to provide pens and pencils; however, they cannot create competition.”); Id. 486 (McDonalds) (“We would attempt to look for alternatives. We find ourselves, though, back to a situation where we don’t have another national player that has a retail footprint nationwide that stocks everything we need . . .”)

In contrast, large B-to-B customers not only view alternative vendors for ink, toner and BOSS as adequate, they increasingly contract with MPS, furniture, and janitorial companies for their primary purchase of these distinct products. See e.g., Hrg Tr. 1019 (Select Medical) (after considering MPS bids in 2013 from Office Depot, OfficeMax, Staples, Total Print and Weaver, Select Medical entered into a contract with Total Print for its MPS needs). In
light of these distinctions, *PepsiCo* does not support a finding that Plaintiffs' alleged market is in error.

In sum, inclusion of ink, toner and BOSS items by large companies in the bundle of goods they want to have the option of purchasing through their primary vendor does not mean that those goods are subject to the same competitive conditions.

b. Consideration of ink and toner during 1997 and 2013 investigations

Next, Defendants argue that the Plaintiffs' alleged market is inconsistent with how the FTC defined the market during its investigation of the Staples and Office Depot proposed merger in 1997 and the Office Depot and Office Max merger in 2013. Defs.' FOF ¶ 113-116.

In 1997, the proposed merger between Staples and Office Depot was enjoined by this Court. *FTC v. Staples*, 970 F. Supp. 1066, 1070 (D.D.C. 1997) (J. Hogan). At that time, FTC included ink and toner in its definition of consumable office supplies. *Id.* at 1080. However, scant precedential value can be gleaned from comparing the defined market in that case and the Plaintiffs' alleged market in this case. The 1997 case is nearly twenty years old, and the office supply market has changed dramatically since that time. For example, as discussed in Section IV.B.1.a. *supra*, the rise of MPS services as a competitive force has occurred in the last several years.
Moreover, the 1997 Staples case was a retail case that focused on how the proposed merger would affect the average consumer. The case before the Court today is a contract channel case focused on large B-to-B customers.

In 2013, after a seven month investigation, the FTC did not challenge Office Depot’s proposed acquisition of Office Max. See FTC’s Closing Statement (“2013 Closing Statement”), https://www.ftc.gov/system/files/documents/public_statements/statement-commission/131101officedepotofficemaxstatement.pdf. Because the Commission cited to the definition of consumable office supplies from Staples in its Closing Statement, Defendants argue that ink and toner should be included in the relevant market because Plaintiffs “presented no evidence whatsoever that the ‘competitive conditions’ are different in any way from November 2013.” Defs.’ FOF ¶ 116.

The Court rejects this argument. In the 2013 Closing Statement, one of the rationales for allowing the proposed merger to proceed was because:

large customers use a variety of tools to ensure that they receive competitive pricing such as ordering certain products (like ink and toner) directly from manufacturers and sourcing (or threatening to source) certain categories of office supply products from multiple firms.

2013 Closing Statement at 3. The FTC’s decision recognized that “yesterday’s market dynamics may be very different
from market dynamics of today." Id. Plaintiffs' decision to not include ink and toner in their proposed relevant market in this case is therefore entirely consistent with the 2013 decision to not challenge the Office Depot and Office Max merger. See also, Hrg Tr. 3593 (Plaintiffs' closing argument noting that the 2013 decision is "wholly consistent with what we're doing here. It's exactly the same thing. We did not see a reason to challenge ink and toner based on the evidence that was developed in the investigation.").

c. Dr. Shapiro and the FTC worked collaboratively to determine that ink and toner should be excluded

Finally, Defendants challenge the propriety of excluding ink and toner from the alleged cluster market based on Dr. Shapiro's testimony indicating that the decision to exclude ink and toner resulted from a collaborative process with the FTC and that he did not perform a market share analysis including ink and toner.Defs.' FOF ¶ 121-124. The Court is not persuaded by Defendants' argument. First, the fact that the FTC works collaboratively with its experts to determine what products should be included in an antitrust market is not problematic. The FTC's own economists contribute to the FTC's decision regarding the relevant market prior to the time the expert witness for trial is retained. See e.g. Hrg Tr. 2907 (Ms.
Reinhart: “The amount of work that went into this investigation is huge. And these staff attorneys, they’re experts themselves. They know the antitrust laws, they know the antitrust economics . . .”).

Further, Defendants take Dr. Shapiro’s testimony regarding market shares of Defendants for ink and toner out of context. Defs.’ FOF ¶ 124. Defendants’ highlight Dr. Shapiro’s statement that if one were to calculate market shares for ink and toner, Defendants’ share would be significantly smaller. Id. Defendants seek to imply that Dr. Shapiro agrees that Defendants’ market shares in the alleged market would be smaller if ink and toner were included. However, Dr. Shapiro’s comment was referring to his earlier statement that:

I think that both the FTC and Staples and Office Depot agree, as far as I can tell, that if you took Staples and Office Depot’s market share in ink and toner, it would be significantly lower than it is in core office supplies and paper. To me that is confirmation that it’s correct not to include ink and toner in the cluster.

Hrg Tr. 2783. In other words, because there are more companies that sell ink and toner, Defendants’ market share in an ink and toner market would be lower than they are in the alleged market.

All of the above arguments are advanced by Defendants to bolster their assertion that the Plaintiffs have “gerrymandered the market” to inflate Defendants’ market
As discussed supra, voluminous record evidence supports excluding ink, toner and BOSS products from the relevant cluster market. To the extent Defendants sought to show that exclusion of ink and toner radically altered Defendants' market share, Defendants could have presented expert testimony to support that proposition.

2. Antitrust laws exist to protect competition, not a particular set of consumers

Defendants' second primary argument in opposition to Plaintiffs' proposed relevant market is that "there is no evidence to support Plaintiffs' claim that large B-to-Bs should be treated as a separate market." Defs' FOF ¶ 77. Defendants maintain that Plaintiffs' attempt to protect "mega companies" is misplaced because the merger "indisputably will benefit all retail customers, and more than 99 percent of business customers." Defs.' FOF ¶ 1.

Antitrust laws exist to protect competition, even for a targeted group that represents a relatively small part of an overall market. See Merger Guidelines § 3 ("When price discrimination is feasible, adverse competitive effects on targeted customers can arise, even if such effects will not arise for other customers."). Indeed, the Supreme Court has recognized that within a broad market, "well-defined submarkets
may exist which, in themselves, constitute product markets for antitrust purposes.” *Brown Shoe Co.*, 370 U.S. at 325, (1962); *Cardinal Health, Inc.*, 12 F. Supp. 2d at 47 (concluding that “the services provided by wholesalers in fact comprise a distinct submarket within the larger market of drug delivery.”); See e.g. *Sysco*, 113 F. Supp. 3d at 40 (holding that “the ordinary factors that courts consider in defining a market—the Brown Shoe practical indicia and the Merger Guidelines’ SSNIP test—support a finding that broadline distribution to national customers is a relevant product market.”); see also *United States v. Phillipsburg Nat’l Bank & Trust Co.*, 399 U.S. 350, 360 (1970) (“[I]t is the cluster of products and services ... that as a matter of trade reality makes commercial banking a distinct” market).

As discussed in Section IV.A.2.a-c *supra*, the nature of how large B-to-B customers operate, including the services they demand, supports a finding that they are a targeted customer market for procurement of consumable office supplies. There is overwhelming evidence in this case that large B-to-B customers constitute a market that Defendants could target for price increases if they are allowed to merge. Significantly, Defendants themselves used the proposed merger to pressure B-to-B customers to lock in prices based on the expectation that they would lose negotiating leverage if the merger were approved. See
e.g., PX05236 (ODP) at 001 ("This offer is time sensitive. If and when the purchase of Office Depot is approved, Staples will have no reason to make this offer."); PX05249 (ODP) at 001 ("[The merger] will remove your ability to evaluate your program with two competitors. There will only be one."); PX05514 (ODP) at 003 ("Today, the FTC announced 45 days for its final decision. You still have time! You would be able to leverage the competition, gain an agreement that is grandfathered in and drive down expenses!").

D. Conclusions regarding the definition of the relevant market

The "practical indicia" set forth by the Supreme Court in Brown Shoe and Dr. Shapiro's expert testimony support the conclusion that Plaintiffs' alleged market of consumable office supplies (a cluster market) sold and distributed by Defendants to large B-to-B customers (a targeted market) is a relevant market for antitrust purposes. The Brown Shoe factors support Plaintiffs' argument that the sale and distribution of consumable office supplies to large B-to-B customers is a proper antitrust market because the evidence supports the conclusion that: (1) there is industry or public recognition of the market as a separate economic entity; (2) B-to-B customers demand distinct prices and demonstrate a high sensitivity to price changes; and (3) B-to-B customers require specialized vendors that offer value-added services. Dr. Shapiro's unrebutted
testimony also supports Plaintiffs' alleged market definition because, in his opinion, "the elimination of competition would lead to a significant price increase to large customers," which implies the HMT is satisfied. Finally, for the reasons discussed in detail in Section IV.C supra, Defendants arguments against Plaintiffs' market definition fail.

E. Analysis of the Plaintiffs' arguments relating to probable effects on competition based on market share calculations

Having concluded that Plaintiffs have carried their burden of establishing that the sale and distribution of consumable office supplies to large B-to-B customers in the United States is the relevant market, the Court now turns to an analysis of the likely effects of the proposed merger on competition within the relevant market. "If the FTC can make a prima facie showing that the acquisition in this case will result in a significant market share and an undue increase in concentration" in the relevant market, then "a presumption is established that [the merger] will substantially lessen competition." Swedish Match, 131 F. Supp. 2d at 166. The burden is on the government to show that the merger would "produce a firm controlling an undue percentage share of the relevant market" that would result in a "significant increase in the concentration of firms in that market." Heinz, 246 F.3d at 715.
The Plaintiffs can establish their *prima facie* case by showing that the merger will result in an increase in market concentration above certain levels. *Id.* “Market concentration is a function of the number of firms in a market and their respective market shares.” *Arch Coal*, 329 F. Supp. 2d at 123.

The Herfindahl-Hirschmann Index ("HHI") is a tool used by economists to measure changes in market concentration. Merger Guidelines § 5.3. HHI is calculated by “summing the squares of the individual firms’ market shares,” a calculation that “gives proportionately greater weight to the larger market shares.” *Id.* An HHI above 2,500 is considered “highly concentrated”; a market with an HHI between 1,500 and 2,500 is considered “moderately concentrated”; and a market with an HHI below 1,500 is considered “unconcentrated”. *Id.* A merger that results in a highly concentrated market that involves an increase of 200 points will be presumed to be likely to enhance market power.” *Id.; see also Heinz*, 246 F.3d at 716-17.

1. Concentration in the sale and distribution of consumable office supplies to large B-to-B customers

Dr. Shapiro estimated Defendants' market shares by using data collected from Fortune 100 companies ("Fortune 100 sample"
or "Fortune 100"). Shapiro Report at 017. During the data collecting process, 81 of the Fortune 100 companies responded with enough detail to be used in Dr. Shapiro's sample. *Id.; see*
also Hrg Tr. 2294:3-19. The critical data provided by the companies was fiscal year 2014 information on: (1) their overall spend on consumable office supplies; (2) the amount spent on consumable office supplies from Staples; and (3) the amount spent on consumable office supplies from Office Depot. Shapiro Report, Exhibit 5A. Some Fortune 100 companies have an established primary vendor relationship with Staples or Office Depot. Id. For example, Staples has 100 percent of the market share relating to \(\cdot\)'s spend on consumable office supplies and Office Depot has 100 percent of the market share relating to \(\cdot\)'s spend on consumable office supplies. Id. Other Fortune 100 customers purchase office supplies from a mix of vendors. For example, Staples accounted for twenty-seven percent of \(\cdot\)'s spend on consumable office supplies in 2014 and Office Depot accounted for twenty-one percent. Id.

Defendants' market share of the Fortune 100 sample as a whole is striking: Staples captures 47.3 percent and Office Depot captures 31.6 percent, for a total of 79 percent market share. Shapiro Report at 017 and Ex. 5B. The pre-merger HHI is already highly concentrated in this market, resting at 3,270. Id. at 021. Put another way, Staples and Office Depot currently operate in the relevant market as a "duopoly with a competitive fringe." Id. If allowed to merge, the HHI would increase nearly
3,000 points, from 3,270 to 6,265. *Id.* This market structure would constitute one dominant firm with a competitive fringe. *Id.* Staples' proposed acquisition of Office Depot is therefore presumptively illegal because the HHI increases more than 200 points and the post-merger HHI is greater than 2,500. Shapiro Report at 02; see also Heinz, 246 F.3d at 716 (noting that the pre-merger HHI for baby food was 4775, "indicative of a highly concentrated industry" and the 500 point post-merger HHI increase "creates, by a wide margin, a presumption that the merger will lessen competition in the domestic jarred baby food market.")

**F. Defendants’ arguments in opposition to Plaintiffs’ Market Share Calculations**

Defendants make several arguments in opposition to Dr. Shapiro’s market share methodology and calculation. See Defs.’ FOF ¶¶ 125-131. Defendants argue that: (1) the Fortune 100 sample overstates Defendants’ actual market share; (2) treatment of Tier 1 diversity suppliers and paper manufacturers was error;12 and (3) Dr. Shapiro underestimates leakage, inflating Defendants’ market shares. *Id.* However, despite significant time spent cross-examining Dr. Shapiro with regard to his

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12 Tier 1 diversity suppliers are minority or veteran owned businesses that are regional in nature and generally rely on large nationwide office supply companies like Staples and Office Depot to service their customers. Hrg Tr. 1379 (PDME).
methodology, Defendants produced no expert evidence during the hearing to rebut that methodology. Moreover, it is significant that Defendants' final 100-page brief devotes only seven paragraphs to challenging Dr. Shapiro's market share calculations. Id.

1. The Fortune 100 is a trustworthy sample to calculate Defendants' market shares

Defendants' first argument in opposition to Dr. Shapiro's focus on the Fortune 100 is that his failure to take a sample of the other approximate 1100 companies in the relevant market is error because it results in "dramatically inflated market shares." Id. ¶ 126. Dr. Shapiro conceded that the data he analyzed is imperfect because it does not include all large B-to-B customers. Shapiro Report at 017. However, Dr. Shapiro was confident that "there is no reason to believe [the market shares] are biased when it comes to estimating the market shares of Staples and Office Depot." Id. To test whether his analysis of the Fortune 100 might have overstated Defendants' market shares because the Fortune 100 companies are especially large, Dr. Shapiro measured the market share of the top half of his sample separate from the bottom half. Id. at 018. The range of spending on consumable office supplies among the companies analyzed in Dr. Shapiro's analysis is vast: from less than $200,000 per year on the low end, to more than $33 million per
year on the high end. *Id.*, Ex. 5A. The combined market share for Defendants is seventy-nine percent among the top half of the Fortune 100 and eighty-nine percent among the bottom half. *Id.* at 018. Thus, Dr. Shapiro states that he is "confiden[t] that the market shares for Staples and Office Depot reported in Exhibit 5B are not overstated." *Id.*

Defendants' second challenge relating to the Fortune 100 sample focuses on the fact that only eighty-one of the 100 companies responded with enough data to be included in Dr. Shapiro's analysis. Defendants argue that the nineteen omitted "are the most likely to purchase supplies from vendors other than Staples and Office Depot." *Id.* ¶ 125. Defendants highlight Costco as an example, a company that charges each department with procuring its own office supplies, whether from Costco or other vendors. *Id.* The fact that Costco is able to purchase office supplies from Costco itself makes that company's procurement of office supplies an anomaly. Because Defendants did not present a case, they do not provide the Court with an analysis of the nineteen Fortune 100 companies excluded from Dr. Shapiro's analysis to show that their exclusion skewed Defendants' market shares in a way favorable to Plaintiffs. Antitrust economists rely on data from third parties through surveys, and therefore the measure of market shares is "normally imperfect." *Id.*, fn 43. Perhaps Judge Mehta said it best: "The
FTC need not present market shares and HHI estimates with the precision of a NASA scientist.” Sysco, 113 F. Supp. 3d at 54; see also H & R Block, 833 F. Supp. 2d at 72 (stating that a “reliable, reasonable, close approximation of relevant market share data is sufficient.”). For all of these reasons, and in view of the absence of expert testimony offered by the Defendants, the Court is persuaded that Dr. Shapiro’s analysis of the Fortune 100 represents a reasonable and reliable approximation of the Defendants’ market share.

2. Dr. Shapiro’s treatment of Tier 1 diversity suppliers and paper manufacturers who rely on Defendants is consistent with commercial realities

Next, Defendants challenge the manner in which Dr. Shapiro dealt with Tier 1 diversity suppliers and paper manufacturers.Defs.' FOF ¶ 127. Defendants contend that the sales made by Tier 1 diversity suppliers and paper manufacturers are improperly attributed to Defendants. Id.

In the normal course, Defendants treat accounts served by Tier 1 diversity partners toward their own revenue. PIs.' FOF 102. Moreover, Tier 1 diversity suppliers cannot serve large B-to-B customers without partnering with Defendants. Id. For these reasons, Dr. Shapiro attributed Tier 1 revenues to Defendants. Hrg Tr. 2309:11-2310:6; 2795:2-2796:3; See also Hrg Tr. 379 (McDonalds) (“Our understanding is that Tier 1s are generally
regional players and may not have the size or scale to handle large geographically-distributed business.

With regard to paper manufacturers, some large companies purchase paper through Defendants and others purchase directly from a manufacturer. Id. 2305-06. Dr. Shapiro included sales of paper that are made through Defendants toward Defendants’ revenue. Id. In these situations, Staples or Office Depot distributes the paper. Id. at 2306. “In cases where the paper manufacturer directly sells and delivers the paper to the customer,” Dr. Shapiro “attribute[d] the sales to the paper manufacturer.” Id. Thus, the Court is satisfied that Dr. Shapiro’s treatment of Tier 1 diversity suppliers and some paper manufacturer’s revenue is consistent with commercial realities and does not overstate Defendants’ market shares.

3. Dr. Shapiro accounted for leakage in his analysis

Finally, Defendants contend that Dr. Shapiro did not adequately account for “leakage” in his market share analysis. Id. ¶ 129. Leakage refers to unreported discretionary employee purchases of office supplies. Shapiro Report at 018. Dr. Shapiro requested an estimate of leakage from the Fortune 100. Shapiro Report at 019. Of the eighty-one companies included in his market-share analysis, twenty-six reported on leakage. Id. Appendix E. Twelve of the twenty-six indicated that leakage spend was “de minimis” or “immaterial”. PX06300, Ex. RC2. In
these cases, Dr. Shapiro assumed that one percent of the companies' spend on office supplies was leakage. Defs.' FOF ¶ 129.

Testimony from fact witnesses during the hearing made it clear that even the largest companies in the world are either not concerned enough about leakage to track it or do not have a reliable way of tracking it. See e.g. Hrg Tr. 344:2-4 (AEP: “We have a methodology [to track leakage] which is an audit process which is ran [sic] on a monthly basis. We choose not to include office supplies every month.”); 464-65 (McDonalds became aware of how to track leakage through “P-card” spend during communications with the FTC in this case; and “data for the P-cards really wasn’t available to procurement, at least we weren’t aware of that.”). These same companies have tremendous incentive to ensure that their employees spend on contract. Purchases made by employees online or from a brick and mortar store are to percent higher than the contract price paid by large companies. Shapiro Report at 019. Most companies with a primary-vendor contract have an official policy that requires employees to purchase office supplies.

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13 “P-Cards” or “procurement cards” are the equivalent of company credit cards that allow goods to be purchased without using a traditional purchasing process.
through the contract. See e.g., Hrg Tr. 464-65 (McDonalds’ policy is that corporate stores must purchase on contract through Office Depot). Best Buy produced a video to educate employees about the benefits of buying on contract. Id. 1212-1214.

For all of these reasons, the Court is confident that Dr. Shapiro accounted for any impact leakage has on Defendants’ market shares in this case.

G. Conclusion regarding Plaintiffs’ market share analysis

Plaintiffs have met their burden of showing that the merger would result in “undue concentration” in the relevant market of the sale and distribution of consumable office supplies to large B-to-B customers in the United States. The relevant HHI would increase nearly 3,000 points, from 3270 to 6265. These HHI numbers far exceed the 200 point increase and post-merger concentration level of 2500 necessary to entitle Plaintiffs to a presumption that the merger is illegal. The Court rejects Defendants’ arguments in opposition to Dr. Shapiro’s market analysis for the reasons discussed in detail in Section IV.F supra. Nevertheless, to strengthen their prima facie case, Plaintiffs presented additional evidence of harm, which the Court analyzes next.

H. Plaintiffs’ evidence of additional harm

Sole reliance on HHI calculations cannot guarantee litigation
victories. Baker Hughes, 908 F.2d at 992. Plaintiffs therefore highlight additional evidence, including bidding data ("bid data"), ordinary course documents, and fact-witness testimony. This additional evidence substantiates Plaintiffs' claim that this merger, if consummated, would result in a lessening of competition.

Mergers that eliminate head-to-head competition between close competitors often result in a lessening of competition. See Merger Guidelines § 6 ("The elimination of competition between two firms that results from their merger may alone constitute a substantial lessening of competition."); see also Heinz, 246 F.3d at 717-19; Swedish Match, 131 F. Supp. 2d at 169; Staples, 970 F. Supp. at 1083. Plaintiffs' evidence supports the conclusion that Defendants compete head-to-head for large B-to-B customers.

1. Bidding Data

Dr. Shapiro analyzed five sets of bid data including: (1) Defendants' win-loss data; (2) data on Defendants' top wins and top losses; and (3) Fortune 100 bid data. Pls.' FOF ¶ 109. Defendants often bid against each other for large B-to-B contracts. See, e.g., PX05028 (ODP) at 001 (of five bids for [redacted]'s RFP, Staples and Office Depot had the best bids); PX05255 (ODP) at 001 ("It is down to OD and Staples"); PX02167 (Orszag Dep. 173:11-18, 194:23-195:10) ("We do observe in the
data that [Staples and Office Depot] are often the last two bidding against each other for the – for large customers as well.”).

The bid data also shows that Defendants win large B-to-B customer bids more frequently than other bidders. Hrg Tr. 2334:10-21. The B-to-B contract market accounts for approximately thirty-five percent of Defendants’ sales. Compl. ¶¶ 29 and 30. According to Dr. Shapiro, the sale of consumable office supplies accounts for about [REDACTED] percent of Defendants’ B-to-B customer revenues. Shapiro Report at 006.

Staples CEO Mr. Sargent describes the B-to-B contract business as a “cornerstone” of Staples’ business. PX04023 (SPLS) at 005 (“This year, [B-to-B sales] will account for almost 40% of company sales . . .”); PX 04630 (SPLS) at 007 (for B-to-B, Staples is the “clear industry leader and gaining share”) (emphasis in original). In fact, seventy-eight percent of Office Depot bid losses are to Staples. PX06500 (Shapiro Demonstrative) at 048. Similarly, eighty-one percent of Staples’ bid losses were to Office Depot. Id. at 049. Defendants compete aggressively for the others’ business, exemplified by Staples’ 2014 “Operation Take Share,” a campaign that sought to capture some of Office Depot’s market share. PX04432 (SPLS) at 003.
2. Ordinary Course Documents

Defendants' own documents created in the ordinary course of their business show that Defendants view themselves as the most viable office supply vendors for large businesses in the United States. See, e.g. PX04082 (SPLS) at 029 (“[T]here are only two real choices for them. Us or Them.”); PX04042 (SPLS) at 024; PX05311 (ODP) at 001. Not surprisingly, Defendants view themselves as each other's fiercest competition. See, e.g., PX04322 (SPLS) at 001 (identifying only Office Depot as “Key Competitor[.]”); PX04414 (SPLS) at 008 (“For core office supplies we often compare ourselves to our most direct competitor, ODP”); PX05229 (ODP) at 149 (stating that Staples is Office Depot's “[t]oughest and most aggressively priced national competitor.”).

Defendants consistently compete head-to-head with each other to win large B-to-B contracts. For example, in early 2015, HPG began negotiations with Staples. Hrg Tr. 1896:9-1898:14, 1901:2-16. Staples' initial price reduction was retracted until Office Depot was invited to bid. Id. Pitting Defendants against each other, HPG received substantial price concessions from both. Id. In November 2014, Staples increased its up-front payment to $ to prevent $ from switching to Office Depot. PX04034 (SPLS) at 001. In March 2014, Office engaged the Defendants in multiple rounds of bidding. PX05234 (ODP) at 001). Ultimately, Office
Depot could not meet the six percent core list savings necessary to win the contract from Staples. Id.

3. Fact Witness Testimony

Large B-to-B customers view Defendants as their best option for nationwide sale and delivery of consumable office supplies. See e.g. Hrg Tr. 225:25-226:5 (AEP: “Q: And after Office Depot and Staples, what’s the -- what’s the next best option after that? A: Then we’re in trouble. We don’t have a good – I don’t think we have a good option after that.”); 1205:17-20 (Best Buy “Q: So today Best Buy has a contract with Office Depot. Who does Best Buy consider to be its next best option for general office supplies and copy paper? A: Staples.”); 1938:14-1939:18 (HPG “There’s two nationally capable office supply vendors, from our perspective. One is Staples and one is Depot. And they control, roughly -- when I say control, they own 80 percent of the market in terms of revenue.”); 361:2-21, 373:9-15; 492:3-7 (McDonalds’ noting its consideration of Staples and Office Depot, but ultimately did not invite Staples to submit an RFP because the company was able to “recognize immediate savings” by not going through an expensive bid process.); 1018:1-13 (Select Medical, a company that contracts with Office Depot, testified that it has concerns about the merger going through because “I believe it’s important to have that competition to be able to properly service our national footprint, our national presence, and to
also be able to provide the best possible pricing."). This testimony shows that absent Office Depot, large B-to-B customers would lose tremendous leverage and likely have to pay higher prices for consumable office supplies. Shapiro Report at 009-10.

This additional evidence strengthens Plaintiffs' claim that harm will result in the form of loss of competition if Staples is permitted to acquire Office Depot.

I. Defendants' response to Plaintiffs' prima facie case

Defendants' sole argument in response to Plaintiffs' prima facie case is that the merger will not have anti-competitive effects because Amazon Business, as well as the existing patchwork of local and regional office supply companies, will expand and provide large B-to-B customers with competitive alternatives to the merged entity. Defs.' FOF ¶¶ 132-203.

Plaintiffs argue that there is no evidence that Amazon or existing regional players will expand in a timely and sufficient manner so as to eliminate the anticompetitive harm that will result from the merger. Pls.' FOF ¶¶ 152-207. For the reasons discussed below, Defendants' argument that Amazon Business and other local and regional office supply companies will restore the competition lost from Office Depot is inadequate as a matter of law.

"The prospect of entry into the relevant market will alleviate concerns about adverse competitive effects only if
such entry will deter or counteract any competitive effects of concern so the merger will not substantially harm customers.”

Merger Guidelines § 9. Even in highly concentrated markets, Plaintiffs' prima facie case may be rebutted if there is ease of entry or expansion such that other firms would be able to counter any discriminatory pricing practices. Cardinal Health, 12 F. Supp. 2d at 54-55. Defendants carry the burden of showing that the entry or expansion of competitors will be “timely, likely and sufficient in its magnitude, character, and scope to deter or counteract the competitive effects of concern.” H&R Block, 833 F. Supp. 2d at 73. The relevant time frame for consideration in this forward looking exercise is two to three years. Hrg Tr. 2660-2662 (Dr. Shapiro confirming that two to three years is the relevant temporal scope for the Court to consider the effects of new entrants or expansion of existing competitors).

1. Amazon Business

Defendants seize on Amazon’s lofty vision for Amazon Business to be the “preferred marketplace for all professional, business and institutional customers worldwide” to support their contention that Amazon not only wants to take over the office supply industry, but desires to “take over the world.” Hrg Tr. 3010 (Ms. Sullivan’s Closing Argument). Amazon Business may eventually transform the B-to-B office supply space. See e.g.
DX05284 at 43 (Mr. Wilson’s 2016 presentation in Baltimore: “It’s still Day One.” Amazon Business plans to “improve with: more selection; an increasing number of produce and business products [sic]; better personalization; a purchasing experience even better tailored for businesses.”); Hrg Tr. 2662: 9-14. The Court’s unenviable task is to assess the likelihood that Amazon Business will, within the next three years, replace the competition lost from Office Depot in the B-to-B space as a result of the proposed merger.

Amazon Business has a number of impressive strengths. For example, Amazon Business already enjoys great brand recognition and its consumer marketplace has a reputation as user-friendly, innovative and reliable. Amazon Business’ strategy documents also reveal a number of priorities that, if successful, may revolutionize office supply procurement for large companies. For example,

However, several significant institutional and structural challenges face Amazon Business. Plaintiffs point to a long list of what they view as Amazon Business’ deficiencies, including, but not limited to: (1) lack of RFP experience; (2) no commitment to guaranteed pricing; (3) lack of ability to control third-party price and delivery; (4) inability to provide customer-specific pricing; (5) a lack of dedicated customer service agents dedicated to the B-to-B space; (6) no desktop delivery; (7) no proven ability to provide detailed utilization and invoice reports; and (8) lack of product variety and breadth. Pls.’ FOF ¶ 191. Although Amazon Business may successfully address some of these alleged weaknesses in the short term, the evidence produced during the evidentiary hearing does not support the conclusion that Amazon Business will be in a position to restore competition lost by the proposed merger within three years.

First, despite entering the office supply business fourteen years ago, large B-to-B customers still do not view Amazon Business as a viable alternative to Staples and Office Depot. PX07518 (Amazon) at 001 (“Our customers tell us that...”). Moreover, Amazon
Business' participation in RFPs has been "limited." Hrg Tr. 546:18-547:4; see also 1943:14-1947:9 (HPG) (noting that HPG's membership and advisory board would require proof of Amazon Business' demonstrated success in serving large B-to-B customers before considering Amazon Business as a primary vendor).

Significantly, Amazon Business also has yet to successfully bid to be a large B-to-B customer's primary vendor. Hrg Tr. 551:11-13; see also Hrg Tr. 206-207 (AEP) (testifying that Amazon Business did not have all services required to be its primary vendor when it was considered by AEP in 2015). When Amazon Business has participated in RFPs, Id. 551:11-552:5; 851:21-852:8; McDevitt Dep. 186:6-16 (Amazon's prices to were % higher than lowest bid).

The Court has considered whether Amazon Business' newly energized focus on the B-to-B space could transform the office supply industry for B-to-B customers in such a dramatic way that the RFP process may be "what dinosaurs do" in the future. Hrg Tr. 2693:19-2694:9 (Ms. Sullivan's cross of Dr. Shapiro: "You know Dr. Shapiro, [Amazon Business] intends to make the RFP process obsolete."). However, during Mr. Wilson's deposition, he testified that Amazon Business does not seek to change the RFP process. PX02125 (Wilson Dep. 193:10-194:1). During cross-
examination, Defendants addressed this point with Mr. Wilson directly:

Ms. Sullivan: And anybody that's been watching what's been going on in the world understands that the way the old companies are doing things, running around, trying to get RFPs and a contract is kind of the old world. The new world is going to be procurement officers sitting at their desks using platforms like the one you're developing?

Mr. Wilson: I don't know -- I mean, that's maybe one vision of what may happen. We'll see how the technology sort of evolves and where things land.

Ms. Sullivan: But that's your plan, that that's going to be the new world?

Mr. Wilson: Well, our plan is to bring Amazon Business shopping experience to customers. And we would like for them to be able to -- to leverage it, and we would like to create a solution that they like.

Hrg Tr. 692:11-25. Mr. Wilson's testimony does not support the conclusion that Amazon Business seeks to make the RFP process obsolete. Defendants did not offer testimony from other industry experts or offer any other credible evidence that the RFP process will become obsolete within the next three years. The evidence before the Court simply does not support a finding that Amazon Business will, within the next three years, either compete for large RFPs in the same way that Office Depot does now, or so transform the industry as to make the RFP process obsolete.

Second, Amazon Business' marketplace model is at odds with the large B-to-B industry. Similar to Amazon's consumer
marketplace, half of all sales on Amazon Business are serviced by Amazon directly, while the other half are serviced by third-party sellers. Hrg Tr. 552. Amazon does not control the price or delivery offered by third-party sellers. Id. 842:14. Mr. Wilson confirmed that this will not change. Id. 843: 7-9 ("Q: You have no plans to force the third parties to offer particular prices? A: No, we'll never do that. No."). Amazon Business' lack of control over the price offered by third-party sellers contributes to Amazon Business' inability to offer guaranteed pricing. Mr. Wilson also testified that Amazon Business will not

Hrg Tr. 849:9-12

The evidence thus shows that Amazon Business' guaranteed pricing is not feasible at this time, and Absent these features, which are fundamental to the current office supply industry for large B-to-B customers, the record is devoid of evidence to support the proposition that large business would shift their entire office supply spend to Amazon Business in the next three years.

Finally, although Amazon Business' 2020 revenue projection is an impressive $[redacted], only [redacted] percent of that
is forecast to come from the sale of office supplies. Hrg Tr. 856:5-16; PX 06300 (Shapiro Reply) at 028. This level of revenue for office supplies would give Amazon Business only a very small share in the relevant market. Shapiro Hrg Tr. 2432:11-19; 2436:15-19 (Dr. Shapiro: “So, in the end, no, I don’t think over the next two years or so that they will - are likely to step in and provide sufficient additional competition to protect large customers . . . .”). Further, Amazon Business’ 2020 forecast

in part because


At the conclusion of Mr. Wilson’s testimony, the Court asked whether, Hrg Tr. 859:10-16. Mr. Wilson answered “” Id. at 859:22-23. Similarly, during
Mr. Wilson’s testimony about Amazon Business’ ability to compete for RFPs, the Court engaged in this exchange:

THE COURT: So, if one were to predict -- if a vice president were to predict five years from now, you’d be in a much better position to respond, just predicting?

THE WITNESS: That’s our point, yes.

THE COURT: Right. And that -- the strength of that prediction is based upon what?

THE WITNESS: Investment in resources.

THE COURT: Right. And that’s something that, I guess from a business point of view, you plan to do?

THE WITNESS: I plan to request the resources.

THE COURT: Right. Because you want to be as successful as you possibly can and compete, right?

THE WITNESS: Absolutely.

Hrg Tr. 553:1-17.

Critically, however, when the Court asked whether Mr. Wilson[REDACTED] Id. at 860 1-3.

This answer, considered in light of Amazon Business’ lack of demonstrated ability to compete for RFPs and the structural and institutional challenges of its marketplace model, leads the Court to conclude that Amazon Business will not be in a position to compete in the B-to-B space on par with the proposed merged entity within three years. Just as it would be “pure
speculation" for an Amazon Business employee to give a date certain for , it would be sheer speculation, based on the evidence, for the Court to conclude otherwise. If Amazon Business was more developed and Mr. Wilson , the outcome of this case very well may have been different. 14

2. WB Mason and other competitors

Brief discussion is necessary with regard to the ability of existing competitors to fill the competition gap that would be left in the wake of this merger. WB Mason is the third largest office supply company in the U.S., but is a distant third behind Defendants, retaining less than one percent market share in the relevant market. PX03021 (WB Mason Decl.) ¶ 6. WB Mason has nine customers in the Fortune 1000. Hrg Tr. 1611:21-1611:24. WB Mason and other regional and local office supply vendors are at a

14 Throughout the hearing Defendants argued that the FTC’s declaration drafting process, especially as it pertained to Mr. Wilson, was “wrong.” Hrg Tr. 3016:11-14. As is routine in antitrust cases, the FTC began drafting declarations based on the interviews that were conducted. The companies and the FTC then engaged in a back-and-forth process of edits. Some companies found the FTC’s drafts to be accurate, others, like Amazon, sought significant edits. Although the Court expressed its concern about this process at various times during the hearing, no evidence of an improper motive on the part of the FTC was ever presented. Hrg Tr. 3016-3018.
competitive disadvantage because they do not have the resources to serve large customers nationwide. *Id.* at 1601:3-8, 1687:13-22, 1697:2-8. Although WB Mason is confident in its ability to compete with Staples in Masonville, it does not bid on large RFPs outside of Masonville. Hrg Tr. (Meehan “We’ll respond to RFPs that are inside of Masonville, that are headquartered in Masonville, that the majority of the business is inside of Masonville.”).

It is significant that WB Mason does not have the desire or the ability to compete with the merged entity outside of Masonville. *Pls.’ FOF ¶ 44.* As WB Mason’s CEO Mr. Meehan testified, “we don’t have any plans to expand [outside of Masonville] ... We’re going to focus on Masonville.” Hrg Tr. Meehan, 1671. After establishing that it would take __________ for WB Mason to expand nationwide, the Court asked Mr. Meehan “If [Defendants] gave you __________, would you accept it to be competitive with them?” He answered “I don’t know if I would. That’s a big challenge. I mean, that’s if I even want to do this, right? Become this. I – no, I would definitely think about it, Your Honor.” *Id.* 1790.

Like WB Mason, other regional and local office supply companies also face the structural disadvantage of purchasing from wholesalers instead of manufacturers. *Id.* Hrg Tr. 1584:23-1585:2. This means their costs are higher than those of
Defendants. Further, because their overall volumes are lower, they cannot offer the deep discounts that Defendants are able to offer. Pls.' FOF ¶ 168. There was simply no other evidence presented during the hearing that supports Defendants' assertion that utilizing a collection of regional or local office supply companies would meet the needs of large B-to-B customers.

J. Weighing the Equities

Although Plaintiffs are entitled to a presumption in favor of injunctive relief for the reasons discussed, Section 13(b)’s "public interest" standard still requires the Court to weigh the public and private equities of enjoining the merger. Heinz, 246 F. 3d at 726. The public interests to be considered include: (1) the public interest in effectively enforcing antitrust laws; and (2) the public interest in ensuring that the FTC has the ability to order effective relief if it succeeds at the merits trial. See e.g. Sysco, 113 F. Supp. 3d at 86. Both factors weigh in favor of granting Plaintiffs' Motion for Preliminary Injunction.

First, the "principle public equity weighing in favor of issuance of preliminary injunctive relief is the public interest in the effective enforcement of the antitrust laws." Swedish Match, 131 F. Supp. 2d at 173. Because the law is clear that this merger is likely to lessen competition in the relevant market, it is in the public's interest for the merger to be enjoined. Second, preserving the FTC's ability to order
effective relief after the administrative hearing also weighs in favor of enjoining the proposed merger. As discussed at some length during the parties' summations, it is "impossible to recreate pre-merger competition" if the parties are allowed to merge pending the administrative hearing. Sysco, 113 F. Supp. 3d at 87 (quoting Swedish Match, 131 F. Supp. 2d at 173); see also Hrg Tr. (Ms. Reinhart: "There's no doubt about it, the eggs would be scrambled. Once that happens, it's very difficult to get the companies apart."). Thus, the second public interest consideration also weighs in favor of enjoining the merger.

Defendants argue that the equities favor allowing the merger to proceed because "it is undisputed that the overwhelming majority (more than 99%) of B2B customers and all retail customers will benefit—or at least not be harmed—from this merger." Defs.' FOF ¶ 297. This argument is the same as Defendants' argument in opposition to Plaintiffs' alleged relevant market, for which Defendants cite no persuasive authority. The Court rejects the argument for the same reasons discussed in Section IV.C.2. supra.

Because Defendants have not made a showing of public equities that favor allowing the merger to proceed immediately, the Court should go no further because "[w]hen the Commission demonstrates a likelihood of ultimate success, a counter showing of private equities alone [does] not suffice to justify denial

V. Conclusion

As Judge Mehta observed in Sysco, “There can be little doubt that the acquisition of the second largest firm in the market by the largest firm in the market will tend to harm competition in that market.” 113 F. Supp. 3d at 88 (quoting J. Tatel in Whole Foods, 548 F.3d at 1043). The Court concludes that Plaintiffs have met their burden of showing by a “reasonable probability” that Staples’ acquisition of Office Depot would lessen competition in the sale and distribution of consumable office supplies in the large B-to-B market in the United States. The evidence offered by Defendants to rebut Plaintiffs’ showing of likely harm was inadequate as a matter of law. Plaintiffs have therefore carried their ultimate burden of showing that they are likely to succeed in proving, after a full administrative hearing on the merits, that the proposed merger “may be

15 Defendants bear the burden of showing that any proposed remedy would negate any anticompetitive effects of the merger and that their claimed efficiencies are: (1) merger specific; and (2) reasonably verifiable by an independent party. H&R Block, 833 F. Supp. 2d at 89. Because Defendants rested at the close of Plaintiffs’ case-in-chief and called no witnesses to support their arguments related to remedies or efficiencies, they have not met their burden.
substantially to lessen competition, or to tend to create a monopoly" in violation of Section 7 of the Clayton Act.

For the reasons discussed herein, Plaintiffs' Motion for Preliminary Injunction is GRANTED. A separate order accompanies this Memorandum Opinion.

SO ORDERED.

Signed: Emmet G. Sullivan
United States District Judge
May 10, 2016
Thank you to Bates White for inviting me to speak at this conference. It is a real pleasure for me to get opportunities like this.\(^1\)

Tonight I will share some high-level thoughts about the role of economics in antitrust enforcement based on what I have seen during my three years at the Antitrust Division. Because the conference is focused on merger enforcement, I will do the same. Also, recognizing that this is a dinner speech, I will keep my remarks relatively short.

It has been a privilege to serve the American people in my current position. It has also been a tremendous learning experience for me. I have had the opportunity to work with, in addition to the many talented lawyers at the Antitrust Division, some of the leading economists in the field. This has included close collaboration with fellow Deputy Assistant Attorney Generals Aviv Nevo and Nancy Rose and our Director of Economics Bob Majure, as well as the career Ph.D economists who work hand in hand with our legal teams. I have also had the opportunity to work with superb outside experts like Mike Whinston. And it is fitting that Carl Shapiro, who has taught me so much over the years, was the plaintiff’s testifying expert in two merger challenges that bookended my time in government: our victory against Bazaarvoice, which was tried shortly after I arrived at the division; and the FTC’s most recent successful challenge to the Staples/Office Depot merger.

The importance of economics in merger analysis has long been recognized at the division. In preparing for tonight’s remarks, we did a little historical research. On Dec. 10, 1936, Assistant Attorney General John Dickinson of the Antitrust Division delivered an address before the Council for Industrial Progress in which he made the following observation: “In the case of a merger the question of whether or not the prohibition of the law applies depends, in part

\(^1\) I am grateful to Mark Niefer and Daniel Haar for their invaluable assistance in researching and preparing these remarks.
at least, upon the reasonableness of the combination and almost wholly upon its economic results as disclosed by a study of the industry and an estimate of the effect of the proposed action upon the competitive situation.”2 He went on to explain, “It is therefore perhaps surprising that provision has never in the past been made for economic consultants in the Department of Justice and that none have ever been regularly attached to its staff until the past year. Within the past six months I have made the innovation of establishing the nucleus of a small economic unit within the limits of a restricted budget and it has already more than justified itself in keeping investigations out of blind alleys and in interpreting the information whether they have elicited.”3 So this year marks at least 80 years since professional economists have been employed by the division. Assistant Attorney General Dickinson was rightly proud of this innovation.

I am confident that you do not want me to recount the history of industrial organization economics since that time and I doubt I could do it justice in any event. So I’ll now jump to the present. Economists play a vital role in every significant merger investigation and litigation we handle. They have the expertise and facility to extract from mountains of raw data a variety of useful measures such as sales volumes, revenues, margins, market shares and others. They review bid data to determine the frequency with which companies encounter each other in the market, the closeness of competition and whether bidding behavior is characterized by coordination. They help us understand how competition works and how data can be used in assessing competitive constraints and predicting the likely impact of a merger. They develop theories of harm that not only guide their own quantitative work but also inform the work of lawyers who pursue the non-quantitative evidence on which cases rely. They also have a seemingly endless supply of lawyer jokes.

It would be impossible for me to list the many times and the many ways in which economists have helped me better understand the matters I have worked on at the division. They have predicted price increases in transactions across a variety of industries. They have modeled competitive effects for commodity products where price is determined by output decisions of suppliers. They have shown how mergers can give parties increased bargaining leverage, in industries ranging from cable and internet to healthcare. They have assessed party arguments about efficiencies and alleged mitigating effects in two-sided markets. To name just a few.

But I am not here simply to congratulate the profession for all its fine work. If hourly rates are any indication, you already know how valuable you are. I would also like to share a few candid thoughts about some of the economic evidence I have seen presented to the division. I am providing these observations from the perspective of a lawyer involved in merger decisions and litigation. My colleagues in the Economics Analysis Group undoubtedly have additional thoughts on these topics.

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2 “The Enforcement of the Antitrust Laws, An Address by Honorable John Dickinson, Assistant Attorney General of the United States,” dated December 10, 1936, at 9. I am attaching a copy of this address to my remarks. It is an enjoyable read, especially for those with an interest in the history of U.S. antitrust enforcement. John Dickinson himself was a fascinating and extraordinarily accomplished individual. A short summary of his life and career, which also provides insights into what was happening with antitrust enforcement and industrial regulation in the wake of the Great Depression, can be found in Volume 101 of the University of Pennsylvania Law Review (October 1952).

3 Dickinson speech (attached), supra note 2, at 13.
To begin with, you should understand that your primary audience when presenting economic evidence to the division consists of our economists. You need to demonstrate to them that your work is valid, that the data are reliable and that your conclusions are supported by accepted methods of economics. I can assure you that if our economists are not convinced, it is extremely unlikely that the legal team will second guess them on the economic work. I have been in front office meetings when arguments have broken out between the parties’ economists and ours. That is not where you want to be.

Second, when presenting to the lawyers at the agency, you need to be able to explain in simple terms the nature of the work you have done, the source of the information that feeds into that work and why it demonstrates the point you are trying to make. It is not persuasive to rattle off technical jargon and expect us to take on faith that a conclusion is valid simply because you obtained some value for a statistic. We need to understand the intuition behind the work and the basis for the results. Note also that if we can’t understand it at the agency, you should not expect to be able to explain it to a generalist federal judge who might have little or no experience with antitrust cases or merger challenges.

While we are on the topic of simple explanations, I believe the economic literature needs to become more accessible to non-economists. There is a problem that some in the profession have referred to as “mathiness” in economics. You write articles for each other, not for the rest of us. I can’t tell you how many times I have picked up a paper written by a leading economist on an important antitrust topic, generally absorbed the gist of the abstract and the introduction, then turned the page only to be confronted with complicated equations and a discussion I could not follow. Obviously scientists must devote considerable time explaining their work to each other and debating the merits of that work in terms the rest of us can’t be expected to grasp. But if the science is to be influential with lawyers who make enforcement decisions and with courts, there need to be sources to which we can turn, written professionally and by respected experts in the field, that provide clear explanations.

Third, I cannot emphasize strongly enough how important candor and credibility are in presenting economic evidence, just as it is with all interactions parties might have with the government or the courts. If your methodology is sound and the data support your conclusion, you shouldn’t need to pull a fast one on us. Conversely, if you try to pull a fast one, we assume either the methodology is unsound or your conclusion is not supported. I offer two examples, one small and one large.

I recall sitting in a front office meeting receiving a presentation from the parties on a merger that was a close call. One of the pieces of economic evidence that was presented was a before-and-after study. The results were shown in the form of graphics to demonstrate that a particular event had not impacted a variable of interest. It was an impressive point. But then something caught my eye. In very small font beneath each graph was a listed data source. The data source for the “before” graph was different from the data source for the “after” graph. One was an objective third-party source and the other was described simply as the economist’s estimate. Of course I became immediately suspicious of the validity of this study. The parties had an explanation when asked and maybe it would have been credible if it had been volunteered

4 See, e.g., Tim Hartford, “Down with Mathiness,” Financial Times (June 5, 2015).
upfront, but it raised a significant doubt in my mind. We ultimately cleared the transaction but, at least speaking for myself, that part of the presentation played no role in my thinking. This is the small example.

The other example I have in mind involves a regression model that purported to show that a prior transaction in the same industry but involving different products had no effect on prices. The model suffered from a number of flaws but one of the things that most bothered me about it was that the underlying data the expert used included the actual products at issue in the transaction under review and the expert’s model yielded statistically significant results showing that prices of those products had gone up. These results were not presented in the expert’s report but were discovered only after some dogged detective work by economists at the division who reviewed the backup data. The explanation for omitting these results from the report: the economist thought they were not robust because they varied when he did alternative runs of the model, which themselves were not disclosed. Whatever debate might have been available to the parties about the robustness of the results or the significance of the parties’ own model showing an increase in prices is of no moment; this should have been disclosed and presented with candor. The transaction was ultimately abandoned.

This brings me to my fourth point. You have to give us the information we need to test and verify your economic work and you have to give us time to do the work. It is our job to be skeptical of models that are constructed by experts employed by the parties. To be sure, the work that is presented to us is often immensely helpful. I have seen it play a big role in our decisions. But we will not take it at face value. So, to take a real world example that I recall, don’t present us with a model that purports to show the market is broader than we have always viewed it in a particular line of commerce, with only one week to go before the deal has to close. It’s not realistic to expect us to take that kind of risk on behalf of consumers without having the time and the information we need to fully vet the economic evidence you are presenting. This transaction also was abandoned.

Fifth, use lots of charts and pictures when presenting to lawyers. Text slides, not so much.

Sixth, recognize that the farther you stray from known methods of studying markets and the more customized and unusual the model you present, the more skeptical we will be that it provides meaningful information. Moreover, the fact that an expert can produce a model to achieve a certain result does not necessarily help us or a court decide the case. In this regard, while I believe the quality of economic work in the field of merger enforcement is generally first rate, we do see junk science from time to time. When data are mined and variables mixed and matched in such a way that a facially helpful conclusion can be drawn from a regression, even though an alternative result can easily be obtained by tweaking the inputs, we will likely view it as biased and unpersuasive.

I recently learned a term I hadn’t heard before from an episode of Last Week Tonight with John Oliver.5 This episode explored how scientific studies often have little value and yet are

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5 Last Week Tonight with John Oliver, https://www.youtube.com/watch?v=0Rnq1NpHdmw (first aired on May 8, 2016).
widely reported by the news media. The term Oliver used is P-hacking and if I understand it correctly, it describes how researchers can sift through data looking for relationships that will show up as statistically significant, rather than study a hypothesis objectively. This process can produce absurd results that appear to be valid but are not. Although I never knew the word for it, this seems to capture what happens with regression models presented to us on some occasions. That is, the expert runs ten regressions, discards nine unfavorable or insignificant results, and keeps the one that is favorable and significant. Don’t p-hack. It wastes time, it will be vulnerable to cross-examination and it undermines the legitimacy of the valuable contributions that economics can make to a case. As an aside, it also provides material for us lawyers to make economist jokes.

Finally, I believe economic evidence is best viewed as a complement to the other evidence in a case, not as a substitute for it. If the non-economic evidence points strongly in one direction, it is highly unlikely that a regression model pointing in the other will save the day. I don’t believe I have seen it happen in my three years at the division.

Moreover, it is wise to bear in mind that courts will be strongly influenced by the non-economic evidence. Opposing economic experts are both likely to be highly qualified professionals with many years of experience, a long list of impressive publications and an ability to recite various statistics that support their respective points of view. Confronted with such a battle of the experts, judges tend to look to other sources of evidence in deciding merger challenges.⁶ This is borne out by recent merger decisions.

In FTC v. Sysco,⁷ for example, the court extensively analyzed evidence relevant to the qualitative factors in Brown Shoe Co. v. United States in determining that broadline foodservice distribution was a market. Among other things, it had distinct product characteristics, distinct customers and the industry recognized the uniqueness of these services. The FTC’s economist also presented the results of an aggregate diversion analysis that showed a hypothetical monopolist over these services could profitably raise prices by a small but substantial and non-transitory amount. Rather than relying on these precise findings, the judge viewed them together with the rest of the evidence with which they were consistent. The defendant’s economist’s testimony, on the other hand, was not accepted by the court because it was contradicted by the weight of the qualitative evidence. In other words, it was the qualitative evidence that did the heavy lifting.

Similarly, in United States v. Bazaarvoice, the Antitrust Division introduced extensive evidence – including the parties’ own documents and lay witness testimony – showing that the market was limited to product rating and review (R&R) platforms, a market in which the merging firms were the two largest players. The division’s expert also presented the results of a hypothetical monopolist test on this question, but the court simply found that this “confirm[ed]}

⁶ Judge Vaughn Walker has described this as follows: “Economic analysis is neither the most nor the least important source of evidence in a merger case. If consistent with the other evidence, the economic analysis will project a convincing image for one side or the other. If not consistent, no amount of sophisticated econometrics will rescue the analyses of the witnesses who present it.” Vaughn Walker, “Merger Trials: Looking for the Third Dimension,” Vol. 5 Competition Policy International 35, 47 (Spring 2009).
what was apparent from the non-expert testimony,” i.e., that “R & R platforms in the United States for retailers and manufacturers are the relevant product and geographic markets.”

Sysco and Bazaarvoice are not unusual cases. One more example: in United States v. H & R Block Inc., the district court defined the market with reference to documentary and lay witness testimony, finding the economics testimony merely “tend[ed] to confirm” the market.

I will close by saying that this is an exciting time to be a lawyer or an economist practicing in the field of merger control. The agencies have been bringing cases across a variety of industries that have presented a range of important issues. With six years of experience under the 2010 Horizontal Merger Guidelines, the principles that are embedded in that document have been extensively debated and applied by the agencies and in some instances by the courts. Concepts like upward pricing pressure have become familiar to everyone practicing in the area. The economics profession should be rightly proud of its important role in bringing us to this place but must not rest on its laurels. There is endless work to be done to invent newer and better tools to study markets, develop consensus around the things that work and the things that don’t and figure out how to help the agencies and the courts make good decisions.

Thank you for your time tonight.

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Toward a More Complete Treatment of Efficiencies in Merger Analysis: Lessons from Recent Challenges

Jonathan M. Orszag and Loren K. Smith

Consider an example of a merger of two hypothetical widget companies: In a properly defined relevant market (Market A), the merger is projected to generate harmful competitive effects of $15. But, the merger is expected to generate efficiencies in a second relevant market (Market B), $20 of which would be passed through to customers, and the vast majority of customers buy the products in both Market A and Market B together so customers in Market A would benefit directly from efficiencies in Market B. Should this merger be approved? If the antitrust authority were to block the merger because of the projected harm in Market A, customers in Market A would be worse off (because they would lose the lower prices that would be achieved in Market B if the merger were to be approved). But the Horizontal Merger Guidelines do not explicitly contemplate the effects of such demand-side complementarities in its treatment of efficiencies.¹

Consider a second example of a merger between two other widget companies. Again, the merger would generate harmful competitive effects of $15 in Market A. But, the proposed merger also would generate merger-specific, verifiable efficiencies with a 40 percent probability, $50 of which would be passed through to customers. Should this merger be approved? In terms of expected value, the merger would yield a net benefit to customers of $5 and should therefore be cleared.² But one could also interpret the probability of realizing the efficiencies as less than 50 percent as meaning that they are “unlikely” to be achieved and thus should not be counted at all.³ Under this interpretation of the Guidelines, the antitrust authority would seek to block the merger because consumers would be subject to a harm of $15 in the absence of efficiencies.

From an economic perspective, one could argue that both of these mergers should be approved by the antitrust agencies because consumers, on an expected value basis, are better off with the mergers. However, a plain reading of the Guidelines would suggest that both of these hypothetical mergers should be blocked.

The issues raised in these two examples are not purely hypothetical—they were part of the economic analysis undertaken by the defendants in two recent merger challenges brought by the agencies: the GE/Electrolux merger⁴ and the Staples/Office Depot merger.⁵ Moreover, the substantive issues raised by these examples have not been fully examined by the literature. Indeed, although there is an extensive literature on determining and measuring the competitive effects of a merger—including studies pertaining to market definition, merger simulation, unilateral and coordinated

² The expected value of the efficiencies is 40 percent multiplied by $50 or $20. Thus, the net beneficial effect of the merger is $5—the $20 of expected merger-specific efficiencies minus the $15 of projected harm.
³ Guidelines, supra note 1, § 10 (“The Agencies credit only those efficiencies likely to be accomplished with the proposed merger . . . .”).
⁴ United States v. Electrolux, No. 15-cv-01039-EGS.
⁵ FTC v. Staples, Inc., No. 15-cv-02115-EGS.
effects, maverick firms, power buyers, and many other issues related directly to analyzing competitive effects—the literature with regard to merger-induced efficiencies is not as well developed.

Such a lack of focus on efficiencies is surprising because the vast majority of mergers are deemed procompetitive by the investigating agencies. For example, the agencies rarely challenge mergers and in 2014 the FTC and DOJ requested additional information only on roughly three percent of all reported mergers. Moreover, retrospective studies of horizontal mergers by agency and academic economists indicate the presence of merger efficiencies.

Although subsequent changes to the Guidelines have provided more clarity surrounding the treatment of efficiencies by the agencies and arguably have conveyed even more openness to efficiency arguments, merger efficiencies still receive far less attention in merger reviews and litigations than do potential merger harms.

This article takes a step toward a more complete perspective on efficiencies, which will hopefully focus more attention on an often short-changed element of merger analysis. Specifically, we provide more depth and clarification with regard to the definition of “inextricably linked” efficiencies in the Guidelines and then discuss whether the standard that efficiencies must be “likely” is appropriate from an economic perspective.

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6 U.S. Dep’t of Justice & Fed. Trade Comm’n, HSR Annual Report (FY 2014) (noting that in fiscal year 2014, 1,663 transactions were report-ed under the HSR Act. 51 transactions received Second Requests, and the agencies brought 33 enforcement actions.)

7 For example, in a retrospective study of mergers and merger enforcement, John Kwoka, Does Merger Control Work? A Retrospective on U.S. Enforcement Actions and Merger Outcomes, 78 Antitrust L.J. 619 (2013). Kwoka finds that 12 of 56 transactions studied (12 of 44 where there was no known remedy imposed by antitrust authorities) resulted in price decreases. In recent merger retrospective studies in healthcare, see, e.g., Aileen Thompson, The Effect of Hospital Mergers on Inpatient Prices: A Case Study of the New Hanover-Cape Fear Transaction, 18 Int’l J. Econ. Bus. 1, (2011); and Deborah Haas-Wilson & Christopher Garmon, Hospital Mergers and Competitive Effects: Two Retrospective Studies, 18 Int’l J. Econ. Bus. 1, (2011), and retail, see, e.g., Daniel Hosken, Luke M. Olsen & Loren K. Smith, Do Retail Mergers Affect Competition? Evidence from Grocery Retailing (Fed. Trade Comm’n Bureau of Economics Working Paper No. 313 (2012)), also find a mix of price increases and price decreases following horizontal mergers, indicating that horizontal mergers can create merger efficiencies.


Toward A More Precise Definition of “Inextricably Linked” Efficiencies

The Guidelines focus attention on the impact of a merger on consumer welfare in a relevant market—i.e., one evaluates the opposing effects of upward pricing pressure from the loss of an independent competitor and the downward pricing pressure from merger efficiencies in the relevant market (or relevant markets).13

In many cases, market-by-market evaluation of likely merger harm is practical and appropriate because markets operate independently enough that harm in a particular relevant market can be resolved through a partial divestiture or other remedy that is limited to that relevant market. However, in some cases the realization of merger efficiencies in one market is dependent on a merger being allowed to proceed in another market. The Guidelines provide a cursory footnote about such instances, noting that in some cases, merger efficiencies in other markets should be counted because they are “so inextricably linked with [the relevant market] that a partial divestiture or other remedy could not feasibly eliminate the anticompetitive effect in the relevant market without sacrificing the efficiencies in the other market(s).”14 In such cases, the appropriate evaluation of merger effects must consider both the anticompetitive effects in the relevant market and the net effects of merger efficiencies in all markets that are inextricably linked.

The limited consideration given to inextricably linked efficiencies in the Guidelines seems mismatched to the potential importance of such efficiencies, particularly for mergers between firms that sell multiple products that are supply-side complements (e.g., are produced using the same technologies or distributed using the same networks) or demand-side complements (e.g., are sold together) or both. That is, the increasing prevalence of multiproduct firms and mergers between them increases the probability incidence of supply-side and demand-side cross-market efficiencies. Recent challenges brought by the DOJ and the FTC against mergers between multiproduct firms, where the competitive effects analysis was limited to relevant markets defined as subsets of products offered by the merging parties, highlight the need to understand how linked merger efficiencies should be counted.15

First, if there are supply-side complementarities across products, cost efficiencies on products where there are no merger concerns may depend on links to products where there are merger concerns—and the Guidelines clearly contemplate this possibility.16 Consider the following example:

- Firms that produce the same two products—A and B—propose to merge. The merger would generate significant upward pricing pressure on product A but not on product B.
- Products A and B rely on the same production technology.
- If the merger is allowed without any divestitures, the combination of the merging parties’ production technologies would reduce production costs on products A and B by $0.10 per unit.

13 See, e.g., Fed. Trade Comm’n & U.S. Dep’t of Justice, Commentary on the Horizontal Merger Guidelines 49 (2006) (“Efficiencies in the form of quality improvements also may be sufficient to offset anticompetitive price increases following a merger. Because a quality improvement involves a change in product attributes, a simple comparison of pre- and post-merger prices could be misleading. A careful analysis of the effects of changes in product attributes and prices on consumer welfare is likely to be necessary.”) See also Guidelines, supra note 1, at 2 (“Regardless of how enhanced market power likely would be manifested, the Agencies normally evaluate mergers based on their impact on customers.”).

14 Guidelines, supra note 1, § 10 n.14.


16 Commentary on the Horizontal Merger Guidelines, supra note 13, at 57.
but the merged entity would realize no production efficiencies if there is a divestiture of product A from one of the merging firms.  

- In the absence of the merger or with a divestiture of product A, a total of 100 units of each product would be sold at $1 each.
- With the merger and the cost improvement of $0.10 per unit, the merged entity would sell 90 units of product A at $1.05 and 120 units of product B at $0.95.

In this example, consumers are better off with the merger because product B is more price elastic than is product A, and thus consumer savings on product B (>100*$0.05) exceed consumer harm on product A (<100*$0.05).

Antitrust authorities have, in rare instances, considered supply-side inextricably linked efficiencies. Kolasky and Dick describe a real-world example—a merger of two natural gas gathering and processing companies that were the only two such companies operating in several counties in West Texas. The two companies planned through a horizontal merger to combine underutilized natural gas gathering systems and processing plants—a production efficiency. Investigators determined that these merger efficiencies outweighed any possible anticompetitive harm and that the efficiencies would not be realized fully if a divestiture of assets was required.

Although this is an instance where supply-side inextricably linked efficiencies were given due consideration by the agency, the cursory explanation of inextricably linked efficiencies in the Guidelines makes it unclear to antitrust practitioners and merging parties as to when such efficiencies will be considered inextricably linked to the relevant market and when they will be disregarded completely.

Moreover, the fact that demand-side complementarities—e.g., through purchases of bundled products—can impact the flow of efficiencies realized through a merger has not been given due consideration in merger analysis. Consider the following example:

- Two firms that produce the same two products—A and B—propose to merge. The merger would generate significant upward pricing pressure on product A but not on product B.
- There are 150 total customers, 50 of whom purchase only product A, 50 of whom purchase only product B, and 50 of whom consider products A and B to be perfect complements (i.e., products A and B are only valuable to these customers if purchased together).
- There is a merger efficiency that reduces the production costs of product B by $0.20 but does not affect product A.
- In the absence of the merger a total of 100 units of each product would be sold to the 150 customers; those that purchase either product A or B à la carte pay $1 each; those that purchase a bundle of products A and B pay $1.90 each.
- Assume that with the cost improvement of $0.20 on product B, the merged entity would sell 45 units of product A at $1.05, 60 bundles of products A and B at $1.80 each, and 75 units of product B at $0.85 each.

17 For example, a situation where realization of merger efficiencies requires an investment that only makes financial sense if the merger involves both product A and product B.
18 This scenario is not unlikely—markets that experience more competition are associated with higher price elasticity of demand, all else being equal.
19 This example could be recast to represent a situation where there is only a single product, the anticompetitive harm is limited to a narrow subset of consumers, but the merger-induced efficiencies apply to all buyers. For example, a hospital merger might be evaluated for its potential impact on commercially insured patients, but any efficiencies realized through the merger could benefit patients with government insurance plans as well.
20 Kolasky & Dick, supra note 9, at 231.
In this example, the welfare of purchasers of both products improves because the benefit to those that purchase a bundle of products A and B more than offsets the harm to à la carte purchasers of product A.

The above example is simplistic. The principle that demand-side complementarity among goods offered by multiproduct firms affects the pass-through of merger efficiencies is more general. For example, Sonia Jaffe and E. Glen Weyl show that in a merger of multiproduct firms, the net upward pricing pressure on one firm’s product is a function of diversion ratios from that product to all of the products of its merger partner (multiplied by margins that incorporate merger efficiencies). In other words, the Jaffe-Weyl model shows that in the presence of complementarities, the upward price pressure associated with one product is inextricably linked with the merger-specific variable cost efficiencies of other products. As discussed below, the reason is simple: one product’s cost efficiencies alter the post-merger relative margins of all products, which changes the pricing incentives associated with those products.

The “generalized upward pricing pressure” or “GePP” model presented in Jaffe-Weyl is somewhat technical. However, complex as it is, under the common assumption that firms engage in Bertrand price competition, as with other UPP indices, GePP can be expressed in terms of diversion ratios and price-cost margins. Moreover, the Jaffe-Weyl model is quite general and thus can be simplified to accommodate only the salient complementarities of a particular merger. For example, consider two multiproduct firms that each sell two products—A and B. Individually, the products are substitutes for each other (i.e., each firm’s product A and product B is a substitute for the corresponding product A and product B produced by the other firm.) Moreover, products A and B are complements when produced by the same firm. Under these conditions, the upward pricing pressure on firm 1’s products in the Jaffe-Weyl model are given by:

\[ GePP^A = \frac{1}{1-D^A_{12}} \left[ D^A_{12} (P^A_2 - c^A_2) + D^{AB} D^B_{12} (P^B_2 - c^B_2) \right] \]  

\[ GePP^B = \frac{1}{1-D^B_{12}} \left[ D^B_{12} (P^B_2 - c^B_2) + D^{BA} D^A_{12} (P^A_2 - c^A_2) \right] \]

where \(D^A_{12}\) is the diversion ratio from firm 1 to firm 2 on product A, \(D^{AB}\) is the (negative) diversion ratio between firm 1’s product A and firm 1’s product B (i.e., the proportion of firm 1’s lost sales on product A that is also lost on firm 1’s product B because the goods are complements), and \(D^{BA}\) is the (negative) diversion ratio between firm 1’s product B and firm 1’s product A.

As would be expected, equations (1) and (2) show that merger price effects are increasing in the magnitude of diversion ratios between the merging firms’ substitute products. However, the equations also imply that it often will be the case that upward pricing pressure on product A is decreasing in the complementarity of product B with product A (i.e., the magnitude of \(D^{AB}\) and

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22 The diversion ratio from firm 1 to firm 2 for product A is the fraction of product A sales firm 1 would lose to firm 2 were firm 1 to increase prices.

23 Although stylized, this example is not so difficult to imagine. For example, in the appliance industry some customers prefer to buy washers and dryers that are of the same brand.

24 These equations can be derived from the multiproduct UPP formula given in Jaffe-Weyl, supra note 21, § II.D (under the heading “Bertrand” on p. 195). See the Appendix, infra, for this derivation.
Intuitively, firm 1 raising the price of product A decreases the sales of firm 1’s complementary product B, decreasing upward pricing pressure. Importantly, when this is the case, the presence of merger efficiencies on firm 2’s product B decreases GePP, a factor that should be considered when weighing an enforcement action involving product A.

The discussion and examples provided above demonstrate the potential importance of efficiencies that are “inextricably linked” across products through either supply-side or demand-side complementarities. In our experience, linked efficiencies are given little, if any, consideration in antitrust investigations and enforcement actions. Multiproduct firms produce and market complementary goods and services, and thus ignoring linked efficiencies potentially causes antitrust agencies to thwart procompetitive mergers. And, although complex, models like that of Jaffe-Weyl provide useful starting points from which the agencies can develop first-order approaches to better fit the particular features of horizontal mergers of multiproduct firms.

**Treatment of Expected Merger Efficiencies in the Context of Merger Litigation**

As noted above, the vast majority of horizontal mergers do not raise significant antitrust concerns. However, when a merger is between close substitutes in a concentrated industry, merging parties typically are required to demonstrate that merger-specific efficiencies will enhance the merged entity’s incentive and ability to compete (to the benefit of consumers). Generally, it is the burden of the merging parties to provide evidence that merger efficiencies will be realized.

Placing responsibility on the merging parties for demonstrating merger efficiencies is reasonable, particularly during the investigation stage of a potential merger challenge. After all, as explained in the Guidelines: “[I]nformation relating to efficiencies is uniquely in the possession of the merging firms.”

Cognizable efficiencies are defined in the Guidelines as those that are both merger-specific and verified. Assume potential merger efficiencies are merger specific. “Verified” is an interesting word to use in the context of a prospective merger evaluation because none of the outcomes of the merger, including any potential merger efficiencies, can be “verified” until after the merger has occurred. Merger investigations typically involve assessments of inherently uncertain events, e.g., expected merger price increases. Yet the Guidelines seem to imply that merging parties are held to a higher standard of certainty with regard to merger efficiencies. For example, the Guidelines state: “Efficiency claims will not be considered if they are vague, speculative, or otherwise cannot be verified by reasonable means.” Such language, as well as standard practices, indicates that merger efficiencies are often evaluated as though it were possible to demonstrate both merger specificity and verifiability before the merger occurs. That is, estimated merger efficiencies are either deemed to be cognizable and credited fully or considered to be not cognizable and given zero credit.

Of course, no efficiencies are 100 percent guaranteed, especially before a merger is consummated. Put another way, each claimed merger efficiency will occur with some positive probability. Hence, a more appropriate treatment of likely merger efficiencies would be to estimate the

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25 Mathematically, the upward pricing pressure of, for example, firm 1’s product A is decreasing in the complementarity between firm 1’s products A and B if the derivative of GePP with respect to the diversion ratio between firm 1’s products A and B (D) is positive. In the case of the GePP in equation (1), \( \frac{\partial GePP_1}{\partial D} = \frac{D_{12} (P_A - c_A) + D_{12} (P_B - c_B)}{(1-D_{12} D_{21})^2} > 0. \)

26 Guidelines, supra note 1, § 10.

27 Id.

28 Id. (emphasis added).
expected value of each claimed merger efficiency, much the same way that investigators currently evaluate the likely price effects of a merger. That is, assume the investigator has been convinced by the merging parties that a $100 efficiency will be realized if a merger is consummated but thinks that another claimed $70 efficiency is somewhat unlikely. Rather than crediting the merging parties with just the $100 efficiency, it would be more appropriate to estimate the expected value of the sum of the two efficiencies—which could be greater than or less than $100.29

The deterministic treatment of merger efficiencies as counting or not counting as opposed to using a probabilistic approach could lead to undesirable outcomes. For example, consider two proposed mergers. For simplicity, assume that each merger is between firms that produce products with identical prices (equal to 1) and percentage margins (equal to 0.5), with symmetric diversion ratios (equal to 0.2). Hence, each merger has a GUPPI of 0.1 for each firm’s product.30 Merger 1 would realize marginal cost efficiencies of 0.3 on each firm’s product with probability 0.7, while Merger 2 would realize marginal cost efficiencies of 0.6 on each firm’s product with probability 0.5. Under a coarse count/do not count standard for efficiencies, the agencies would allow Merger 1 but block Merger 2—which is precisely the wrong outcome from a consumer welfare standpoint.31

Refining merger efficiencies to probabilistic outcomes is likely an unnecessary step for most merger investigations, especially those that are not close calls. Moreover, calculations of probability-weighted merger efficiencies would place a significant burden on merging parties and the antitrust authorities during the investigation phase of a merger review. Hence, it would be pragmatic and appropriate for preliminary merger reviews to consider claimed merger efficiencies as is done currently—by either counting such efficiencies fully or not counting them at all.

As part of merger litigations, however, using probability-weighted measures of merger efficiencies, instead of the coarse count/do not count standard suggested by the Guidelines, would be a more effective approach to produce the correct outcome for consumer welfare. Indeed, all elements of a merger evaluation—market definition, competitive effects analysis, etc.—typically are reevaluated and sharpened for presentation to the court, so reevaluating efficiencies should not impose any additional burden.

Perhaps even more importantly, our recommended approach for the final stages of a merger investigation and in the litigation phase of merger challenges would harmonize the economic analysis of upward price pressure resulting from the loss of an independent competitor with the economic analysis of merger-specific efficiencies. When one analyzes the potential effects of the merger on prices, there is always some uncertainty regarding the precise point estimate of the potential merger effect. Yet, lawyers and economists usually accept the best point estimate as the

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30 The GUPPI for firm 1 in a merger with firm 2 can be expressed as $\text{GUPPI}_1 = D_{12} \times M_2 \times \frac{P_2}{P_1}$. The subscripts in the equation index firms, $D$ is diversion ratio, $M$ is percent margin, and $P$ is price. Under the stated assumptions, the GUPPI for each firm is the same, say $\text{GUPPI} = D \times M$.

31 In expectation, Merger 1 would realize efficiencies of 0.21, which is less than $0.1\frac{(1-D)(1-M)}{0.8\times0.5} = 0.25$, while Merger 2 would realize efficiencies of 0.30, which is greater than this expression. Hence, in expectation, Merger 1 would lead to a price increase because $\frac{\text{GUPPI}}{1-D(1-M)}$ exceeds expected realized efficiencies (i.e., 0.25 > 0.21), while Merger 2 would result in a price decline because $\frac{\text{GUPPI}}{1-D(1-M)}$ is less than expected realized efficiencies (i.e., 0.30 > 0.25). For a derivation and explanation of this test for weighing merger efficiencies against upward pricing pressure, see Farrell & Shapiro, supra note 21, at 12–13.
best available measure of the merger price effect. The approach we recommend for merger litigations puts efficiencies on the same playing field as price effects: We would use the best point estimate of efficiencies, taking into account uncertainties about the potential outcomes.

**Conclusion**
For too long, efficiencies—the primary motivator for the vast majority of mergers—have been short-changed in merger analysis. This article helps to provide a deeper understanding of the appropriate framework for considering merger-specific efficiencies. But the research into efficiencies, given their importance in difficult merger decisions, cannot end here. We must continue to investigate and refine how the treatment of efficiencies can be improved going forward.
Appendix: Derivation of $2 \times 2$ Multiproduct UPP for Bertrand Competition

The multiproduct UPP formula for Bertrand competition is given by:

$$GePP_i = -\left(\frac{\partial Q_i}{\partial P_i}\right)^{-1} \left(\frac{\partial Q_j}{\partial P_i}\right)^T (P_j - c_j),$$

where $GePP_i(P)$ is a vector of $GePP$ for the products sold by firm $i$, and $j$ indexes firm $i$’s merger partner.$^{32}$

Assume merging parties, indexed by 1 and 2, each produce products A and B. Then the multiproduct UPP for firm 1 is given by:

$$GePP_1 = \begin{bmatrix} GePP_1^A \\ GePP_1^B \end{bmatrix} = -\left(\begin{bmatrix} \frac{\partial Q_1^A}{\partial P_1^A} & \frac{\partial Q_1^A}{\partial P_1^B} \\ \frac{\partial Q_1^B}{\partial P_1^A} & \frac{\partial Q_1^B}{\partial P_1^B} \end{bmatrix}\right)^{-1} \begin{bmatrix} \frac{\partial Q_2^A}{\partial P_1^A} & \frac{\partial Q_2^A}{\partial P_1^B} \\ \frac{\partial Q_2^B}{\partial P_1^A} & \frac{\partial Q_2^B}{\partial P_1^B} \end{bmatrix} \begin{bmatrix} (P_2^A - c_2^A) \\ (P_2^B - c_2^B) \end{bmatrix}.$$ 

Given the assumption that products A and B are complements only when produced by the same firm, $\frac{\partial Q_2^A}{\partial P_1^B} = \frac{\partial Q_2^B}{\partial P_1^A} = 0$, and thus $GePP_1$ can be rewritten:

$$GePP_1 = \frac{1}{\frac{\partial Q_1^A}{\partial P_1^A} \frac{\partial Q_1^B}{\partial P_1^B} - \frac{\partial Q_1^A}{\partial P_1^B} \frac{\partial Q_1^B}{\partial P_1^A}} \begin{bmatrix} \frac{\partial Q_1^B}{\partial P_1^A} \frac{\partial Q_1^A}{\partial P_1^B} (P_2^A - c_2^A) + \frac{\partial Q_1^B}{\partial P_1^A} \frac{\partial Q_2^B}{\partial P_1^B} (P_2^B - c_2^B) \\ \frac{\partial Q_1^A}{\partial P_1^B} \frac{\partial Q_1^A}{\partial P_1^B} (P_2^A - c_2^A) + \frac{\partial Q_2^B}{\partial P_1^A} \frac{\partial Q_2^B}{\partial P_1^B} (P_2^B - c_2^B) \end{bmatrix}.$$ 

$^{32}$ See Jaffe & Weyl, supra note 21, § II.D.
Finally, dividing the numerator and the denominator of $GePP_1$ by $\frac{\partial Q_X^A}{\partial P_1^A} \frac{\partial Q_X^B}{\partial P_1^B}$ and multiplying through gives:

$$GePP_1^A = \frac{1}{1-D_1^{AB} D_1^{BA}} [D_{12}^A (P_2^A - c_2^A) + D_1^{AB} D_{12}^B (P_2^B - c_2^B)]$$ and

$$GePP_1^B = \frac{1}{1-D_1^{AB} D_1^{BA}} [D_{12}^B (P_2^B - c_2^B) + D_1^{BA} D_{12}^A (P_2^A - c_2^A)],$$

where $D_{12}^X = -\frac{\partial Q_X^A}{\partial P_1^A} \frac{\partial Q_X^B}{\partial P_1^B}$ is the diversion ratio from firm 1 to firm 2 for product $X = A, B$, and

$$D_1^{AB} = -\frac{\partial Q_1^B}{\partial P_1^A} \frac{\partial Q_1^A}{\partial P_1^A}$$ and $$D_1^{BA} = -\frac{\partial Q_1^A}{\partial P_1^B} \frac{\partial Q_1^B}{\partial P_1^B}$$ are the diversion ratios between firm 1’s products A and B.
INTRODUCTION

The Court completed a bench trial in this case in October of 2013, and directed counsel to file proposed Findings of Fact and Conclusions of Law. Those have been filed and the case is at issue. For the reasons explained below, the Court finds for the plaintiffs and will order divestiture of the affiliation between St. Luke’s and the Saltzer Medical Group.

Findings of Fact & Conclusions of Law – page 1
SUMMARY

For years, health care costs have exceeded the inflation rate. Americans spend more on health care than the next 10 biggest spenders combined – a list that includes Japan, Germany, France and the U.K. – yet we lag behind many of them on quality and patient outcomes. In Idaho, the quality of our health care is outstanding, but we pay substantially more than the national average for that quality.

Among the experts, there is a rough consensus on a solution to the cost and quality concerns nationwide. They advocate moving away from our present fee-for-service health insurance reimbursement system that rewards providers, not for keeping their patients healthy, but for billing high volumes of expensive medical procedures. A far better system would focus on maintaining a patient’s health and quality of life, rewarding successful patient outcomes and innovation, and encouraging less expensive means of providing critical medical care. Such a system would move the focus of health care back to the patient, where it belongs.

In fact, there is a broad if slow movement to such a system. It will require a major shift away from our fragmented delivery system and toward a more integrated system where primary care physicians supervise the work of a team of specialists, all committed to a common goal of improving a patient’s health.

St. Luke’s saw this major shift coming some time ago. And they are to be complimented on their foresight and vision. They started purchasing independent physician groups to assemble a team committed to practicing integrated medicine in a system where compensation depended on patient outcomes.
In Nampa, they acquired the Saltzer Medical Group (“the Acquisition”). The combined entity now includes 80% of the primary care physicians in Nampa. Its size, and the sterling reputations of Saltzer and St. Luke’s, make it the dominant provider in the Nampa area for primary care, and give it significant bargaining leverage over health insurance plans.

These circumstances prompted the Federal Trade Commission (FTC), and a group of other health care providers including St. Alphonsus and Treasure Valley Hospital, to file this lawsuit claiming that the Acquisition violated the antitrust laws. They ask the Court to unwind the deal.

The antitrust laws essentially require the Court to predict whether the deal under scrutiny will have anticompetitive effects. The Court predicts that it will. Although possibly not the intended goal of the Acquisition, it appears highly likely that health care costs will rise as the combined entity obtains a dominant market position which will enable it to (1) negotiate higher reimbursement rates from health insurance plans that will be passed on to the consumer, and (2) raise rates for ancillary services (like x-rays) to the higher hospital-billing rates.

The Acquisition was intended by St. Luke’s and Saltzer primarily to improve patient outcomes. The Court believes that it would have that effect if left intact, and St. Luke’s is to be applauded for its efforts to improve the delivery of health care in the Treasure Valley. But there are other ways to achieve the same effect that do not run afoul of the antitrust laws and do not run such a risk of increased costs. For all of these
reasons, the Acquisition must be unwound. The Court will set forth its detailed Findings of Fact and Conclusions of Law below.

**FINDINGS OF FACT**

**Plaintiff Saint Alphonsus**

1. Saint Alphonsus Health System, Inc. (“St. Alphonsus”) operates hospitals, outpatient clinics, and other health care facilities in the Treasure Valley of Idaho and eastern Oregon.

2. In Idaho, St. Alphonsus owns and operates plaintiff Saint Alphonsus Regional Medical Center, Inc., a 381-bed hospital located in Boise, and Saint Alphonsus Medical Center, Nampa, Inc. (“St. Alphonsus Nampa”), a 152-bed acute care hospital located in Nampa.

3. Saint Alphonsus Nampa is the only hospital in the City of Nampa. *Trial Tr.* at 324 (J. Crouch).


5. Over 60 of the SAMG physicians provide primary care services.

6. SAMG currently employs 20 primary care physicians in Canyon County, at least nine of whom practice in Nampa. *Trial Tr.* at 791 (N. Powell).

7. Saint Alphonsus is owned by Michigan-based Trinity Health, one of the largest Catholic health care systems in the United States. Trinity operates approximately 50 hospitals across the country. *Trial Tr.* at 855 (K. Keeler); *Trial Tr.* at 979-81 (B.Checketts); *Trial Tr.* at 650 (D. Pate)
Plaintiff Treasure Valley Hospital

8. Plaintiff Treasure Valley Hospital Limited Partnership, doing business as Treasure Valley Hospital (“TVH”), is a nine-bed, physician-owned, for-profit hospital in Boise, largely used for outpatient surgeries.

Partnership Between TVH and Saint Alphonsus

9. In the fall of 2012, Saint Alphonsus and TVH jointly opened a new outpatient surgery center in Nampa called the Treasure Valley Surgery Center (“TVSC”).

St. Luke’s


12. St. Luke’s employs or has entered into a professional services agreement (“PSA”) with each of its 500 physicians in numerous medical specialties who are geographically dispersed across southern Idaho and eastern Oregon.  

13. Each of the physicians employed by or under a PSA with St. Luke’s is part of the St. Luke’s Clinic.  *Trial Tr.* at 1863-64 (M. Johnson); *Trial Tr.* at 1879 (J. Kee).

14. Prior to the Saltzer transaction, no more than eight of the St. Luke’s Clinic physicians who practiced adult primary care services did so in Canyon County.  *Trial Tr.* at 2658 (A. Enthoven).


16. In the fall of 2011, seven physicians affiliated with the Mercy Physicians Group, who were employed by Saint Alphonsus in Nampa, decided to leave Saint Alphonsus and join St. Luke’s.  *See Jeffcoat Deposition (Dkt. No. 397)* at 66, 68; *Trial Tr.* at 871-72 (N.Powell).

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1 Under a professional services agreement (“PSA”), a physician practice group agrees to provide health care services exclusively on behalf of St. Luke’s, and St. Luke’s is reimbursed for the practice’s services under contracts that St. Luke’s enters into with payors. Although physicians practicing under a PSA do not have a direct employment relationship with St. Luke’s, the PSA sets forth the compensation that St. Luke’s pays the physician practice for services provided by the physicians on its behalf. For purposes of this case, a PSA arrangement creates a relationship functionally equivalent to employment to the extent that it provides, at the group level, the same clinical and financial alignment that employment provides at the individual level. Therefore, St. Luke’s PSA-based relationships with physicians will be described and regarded as the same as “employment” by St. Luke’s.
17. Prior to the closing of the Saltzer transaction, St. Luke’s had recruited another primary care physician to join the seven who departed from Saint Alphonsus, for a total of eight St. Luke’s primary care physicians practicing in Nampa. *Id.*

**Saltzer Medical Group**

18. Saltzer Medical Group consisted of 41 physicians, nearly three-quarters of whom provide adult or pediatric primary care services.

19. Specifically, 19 Saltzer physicians practice in the specialties of family medicine and internal medicine, while 10 Saltzer physicians are general pediatricians. Thirty-four of the Saltzer physicians, including 16 of the adult primary care physicians and 8 of the pediatricians, practice in Nampa.

20. Saltzer was the largest, independent, multispecialty physician group in Idaho. *Trial Tr.* at 465 (L. Duer).

21. Saltzer is a very prestigious group with a long history. *Trial Tr.* at 465 (L. Duer).

Saltzer is “a reputable and long-standing significant player” in the Treasure Valley healthcare community. *See Castledine Deposition (Dkt. No. 262) at 122; see also Trial Tr. 2001-02 (John Kee).*

**The Acquisition**

22. For years before the transaction with St. Luke’s, physician leadership at Saltzer saw that health care was demanding integrated services and high quality at reduced costs. *Trial Tr. at 2371-72 (J. Kaiser); see also Trial Tr. at 808 (N. Powell).*

23. Saltzer physicians were concerned that the traditional fee-for-service reimbursement model was no longer sustainable and that they needed to explore transitioning to a
value-based compensation model. *Trial Tr.* at 3344 (H. Kunz); *see also Savage Deposition (Dkt. No. 253)* at 65-66.

24. Saltzer believed that it needed to upgrade its medical record system and health information technology to keep pace with the industry, but could not afford to do so without partnering with a larger system. *Trial Tr.* at 3344 (H. Kunz).

25. Prior to making the decision to join St. Luke’s, Saltzer made attempts to coordinate care with other health systems under less-formal affiliations. For example, Saltzer worked with the Mercy Medical Center (the former name of what is now Saint Alphonsus-Nampa) in an attempt to coordinate limited services. None of those projects came to fruition because Mercy’s out-of-state parent, Catholic Health Initiatives (“CHI”), was unwilling to participate. *Trial Tr.* at 2372-74 (J. Kaiser).

26. After Saltzer’s negative experience with Mercy and CHI, Saltzer determined that in order to work effectively towards a solution it would need a local partner in the Idaho community. *Trial Tr.* at 2374 (J. Kaiser).

27. In December of 2008, Saltzer and St. Luke’s executed a memorandum of understanding (“MOU”) establishing an informal partnership to begin more deliberate and focused efforts around a series of joint initiatives aimed at improving access to high quality medical care, enhancing coordination of medical services, and streamlining the health care delivery model in Ada and Canyon Counties. *Trial Tr.* at 2225-27 (C. Roth); Exhibit 2196.

28. The MOU also outlined five core areas of improvement sought to be achieved by the informal alignment. *Trial Tr.* at 2227 (C. Roth).
29. Although the parties made some progress in the five areas (Trial Tr. at 2228 (C. Roth)), and Saltzer physicians such as Dr. Kaiser testified that the relationship succeeded in getting the parties “finally talking about” integration, the parties did not get “a whole lot of things accomplished” (Trial Tr. at 2373 (J. Kaiser)), and what limited success was achieved often took years to develop. Trial Tr. at 2227-28 (C. Roth).

30. In 2009, Saltzer initiated discussions with St. Luke’s regarding a closer affiliation. Trial Tr. at 2228-29 (C. Roth); Trial Tr. at 3345 (H. Kunz); Trial Tr. at 3081 (W. Savage). Negotiations between Saltzer and St. Luke’s progressed over approximately three years (Trial Tr. at 2237 (C. Roth)) and “evolved significantly” during that time. Trial Tr. at 1712 (D. Pate).

31. Effective December 31, 2012, St. Luke’s acquired the assets of Saltzer for an amount not to exceed $16,000,000. See St. Luke’s Answer (Dkt No. 100) at ¶18. Pursuant to this transaction (the “Acquisition”), St. Luke’s received Saltzer’s intangible assets, personal property, and equipment.

32. In addition, Saltzer, on behalf of its physicians, entered into a five-year professional services agreement (“PSA”) with St. Luke’s. See Exhibit 24.

33. The PSA guarantees Saltzer physicians’ annual compensation for the first two years after the agreement will be no less than the average for three years ending September 30, 2011. The PSA also specifies that Saltzer physicians will be compensated on the basis of work Relative Value Units (“wRVUs”) for the procedures and services performed by the physicians. See Exhibit 24 at SLHS000787894.
34. The PSA contains an “exclusivity” provision that prohibits the Saltzer physicians from becoming employed by or financially affiliated with other health systems or hospitals during the term of the PSA. *Id.* at §§ 3.2, 3.3, 4.1.

35. The PSA also provides that “all Saltzer physicians may have privileges at any hospital and may refer patients to any practitioner or facility regardless of its affiliation with St. Luke’s.” *Id.* at § 2.2(a).

The parties to the PSA uniformly interpret that provision to mean that Saltzer physicians have complete freedom to refer patients wherever they choose. *Trial Tr.* at 773 (N. Powell); *Trial Tr.* at 1958-60 (J. Kee); *Trial Tr.* at 2241-42 (C. Roth); *Trial Tr.* at 2387 (J. Kaiser).

36. Saltzer physicians currently have a guaranteed salary with additional compensation based on RVUs. *Trial Tr.* at 3321 (T. Patterson).

37. A plan to implement quality-based incentives was referenced in the PSA, but specific quality incentives were not built into the contract at the outset because, according to Dr. Patterson, “it takes time to develop what the outcome measures would be, and so it wasn’t something that could be established at the time.” *Trial Tr.* at 1337 (T. Patterson).

38. However, it was expected that compensation for the Saltzer physicians would include quality-based incentives in the future. *Trial Tr.* at 3326-27 (T. Patterson).

39. Saltzer and St. Luke’s have amended their initial PSA to include an addendum that provides for up to 20 percent of Saltzer’s compensation being put at risk or otherwise tied to quality-based incentives. *See* Exhibit 2624; *Trial Tr.* at 3327 (T. Patterson).
40. There is nothing in the PSA that expressly ties compensation for the Saltzer physicians to where they make referrals or to the volume or revenue generated by Saltzer physicians for ancillary services, such as laboratory or imaging services.

41. Saltzer’s primary motivation for affiliating with St. Luke’s was to provide the best possible health care to the community. *Trial Tr.* at 3313 (T. Patterson); *Trial Tr.* at 3346 (H. Kunz).

42. Saltzer believed that becoming “tightly aligned” with St. Luke’s increased the likelihood that St. Luke’s would invest the time, resources, and risk to bring much-needed additional services and facilities to Canyon County. *See Page Deposition (Dkt. No. 270)* at 130-31.

43. Saltzer physicians also considered it important that an affiliation with St. Luke’s would give them the ability to be “involved in all aspects of care rather than being fragmented as part of an outside system that works in concert with the health system but not integrated with the health system.” *Trial Tr.* at 3315 (T. Patterson).

44. Additionally, Saltzer did not believe that by itself, it was big enough, or had sufficient financial reserves, to engage in capitation (or value-based billing) that will be discussed in more detail below. *Trial Tr.* at 2374-75 (J. Kaiser).

45. Saltzer leadership believed that a closer affiliation was necessary to permit Saltzer to transition to value-based compensation, and did not view a joint venture or looser affiliation with St. Luke’s as sufficient. *Trial Tr.* at 3318, 3345-46 (T. Patterson).

46. It was also important to Saltzer that an affiliation with St. Luke’s would increase access to medical care for the significant population of Medicaid and Medicare
patients in Canyon County by enabling Saltzer to move away from providing fee-for-service care as an independent group, which required many Saltzer physicians to manage their patient populations to limit the number of Medicaid or uninsured patients they could accept. *Trial Tr.* at 787 (N. Powell); *Trial Tr.* at 3323 (T. Patterson).

47. Saltzer received almost $9 million in payment for goodwill and intangibles as part of the Acquisition—which does not have to be paid back if the Acquisition is undone. *Trial Tr.* at 244:5-11 (John Kaiser).

**Product Market**

48. With regard to the FTC action, there is no dispute that the relevant product market is Adult Primary Care Services sold to commercially insured patients (“Adult PCP services”). *See Proposed Findings of Defendants (Dkt. No. 404)* at ¶ 598; *Proposed Findings of Plaintiffs (Dkt. No. 430)* at ¶ 47.

49. Adult PCP services include physician services provided to commercially insured patients aged 18 and over by physicians practicing internal medicine, family practice, and general practice. *See Reinhardt Deposition (Dkt. No. 363)* at 134-35; *see generally Trial Tr.* at 1313 (Dr. Dranove).

**Geographic Market**

50. A proper geographic market is “an area of effective competition . . . where buyers can turn for alternate sources of supply.” Morgan, *Strand v. Radiology Ltd.* 924 F.2d 1484, 1490 (9th Cir. 1991) (quotations omitted).

52. Economists define a market by using the “hypothetical monopolist” or “SSNIP” test.

53. The SSNIP test evaluates whether all the sellers in the proposed candidate market would be able to impose a small but significant, non-transitory increase in price (SSNIP), which is generally 5 to 10 percent, and still make a profit. *Trial Tr.* at 1311-14 (Dr. Dranove).

54. When consumers are the direct purchasers of the product at issue, the SSNIP test evaluates whether the market sellers’ price hike would cause consumers to travel to adjacent areas where sellers offer lower prices, thereby making the price hike unprofitable. If that is likely, the market definition would need to be broadened to include those adjacent areas. *Id.*

55. In this case, however, the vast majority of health care consumers are not direct purchasers of health care – the consumers purchase health insurance and the insurance companies negotiate directly with the providers. The consumers pay indirectly through their insurance premiums and more directly through co-pays and deductibles. *Id.*

56. Under these circumstances, the SSNIP test examines the likely response of insurers to a hypothetical demand by all the PCPs in a particular market for a significant non-transitory reimbursement rate hike. *Id.*

57. If it is likely that the insurers would reject the demand, drop those PCPs from their network, and depend on PCPs in adjacent regions to provide care for their insureds,
the definition of the relevant market would need to be broadened to include those
adjacent regions. *Id.*

58. If, however, it is likely that the insurers would agree to the demand — that is, it is
likely that the PCPs in that particular market could successfully demand a SSNIP —
then the relevant market is the area where those PCPs practice. *Id.*

59. The largest insurer in Idaho is Blue Cross of Idaho (BCI). *Trial Tr.* at 305 (J.
Crouch).

60. BCI has PCPs in-network in every zip code where they have enrollees. BCI does not
require a single enrollee to travel outside of their zip code for primary care. *Trial Tr.*
at 1329 (Dr. Dranove).

61. BCI considers “primary care services in the direct community that the member
resides” to be a “threshold” consideration for an employer evaluating a potential
health plan. *Trial Tr.* at 230 (J. Crouch).

62. In many instances, if a health plan does not have primary care physicians close to a
potential client’s employees, the health plan will not even be considered an eligible
vendor for the employer. *Trial Tr.* at 235 (J. Crouch).

63. This applies to health plans offered to Nampa employers. St. Luke’s System Director
of Payer Contracting, Steve Drake, testified that the Board for St. Luke’s Select
Medical Network decided it should include Saltzer in the network because it needed
providers in Nampa in order to market itself to employers. *See Drake Deposition*
(*Dkt. No. 322*) at 181:19-183:3; Exhibit 1196
64. This is confirmed by the statistics showing where Nampa residents want to obtain their primary care.

65. 68% of Nampa residents get their primary care from providers who are located in Nampa. Trial Tr. at 1320 (Dr. Dranove).

66. Only 15% of Nampa residents obtain their primary care in Boise. Trial Tr. at 1320-21 (Dr. Dranove).

67. Those Nampa residents getting their primary care outside of Nampa “are getting their physician services near where they work. And this is basically confirming that patients like to get their medical care close to home.” Trial Tr. at 1320 (Dr. Dranove).

68. St. Luke’s Dr. Mark Johnson, a family practice physician with Mountain View Medical, a St. Luke’s Clinic located in West Boise, does not consider Saltzer to be a competitor because of its “geographic separation.” See Johnson Deposition (Dkt. No. 249) at 124:14-18; Trial Tr. at 1873:6-22 (Mark Johnson).

69. Because Nampa patients strongly prefer access to local PCPs, commercial health plans need to include Nampa PCPs in their networks to offer a competitive product. Health plans in the Treasure Valley consistently include Nampa-based PCPs in their provider networks. See Exhibit 1782 at Fig. 11; Trial Tr. at 1329-30 (Dr. Dranove).

70. A health plan could not successfully offer a network of PCP services to Nampa residents that only included Boise PCPs. As Dr. Dranove testified, that would be akin to the health plan saying to Nampa residents “I’m not going to have any doctors in Nampa, but don’t worry, if you want to have a convenient PCP, just get a job in
Boise, like the other folks who are seeing doctors in Boise.” Trial Tr. at 1324 (Dr. Dranove).

71. Given this dynamic – that health plans must offer Nampa Adult PCP services to Nampa residents to effectively compete – Nampa PCPs could band together and successfully demand a 5 to 10% price increase (or reimbursement increase) from health plans. Trial Tr. at 3434 (Dr. Dranove).

72. Thus, Nampa PCPs have the leverage with health plan networks to profitably impose a SSNIP in Nampa.

73. Nampa is therefore the relevant geographic market.

**Anticompetitive Effects – Market Share**

74. With the Acquisition, there is no dispute that St. Luke’s became the largest provider of adult primary care services in Nampa. See St. Luke’s Answer (Dkt. No. 100) at ¶3; see also Saltzer’s Answer (Dkt. No. 105) at ¶3.

75. Under the FTC’s *Merger Guidelines*, market concentration is “often one usual indicator of the likely competitive effects of a merger.” See *Merger Guidelines § 5.3 (Appendix B1).*

76. In evaluating market concentration, the FTC looks at both the pre- and post-merger market concentration.

77. The preeminent measure of market concentration is the Herfindahl–Hirschman Index (“HHI”). It is calculated by squaring the market share of each firm competing in a market and then summing the resulting numbers. The FTC uses HHI numbers to determine thresholds for when an industry is considered highly concentrated or when

78. A particular HHI will range anywhere from zero (representing an infinite number of very small providers) to 10,000 (representing one pure monopolist). *Trial Tr.* at 1336 (Dr. Dranove).

79. A market is considered highly concentrated if the HHI is above 2500, and a merger that increases the HHI by more than 200 points will be presumed to be likely to enhance market power. *See Merger Guidelines § 5.3.*

80. Combined, St. Luke’s and Saltzer account for nearly 80 percent of PCP services in Nampa. *Trial Tr.* at 1340 (Dr. Dranove); Exhibit 1789.

81. As a result of the merger between St. Luke’s and Saltzer, the Nampa market has a post-merger HHI of 6,219 and an increase in HHI of 1,607, both of which are well above the thresholds for a presumptively anticompetitive merger (more than double and seven times their respective thresholds, respectively). *Trial Tr.* at 1340-41 (Dr. Dranove).

82. The Acquisition is therefore presumptively anticompetitive under § 7 of the Clayton Act.

**Anticompetitive Effects – Saltzer Leverage pre-Acquisition**

85. There is evidence in addition to the HHI numbers that the Acquisition will have anticompetitive effects.

83. Saltzer is the preeminent group of primary care physicians in Canyon County. *Trial Tr.* at 2230 (testimony of St Luke’s CEO Christopher Roth that “Saltzer was and is an
incredibly well-respected group. They are the preeminent group, if you will, in the state of Idaho relative to multispecialty group practice. They know Nampa. They know Canyon County. They have the relationships. They have the trust of the community”).

84. The largest health plan in Idaho – Blue Cross of Idaho – considers Saltzer “to be a must have provider for Blue Cross in Nampa.” Trial Tr. at 331 (J. Crouch).

85. Ed Castledine (St. Luke’s Director of Business Development) sent a list of names of Nampa physicians in an e-mail to Chris Roth (St. Luke’s Regional Medical Center CEO) and remarked that “[t]his begins to show the dominance of Saltzer in the Nampa market . . . . Out of roughly 80 physicians in Nampa, Saltzer represents 47. If you add the [7 physicians St. Luke's hired from Nampa’s] Mercy Group, we have the opportunity to work exclusively with 54 of the 80.” See Exhibit 1281 at CON0007045; Castledine Deposition (Dkt. No. 262) at 120.

**Anticompetitive Effects – St. Luke’s Leverage pre-Acquisition**

86. Between January 2007 and January 2012, St. Luke’s acquired 49 physician clinics in the Treasure Valley and at least 28 physician practices in the Magic Valley. See Exhibit 2148 (identified at Trial Tr. 412-413 (J. Crouch)).

87. In 2007, according to BCI’s statistics, St. Luke’s Boise facility was receiving an average amount of reimbursement from BCI as compared to other facilities in Idaho, and St. Luke’s had just one hospital in the top five highest paid in Idaho.
88. By 2012, St. Luke’s had three of the top five highest paid hospitals, and its top hospital was receiving reimbursements 21% higher than the average Idaho hospital. *Trial Tr.* at 292 (J. Crouch); Exhibit 1300 at BCI368370.

89. If St. Luke’s chose not to contract with BCI, then BCI would have an “immediately unsustainable product” in the markets where St. Luke’s is a provider. *Trial Tr.* at 299 (J. Crouch).

**Anticompetitive Effects – St. Luke’s/Saltzer Leverage post-Acquisition**

97. A prominent report from the School of Public Health at U.C. Berkeley concluded that the recent trend of physician employment by hospitals increases costs because “larger physician groups with added bargaining power can negotiate for higher [reimbursement] rates.” *See Berkeley Forum, A New Vision* at p. 38 (Feb. 2013).

98. The Acquisition will increase substantially St. Luke’s bargaining leverage with health plans.

99. The Acquisition is not only a merger of the first and second largest providers for primary care services but is also a merger of each of those providers’ closest substitutes. *Trial Tr.* at 1437 (Dr. Dranove).

100. If St. Luke’s Nampa patients could not see St. Luke’s physicians, 50 percent of them would choose to go to Saltzer. *Trial Tr.* at 1351-52 (Dr. Dranove).

101. If Saltzer’s Nampa location were unavailable, one-third of its patients would switch to St. Luke’s – more than any other provider. *Trial Tr.* at 1352-53 (Dr. Dranove).
102. Thus, the Acquisition merges the closest substitutes for the two largest providers in Nampa. *Trial Tr.* at 1437 (Dr. Dranove).

103. Moreover, as discussed, consumers of health care are typically not direct purchasers of health care, and it is health insurers that are negotiating with providers.

104. And so bargaining leverage is a function of the relative strength of the insurer and the provider.

105. Bargaining leverage consists largely of the ability to walk away.

106. A buyer has leverage if he has acceptable alternatives to a seller driving a hard bargain.

107. Stripped of acceptable alternatives, the buyer’s leverage disappears.

108. Economists have an acronym for this process called BATNA – the best alternative to a negotiated agreement.

109. If a health plan were negotiating with Saltzer before the Acquisition, its best outside option for PCP services in Nampa was St. Luke’s. The best outside option for a health plan negotiating with St. Luke’s was Saltzer. For both examples, the merger takes away the health plan’s best outside option and makes less desirable the health plan’s BATNA. *Trial Tr.* at 1354 (Dr. Dranove); *Trial Tr.* 239 (J. Crouch).

110. After the Acquisition, if a health plan removed St. Luke’s/ Saltzer from its network in Nampa, patients would be forced to choose their third best option. That is not an attractive option for a health plan trying to market that network to patients who live in Nampa. *Trial Tr.* at 1305-06 (Dr. Dranove).
111. The Acquisition adds to St. Luke’s market power and weakens BCI’s ability to negotiate with St. Luke’s. As BCI’s Jeff Crouch explained, St. Luke’s is already the dominant provider in a number of markets, and the transaction extends their reach to the Nampa market. Trial Tr. at 311, 433 (J. Crouch).

112. BCI’s concerns are supported by an e-mail written by Christopher Roth (St. Luke’s Regional Medical Center CEO) to St. Luke’s CFO and COO. See Exhibit 1093 at SLHS0000006605. The purpose of the e-mail, written in December of 2011, was to identify ways to improve St. Luke’s financial performance in 2012. Id. The e-mail discussed revenue and volume shortfalls in 2011 and contained a plan for improvement. The e-mailed plan called for (1) reducing expenses, (2) increasing volume, and (3) a “Price Increase ($ Unknown).” Id. Under that heading of “Price Increase” was a bullet point stating: “Pressure Payors for new/directed agreements.” Id. In explaining this e-mail, Roth claimed that he did not mean that St. Luke’s could pressure payors for more reimbursement but rather could pressure them to direct more patients to St. Luke’s high quality and low cost clinics. Trial Tr. at 2339 (Roth). That explanation is not credible, however, given that the “pressure” language quoted above was contained under a heading entitled “Price Increase” and was part of a discussion of how to increase income. The point being made in the e-mail was that St. Luke’s should use its bargaining leverage to increase reimbursements from health plans.

113. Saltzer’s documents likewise confirm that the Acquisition will enhance its negotiating leverage. In an internal exchange, Nancy Powell (who at the time was Saltzer’s Chief Financial Officer) informed Dr. Page (Saltzer’s Chairman of the
Contracting Committee) that BCI’s changed policy on reimbursements for consults would cost Saltzer $22,000. See Exhibit 1361. Dr. Page responded that “this is a pretty big blow,” and he speculated that “[i]f our negotiations w/luke’s go to fruition, this will be something we could try to get back, i.e. consult codes, as there would be the clout of the entire network.” Id. (emphasis added).

114. Dr. Dranove testified that Dr. Page’s response in this e-mail informed his opinion that the Acquisition would enhance St. Luke’s/Saltzer’s bargaining leverage to the point where they could re-open past negotiations and take back past bargaining losses. Trial Tr. 1344-45 (Dr. Dranove).

115. St. Luke’s bargaining tactic is common. In a study by Casalino et. al. entitled “Benefits of and Barriers to Large Medical Group Practice in the United States,” the authors interviewed 195 leaders of physician groups, hospitals and health insurance plans, and obtained further information from 6,000 physicians. The authors sought to cull from these surveys the main benefits and barriers to large group practices as cited by these medical provider participants. What they found was this: “Gaining negotiating leverage with health insurance plans was the most frequently cited benefit; it was cited 8 times more often than improving quality.” Trial Tr. at 2671 (Dr. Enthoven)

116. St. Luke’s itself confirmed the importance of gaining negotiating leverage with health insurance plans. In a 2009 presentation to the Board of Directors discussing a plan to integrate physician practices with the hospital, St. Luke’s officials wrote that “St. Luke’s Treasure Valley recognizes that market share in primary care is a key
success factor, critical to sustaining a strong position relative to payer contracting . . . ” See Exhibit 1461 at SLHS000039821.

**Anticompetitive Effects – Twin Falls Example**

117. In the Twin Falls Idaho market, the dominant provider of primary care services was the Physician Center, managed by St. Luke’s. *Trial Tr.* at 241 (J. Crouch).

118. Between 2002 and 2009, BCI did not contract with this St Luke’s group, believing that there remained sufficient coverage with about 20 primary care providers within 15 miles and almost 50 primary care providers within 30 miles, including the Burley area. *Trial Tr.* at 244-45 (J. Crouch).

119. But patients did not want to drive that distance for primary care, and thus employers were purchasing “very little” insurance from BCI in this market during this six year period. *Trial Tr.* at 241, 245 (J. Crouch).

120. Eventually, the St. Luke’s negotiators had such leverage that BCI had no choice but to concede to their pricing proposal. *Trial Tr.* at 247 (J. Crouch).

**Anticompetitive Effects – Hospital-Based Billing**

121. It is likely that St Luke’s will exercise its enhanced bargaining leverage from the Acquisition to charge more services at the higher hospital-based billing rates. *Trial Tr.* at 1347 (Dr. Dranove).

122. The Berkeley Forum Study concluded that the recent trend of physician employment by hospitals increases costs because “physician reimbursement may be higher for services rendered at hospitals than in physicians’ offices . . . .” See *Berkeley Forum, supra* at p. 38.
123. St. Luke’s own analysis of the Acquisition considered the possibility that it could increase commercial reimbursements by insisting that health plans pay higher “hospital-based” rates for routine ancillary services, such as X-rays and laboratory tests, even when those services are performed in the same physical location as before the Acquisition. See Exhibit 1277, SLHS000820291 at SLHS000820297; Trial Tr. at 252-53 (J. Crouch).

124. Prior to the Acquisition, Saltzer performed many routine ancillary services at its own facilities. Such services included laboratory and diagnostic imaging, as well as therapy services and specialized facility services for colonoscopies and minor outpatient surgeries. Trial Tr. 252-53 (J. Crouch).

125. After the Acquisition, if St. Luke’s were to bill for these ancillary services at the higher “hospital-based” rates, BCI estimates that costs under its commercial contracts would increase by 30 to 35 percent. Trial Tr. 253-54 (J. Crouch).

126. St. Luke’s own analysis projected that it could gain an extra $750,000 through hospital-based billing from Saltzer from commercial payers for lab work and $900,000 extra for diagnostic imaging. See Exhibit 1277 at SLHS000820291, SLHS000820297; see also Trial Tr. at 1347 (Dr. Dranove) (testifying that St. Luke’s “thought that hospital-based billing alone could generate an extra $750,000 . . .”).

127. St. Luke’s planned to fund a 30% pay raise for its physicians in connection with the Acquisition by obtaining “higher hospital reimbursement” from the health plans. See Exhibit 1262 at 7.
128. Consultant Peter LaFluer prepared an analysis at the direction of St. Luke’s showing how office/outpatient visits could be billed for higher amounts if the visit was hospital-based rather than Saltzer-based. The hospital-based billings were more than 60% higher. See LaFluer Deposition (Exhibit 54) at 74; Trial Tr. at 735-36 (N. Powell); Exhibit 1480 at CON0000984-026, -027.

129. The leverage gained by the Acquisition would give St. Luke’s the ability to make these higher rates “stick” in future contract negotiations. Trial Tr. at 1347-49 (Dr. Dranove).

130. By increasing St. Luke’s relative leverage, the Acquisition will likely lead to higher reimbursements from health plans. Trial Tr. at 3425-26 (Dr. Dranove).

131. When health plans pay more, they pass that increase along to their customers in the form of higher premiums and higher out-of-pocket costs. Trial Tr. at 1309-10 (Dr. Dranove).

**Anti-competitive Effects – Referrals**

132. Patients largely accept the recommendations of their primary care physician as to what hospital, specialist, and ancillary services they should use. Trial Tr. at 1478-49 (D. Haas-Wilson) (“[T]he primary care providers are key to determining where patients receive their outpatient services, their ancillaries, and how they decide which hospital to use for their inpatient or outpatient services’’); Trial Tr. at 3058 (D. Argue) (“[M]any patients do not have a preference about where they are hospitalized and will just follow their physicians’ recommendations’’).
133. The Berkeley Forum Study concluded that the recent trend of physician employment by hospitals increases costs because “physicians may be influenced by hospitals to . . . increase referrals and admissions.” See Berkeley Forum, supra at p.38.

134. It is true that Saltzer physicians have complete discretion under the terms of the PSA in referring patients. See Exhibit 24 (PSA) at Section 2.2(a) (stating that Saltzer physicians “may refer patients to any practitioner or facility regardless of its affiliation with St. Luke’s”); Trial Tr. at 1649 (testimony of Dr. Pate, St. Luke’s CEO, that “as a physician, I would find it completely objectionable for us to direct where our physicians are supposed to refer business”).

135. While this complete discretion has been the rule for years, in practice that discretion has been exercised to favor the hospital where the physician was employed.


137. For example, before Idaho Cardiothoracic and Vascular Associates was purchased by St. Luke’s, 34% of their inpatient referrals were to St. Alphonsus in Boise. After

2 The five specialty care clinics were (1) Boise Orthopedic Clinic, (2) Idaho Cardiothoracic and Vascular Associates, (3) Idaho Pulmonary Associates, (4) Intermountain Orthopedics, and (5) Idaho Cardiology Associates.
the purchase, none were referred there, and all their referrals were to St. Luke’s. See Exhibit 1705.

138. Similarly, inpatient referrals from Boise Orthopedic Clinic to St. Alphonsus dropped from 57% to 6% after the purchase by St. Luke’s. Id.

139. This pattern carries over to the use of imaging services. After the group of seven primary care physicians previously with the Mercy Medical Group went to work for St. Luke’s, the percentage of imaging services they performed at St. Alphonsus fell from 81% to 19%. Trial Tr. at 1505 (D. Haas-Wilson).

140. After the Acquisition, it is virtually certain that this trend will continue and Saltzer referrals to St. Luke’s will increase.

**Anticompetitive Effects -- Conclusion**

141. The Acquisition results in a substantial market share for St. Luke’s in the Nampa market for primary care services.

142. After the Acquisition, St. Luke’s will have 80 percent of PCP services in Nampa, and the HHI in the Nampa market will be 6,219.

143. This substantial market share will give St. Luke’s a dominant bargaining position over health plans in the Nampa market.

144. It is highly likely that St. Luke’s will use its bargaining leverage over health plan payers to receive increased reimbursements that the plans will pass on to consumers in the form of higher health care premiums and higher deductibles.
145. Services that used to be performed outside the hospital setting will increasingly be referred to St Luke’s and billed out with the higher hospital-based billing rates, increasing the cost to the patient.

146. While the St. Luke’s/Saltzer entity will continue its outstanding quality of care, the cost of that care will rise as a result of the Acquisition.

**Efficiency Defense**

147. St Luke’s argues that the merger will create efficiencies that will far outweigh any anticompetitive effects.

148. As discussed further below in the Conclusions of Law section, the efficiencies must be merger-specific – that is, “they must be efficiencies that cannot be achieved by either company alone because, if they can, the merger’s asserted benefits can be achieved without the concomitant loss of a competitor.” *F.T.C. v. H.J. Heinz Co*, 246 F.3d 708, 722 (C.A.D.C. 2001).

149. St. Luke’s recognizes this requirement that the efficiencies be merger-specific, and argues that “[t]he transaction’s benefits are merger-specific because the transaction will enhance the ability of the combined St. Luke’s/Saltzer to offer coordinated, patient-centered care; to support physicians in the practice of evidence-based medicine in an environment that rewards teamwork and value of care rather than volume of care; to accept risk and accountability for patients’ outcomes; and to manage population health. Saltzer and St. Luke’s could not achieve these benefits as effectively or as quickly by any looser affiliation or other means.” *See Proposed Findings and Conclusions (Dkt. No.404) at ¶ 646.*
150. One of the driving forces behind the Acquisition is St. Luke’s desire to improve quality and reduce costs by moving toward value-based or risk-based care and away from fee-for-service (“FFS”) care.

151. The present system of fee-for-service reimbursement is a leading factor in rising health care costs.

152. Health care costs in the United States are at least twice that of other developed countries. See Trial Tr. at 191 (J. Crouch).

153. For example, in 2012, the per capita health expense in the United States was $8,233, more than twice the expense in France ($3974) or the United Kingdom ($3433), and nearly twice that of Germany ($4338) or Canada ($4445). See OECD Health Data 2012 (June 28, 2012).³

154. Despite, such extraordinary expense, the health care delivered in the United States is decidedly ordinary. In virtually every study comparing the quality of health care delivered to consumers, the United States is consistently in the middle of the pack among developed nations. See Why Not the Best? Results from the National Scorecard on U.S. Health System Performance (Oct. 2011).⁴

155. For example, the United States ranks last out of 16 industrialized countries on a measure of mortality amenable to medical care (deaths that might have been


prevented with timely and effective care), with premature death rates that are 68% higher than in the best-performing countries. *Id.*

156. In Idaho, health care costs are above even the already-high national average.

157. Idaho’s largest insurer, Blue Cross of Idaho (BCI), pays considerably more than what the average commercial insurance plans pays in the United States. *Trial Tr.* at 204 (J. Crouch).

158. Across the United States, the average commercial insurance plan pays about 120% of what Medicare pays. *Id.* For overnight hospital stays in Idaho, BCI pays between 150% to 200% more than Medicare pays. *Id.* at 211. For outpatient hospital services, BCI pays 300% more than Medicare. *Id.* For routine office visits, BCI pays 140% more than other commercial plans. *Id.* at 206.

159. Idaho’s reimbursement rate for routine office visits is higher than 95% of the rates paid by other insurance plans across the country. *Id.* at 224-225; see also Baker, Bundorf & Royalty, *Private Insurers’ Payments For Routine Physician Office Visits Vary Substantially Across The United States, in Health Affairs* (Sept. 2013) at 1583.

160. For other medical services, BCI pays between 175% and 200% more than Medicare. *Id.* at 204.

**Efficiency Defense – Elimination of Fee-For-Service Reimbursement System**

161. One reason – perhaps the principal reason – for the extraordinary cost of the U.S. health care system is our fee-for-service (FFS) reimbursement system. *Trial Tr.* at 191-92 (J. Crouch).
162. It is the primary way that health care providers are compensated under the current system in the U.S. and in Idaho. *Id.*

163. In the FFS system, providers are rewarded for doing more, whether or not more leads to better health outcomes. *See Trial Tr.* at 1608 (D. Pate).

164. The FFS system “incentivizes volume” because “the more services [physicians] perform, the more they can bill and the more they’re compensated.” *Trial Tr.* at 191-92 (J. Crouch).

165. For providers compensated on a FFS basis, there is no reward for teamwork or enhancing the value of care for patients. If a botched hip replacement must be redone, both surgeries will be paid for under the FFS system, providing no incentive to get it right the first time. *Trial Tr.* at 2578 (Dr. Enthoven).

166. Because of the focus on volume rather than value, the National Academy of Sciences estimates that 30% to 40% of health care spending is waste. *Id.* at 2573-74 (Dr. Enthoven).

167. The Berkeley Forum Report, endorsed by Dr. Enthoven at trial, concluded that “[o]ur predominately fee-for-service payment system often results in incentives that lead to uncoordinated care, fragmented care delivery, low-value services and suboptimal population health.” *See Berkeley Forum, supra,* at p. 40; *Trial Tr.* at 2606-10 (Dr. Enthoven).

168. To remedy this problem, the Berkeley Report recommended a movement toward integrated care and risk-based reimbursement. *Trial Tr.* at 2606-2610 (A. Enthoven).
169. The Berkeley Report concluded that “the few examples of fully-integrated delivery systems that exist today demonstrate that financial accountability for a population’s health is a very effective motivator of innovative practices in prevention, chronic disease management and care for seriously ill patients.” Berkeley at p. 13.

170. In an integrated delivery system, primary care physicians (“PCPs”) and specialty physicians work as a team, with PCPs managing patient care and specialty physicians consulting and providing care as needed. Trial Tr. at 2585-2586 (Dr. Enthoven).

171. In this integrated system, the primary care physician acts “as the coordinator and team leader” to “review the whole thing, make sure what’s needed is done and nothing falls between the cracks.” Id.

**Efficiency Defense – Move to Risk-Based Reimbursement System**

172. In this integrated system, providers receive reimbursement from insurers in the form of a set amount for each patient rather than a payment for each service rendered. The set amount is based on the average expected health care utilization for the patients given such factors as their age and medical history. This set amount is often referred to as “capitation.”

173. Capitation motivates providers to consider the costs of treatment as they will share in the savings if they can keep actual costs below the set amount they receive. Trial Tr. at 2576 (Dr. Enthoven)

174. For the same reason, providers have an incentive to practice preventative care and keep their patients healthy. Id. at 2572, 2574-2575 (Dr. Enthoven).
175. In the botched hip replacement example discussed above, capitation provides an incentive to get the operation done right the first time, and would financially punish providers whose shoddy work required a second surgery.

176. In addition to punishing errors, capitation promotes innovation. For example, when the Duke Medical School identified an improved procedure for treating coronary bypass patients that resulted in lower cost and better results for patients, reimbursement based on a capitation system would ensure that the innovation increased the School’s revenue while reimbursement based on an FFS system would have the opposite effect (because the volume of services declined). *Trial Tr.* at 2574 (Dr. Enthoven).

177. In this way, incentives are properly aligned between providers and patients, so that providers have incentives to provide higher-value care at lower cost—not to provide higher volume of care without regard to value. *Id.* at 2586-2587 (Dr. Enthoven).

**Efficiency Defense – Employed Physicians**

178. Integrated medicine is “team-based medicine,” and one way to create a committed and unified team of physicians is to employ them. *Trial Tr.* at 2611, 2616 (Dr. Enthoven).

179. Successful groups like Kaiser Permanente and the Cleveland Clinic have mostly employed physicians.

180. But physicians are committed to improving the quality of health care, and lowering its cost, whether they are employed or independent. *Trial Tr.* at 3524 (testimony of Dr. Kizer – board certified in six specialties and a professor at the...
University of California at Davis – that physicians are committed to improving quality, and citing a study finding 95% of physicians “recognize they have a responsibility for lowering the cost of healthcare”).

181. There is no empirical evidence to support the theory that St Luke’s needs a core group of employed primary care physicians beyond the number it had before the Acquisition to successfully make the transition to integrated care. *Trial Tr.* at 3538-39 (Dr. Kizer).

182. Integrated care – and risk-based contracting – do not require a large number of physicians because the health plans “manage the level of risk proportionate to the level of the provider organization.” *Trial Tr.* at 195 (J. Crouch).

183. In Idaho, independent physician groups are using risk-based contracting successfully. *Trial Tr.* at 195-96 (J. Crouch).

184. It is the committed team – and not any one specific organization structure – that is the key to integrated medicine. *Trial Tr.* at 3525 (Dr. Kizer).

185. Because a committed team can be assembled without employing physicians, a committed team is not a merger-specific efficiency of the Acquisition. *Trial Tr.* at 3558 (there are “alternative models [to employing physicians] . . . that are being widely utilized and can be utilized to achieve those same purposes”) (Dr. Kizer).

**Efficiency Defense – Shared Electronic Record**

186. An important component of integrated care delivery is a shared electronic record. *Trial Tr.* at 3540 (Dr. Kizer).
187. When a patient sees multiple providers for treatment, the electronic health record enables those providers not only to communicate with one another in real time, but also to have a complete picture of the medical progress of that patient as they consider their own treatment approach. *See Trial Tr.* at 1920 (J. Kee).

188. When, for example, a patient suffers from multiple conditions like diabetes, coronary artery disease, and depression, which require him to see a primary care physician, endocrinologist, cardiologist, and psychiatrist, the physicians can ensure, via the electronic health record, that none of their prescribed medications conflict, and that all services that need to be provided are made available. *See Trial Tr.* at 2586 (Dr. Enthoven).

189. The electronic health record improves preventative care. Physicians can categorize and track who, for example, is due for a mammogram or suffers from diabetes and does not have their blood sugar under control. *See Trial Tr.* at 2590 (Dr. Enthoven). This monitoring seeks to avoid preventable, serious episodes that would otherwise require costly treatment.

190. An electronic health record “can make health care delivery more efficient, cost-effective, and safe because it makes practice guidelines and evidence databases available to health care providers and improves computerized patient record accessibility.” *See Big Data, 99 Iowa L. Rev. 225 (Nov. 2013)* at 247-48.

191. Nevertheless, providers have generally “been slow to adopt [electronic health records] for financial reasons, since transitioning to electronic systems often entails high up-front costs for training and new infrastructure.” *Id.* at 248.
192. St. Luke’s is in the process of implementing Epic, an electronic health record that tracks, centralizes, and updates a patient’s family and medical history and, in turn, improves the continuity and coordination of care the patient receives across multiple providers. Transcript at 2796:13-2797:23 (M. Chasin).

193. The Epic system is “generally recognized at or near the top of . . . enterprise-wide patient health records systems.” Trial Tr. 1918-19 (J. Kee).

194. St. Luke’s presently has 500 providers on the system and has spent $40 million installing the system. Trial Tr. at 1919-20 (J. Kee).

195. Epic allows patients to get more involved in their own health care. Trial Tr. at 2798-99 (M. Chasin). Through its patient portal, MyChart, patients have secure email access to their physicians, as well as the ability to track and manage their appointments, view their lab results, and refill their prescriptions. Id. Patients can increase their participation in their own care without increasing the amount of time they need to spend in a physician’s office – or incur the costs of an office visit – to do so. Trial Tr. 2627-28 (Dr. Enthoven).

196. Furthermore, Epic allows physicians to share information across specialties, creating a complete picture of the patients’ treatment experiences. Trial Tr. at 1920-22 (J. Kee). Physicians can view the entire health history of a patient, including all of his or her lab work and radiological images, all of the contemporaneous notes physicians have made on the patient, all of the tests pending, and all of the preventative care measures outstanding. Trial Tr. at 2807 (M. Chasin).
197. Epic reduces errors resulting from incomplete information, as well as duplicative testing. *Trial Tr.* 1621-22 (D. Pate); *Trial Tr.* 1922 (J. Kee).

198. Epic also improves communication between providers and enhanced coordination of care. *Trial Tr.* 2047-48; 2097 (J. Souza).

199. To achieve all of these benefits, it is crucial that all physicians – whether employed by St. Luke’s or practicing independently – have access to Epic. *Trial Tr.* at 3549 (testimony by Dr. Kizer that “interoperability is both a business imperative as well as national policy”); *Trial Tr.* at 1658 (testimony by Dr. Pate, St. Luke’s CEO, that “[t]he delivery system necessary to provide this population health management will include St. Luke’s, but includes many independent physicians and facilities all working together around the state”).

200. The numerous benefits of Epic listed above would be severely reduced if that system was off limits to independent doctors. *Trial Tr.* at 3546 (testimony by Dr. Kizer that “if one’s intent is to optimize quality and lower costs, you want maximum ability of information, which means that you would want to be able to connect with as many other providers as possible and share information”).

201. To ensure that Epic is accessible, St Luke’s is developing the Affiliate Electronic Medical Records program that would allow independent physicians access to Epic. *Trial Tr.* at 3545 (Dr. Kizer).

202. The Affiliate program would allow independent physicians to share in Epic’s health records so long as those physicians were willing “to adhere to very significantly rigid standards.” *Trial Tr.* at 1961 (J. Kee).

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203. St. Luke’s plans to roll out the Affiliate program in April of 2014, and already has about 15 groups showing interest. Trial Tr. at 1964, 2006 (J. Kee).

204. These circumstances demonstrate that the efficiencies resulting from the use of Epic do not require the employment of physicians and hence are not merger-specific.

205. The same analysis applies to the White Cloud data analytics tool. Trial Tr. at 3562 (testimony from Dr. Kizer that “independent physicians currently use and have available to them a wide array of . . . data analytics tools . . .”).

206. For all of these reasons, the efficiencies resulting from Epic and White Cloud are not merger-specific.

**Entry Defense**

207. St. Luke’s raises the defense that other providers will enter the Nampa market and compete, thereby mitigating any anticompetitive effects of the Acquisition.

208. As will be discussed further in the Conclusions of Law section below, St. Luke’s must show that entry by competitors will be “timely, likely, and sufficient in its magnitude, character and scope to deter or counteract the competitive effects” of a proposed transaction. See Merger Guidelines § 9; FTC v. Procter & Gamble, Co., 386 U.S. 568, 579 (1967).

209. It is difficult to recruit family doctors to Canyon County. Trial Tr. at 1179 (David Peterman).

210. Younger doctors prefer to live and practice in Ada County. Trial Tr. at 1181 (David Peterman).
211. Recruiting general internists has been difficult because there is a tendency among internal medicine physicians who finish their residencies either to go into a hospitalist program, which is just inpatient medicine, or to go on to various subspecialties like cardiology or pulmonology. *Trial Tr.* at 714 (Nancy Powell).

212. In 2013, SAMG was not able to recruit any family practice doctors to Nampa. *Trial Tr.* at 715:5-7 (Nancy Powell).

213. SAMG has also been unable to recruit any pediatricians or general internists to Nampa in the last two years. *Trial Tr.* at 713-14 (Nancy Powell).

214. Given these circumstances, the Court cannot find that entry of competitors is likely to mitigate the anticompetitive effects of the Acquisition.

**Conclusions of Law**

**Jurisdiction**

1. This is a civil action arising under Section 7 of the Clayton Act, 15 U.S.C. § 18, and the Idaho Competition Act, Idaho Code § 48-106.\(^5\)


6. Defendant Saltzer Medical Group, P.A. is, and at all relevant times has been, engaged in activities in or affecting “commerce” as defined in Section 4 of the FTC Act, 15 U.S.C. § 44 (2006), and Section 1 of the Clayton Act, 15 U.S.C. § 12 (2006). It has also engaged in “Idaho Commerce” as defined in Idaho Code Section 48-103(1) of the Idaho Competition Act.

F.2d 1206, 1214–15 (11th Cir. 1991) (holding that 15 U.S.C. § 21 makes clear that the FTC’s enforcement of Section 7 applies to asset acquisitions by nonprofit hospitals).

8. Because the FTC has jurisdiction to enforce Section 7 against St. Luke’s and Saltzer, it has the authority under Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), to bring this civil action asking this Court, “after proper proof,” to issue a permanent injunction and grant other equitable relief. 15 U.S.C. § 53(b); Univ. Health, 938 F.2d at 1217 n.23 (holding that “Section 13(b) authorizes the FTC to seek injunctive relief against violations of ‘any provision of law enforced by [it]’); see also FTC v. H.N. Singer, Inc., 668 F.2d 1107, 1111 (9th Cir. 1982) (holding that “[Section] 13(b) gives the Commission the authority to seek, and gives the district court the authority to grant, permanent injunctions in proper cases even though the Commission does not contemplate any administrative proceedings”).

9. St. Luke’s and Saltzer transact business in the District of Idaho and are subject to personal jurisdiction here. See St. Luke’s Answer (Dkt. No. 100) at ¶12; Saltzer’s Answer (Dkt. No. 105) at ¶12. Venue is therefore proper in this district under 28 U.S.C. § 1391(b) and (c) and under 15 U.S.C. § 53(b).

Clayton Act

10. The Acquisition is illegal under Section 7 of the Clayton Act if “the effect of such acquisition may be substantially to lessen competition.” 15 U.S.C. § 18.
11. Congress used the words “may be” “to indicate that its concern was with probabilities, not certainties.” Brown Shoe Co., Inc. v. United States, 370 U.S. 294, 323 (1962).


13. At the same time, § 7 deals with “probabilities” and not “ephemeral possibilities” of anticompetitive effects. Brown Shoe, 370 U.S. at 323; United States v. Marine Bancorporation, Inc., 418 U.S. 602, 622–23 (1974) (rejecting claim that was “considerably closer to ‘ephemeral possibilities’ than to ‘probabilities’”).

14. Section 7 necessarily “requires a prediction” of a transaction’s likely competitive effect, and “doubts are to be resolved against the transaction.” FTC v. Elders Grain, Inc., 868 F.2d 901, 906 (7th Cir. 1989).

15. Although the burden of persuasion always remains firmly on the plaintiffs in a § 7 case, the burden of production shifts based on the plaintiffs’ and defendants’ showings. See, e.g., United States v. Citizens & S. Nat’l Bank, 422 U.S. 86, 120 (1975).

16. First the plaintiffs must show that the Acquisition would produce “a firm controlling an undue percentage share of the relevant market, and [would] result[ ] in a significant increase in the concentration of firms in that market.” Philadelphia Nat’l Bank, 374 U.S. at 363.
17. Such a showing establishes a “presumption” that the merger will substantially lessen competition. *Heinz*, 246 F.3d at 715.

18. To rebut the presumption, the defendants must produce evidence clearly showing that the market’s concentration inaccurately predicts the likely competitive effects of the transaction. *United States v. Marine Bancorporation, Inc.*, 418 U.S. 602, 631 (1974).

19. This rebuttal evidence could take the form of a showing that “the anticompetitive effects of the merger will be offset by efficiencies resulting from the union of the two companies.” *Heinz*, 246 F.3d at 715

20. Other forms of rebuttal evidence may include a showing of “ease of entry into the market, the trend of the market either toward or away from concentration, and the continuation of active price competition.” *Heinz*, 246 F.3d at 715 n. 7.

21. If the defendant successfully rebuts the presumption of illegality, the burden of producing additional evidence of anticompetitive effect shifts to the plaintiffs, and merges with the ultimate burden of persuasion, which remains with the plaintiffs at all times. *Id.* at 715.

**Idaho Competition Act**

22. Like Section 7 of the Clayton Act, the Idaho Competition Act prohibits acquisitions that may substantially lessen competition. Idaho Code § 48-106. Because the provisions of the Idaho Competition Act “shall be construed in harmony with federal judicial interpretation of comparable federal antitrust
statutes,” the antitrust analysis under the Clayton Act applies equally to the Idaho

**FTC’s Prima Facie Case**

23. Adult PCP services sold to commercially insured patients in Nampa constitutes the
relevant product and geographic markets for purposes of analysis under § 7 of the
Clayton Act.

24. The Acquisition will result in a post-merger HHI of 6,219 and an increase in HHI
of 1,607, far above the levels necessary to trigger the presumption that the
combined entity will lessen competition. *See Merger Guidelines § 5.3.*

25. Moreover, it is highly likely that the combined entity will use its substantial
market share (1) to negotiate higher reimbursements with health plans, and (2)
charge more services at the higher hospital billing rates. This will raise costs to
consumers.

26. For all these reasons, the plaintiffs have established a prima facie case that the
Acquisition is anti-competitive. *Heinz*, 246 F.3d at 716.

**Defense – Ease of Entry**

27. St. Luke’s raises the defense that other providers will enter the Nampa market and
compete, thereby mitigating any anticompetitive effects of the Acquisition.

28. To constitute a defense, St. Luke’s must show that entry by competitors will be
“timely, likely, and sufficient in its magnitude, character and scope to deter or
counteract the competitive effects” of a proposed transaction. *See Merger
29. The higher the barriers to entry, as in this case, the less likely it is that the “timely, likely, and sufficient” test can be met. *United States v. Visa U.S.A., Inc.*, 163 F.Supp.2d 322, 342 (S.D.N.Y.2001), *aff’d*, 344 F.3d 229, 240 (2d Cir.2003).

30. In assessing the evidence, the “history of entry into the relevant market is a central factor in assessing the likelihood of entry in the future.” *F.T.C. v Cardinal Health*, 12 F.Supp.2d 34, 56 (D.C.D.Ct. 1998); *see also* Horizontal Merger Guidelines § 9 (“Recent examples of entry, whether successful or unsuccessful, generally provide the starting point for identifying the elements of practical entry efforts.”).

31. That history, discussed in the Findings of Fact section above, demonstrates that entry into the market has been very difficult and would not be timely to counteract the anticompetitive effects of the Acquisition.

32. Those Findings demonstrated how difficult it is to recruit primary care physicians into Canyon County, and how difficult it is for new primary care physicians to open an office, hire staff, earn a reputation, and develop a practice with the quality to compete with St. Luke’s/Saltzer.

33. St. Luke’s has not carried its burden of proving that entry is likely and will be timely.

**Defense – Efficiencies Defense**

36. St. Luke’s argues that the merger will create efficiencies that will far outweigh any anticompetitive effects.

37. This defense requires “convincing proof” of “significant” and “merger-specific” efficiencies arising as a result of the merger. *Areeda* at ¶ 971, p. 48.
38. Although the Supreme Court has not sanctioned the use of the efficiencies defense in a section 7 case, see Procter & Gamble Co., 386 U.S. at 580, the trend among lower courts is to recognize the defense. See, e.g., F.T.C. v. H.J. Heinz Co, 246 F.3d 708, 720 (C.A.D.C. 2001).

39. When high market concentrations will result from the merger, the defense requires “proof of extraordinary efficiencies.” Id.

40. Professor Areeda explains that an “extraordinary” showing is necessary when the “post merger market's HHI is well above 1800 and the HHI increase is well above 100 . . . [because] the likelihood of a significant price increase is particularly large . . . .” 4A Areeda, et al., Antitrust Law ¶ 971f, at 48.

41. Moreover, given high concentration levels, “courts must undertake a rigorous analysis of the kinds of efficiencies being urged by the parties in order to ensure that those ‘efficiencies’ represent more than mere speculation and promises about post-merger behavior.” Heinz, 246 F.3d at 721.

42. The efficiencies must be merger-specific – that is, “they must be efficiencies that cannot be achieved by either company alone because, if they can, the merger’s asserted benefits can be achieved without the concomitant loss of a competitor.” Heinz, 246 F.3d at 722.

43. The Merger Guidelines “credit only those efficiencies likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects.” See Merger Guidelines at § 10.
44. St. Luke’s believed that the best way to create the unified and committed team of physicians required to practice integrated medicine was to employ them.

45. St. Luke’s followed this strategy to improve the quality of medical care.

46. However, the Findings of Fact demonstrate that while employing physicians is one way to put together a unified and committed team of physicians, it is not the only way. The same efficiencies have been demonstrated with groups of independent physicians.

47. There are a number of organizational structures that will create a team of unified and committed physicians other than that selected by the Acquisition, a structure that employs physicians and creates a substantial concentration of market power.

48. Moreover, the efficiencies of a shared electronic record can be similarly achieved even without the Acquisition, and thus these efficiencies are also not merger-specific.

49. The Court finds that St. Luke’s has not carried its burden of showing convincing proof of significant and merger-specific efficiencies arising as a result of the Acquisition.

**Remedy**


51. Divestiture “should always be in the forefront of a court’s mind when a violation of Section 7 has been found.” *Ash Grove Cement Co. v. FTC*, 577 F.2d 1368, 1380 (9th Cir. 1978).
52. In *Garabet*, the Circuit stated that “the costs and complexities of unwinding a merger may be considered in evaluating prejudice to the affected parties.” *Garabet*, 116 F. Supp. 2d at 1173.

53. However, in this case, St. Luke’s represented to the Court that “we will not oppose divestiture on grounds that divestiture cannot be accomplished.” *Transcript of Preliminary Injunction Hearing (Dkt. No. 49)* at 87–88; *see also* TX 2625 (letter by St Luke’s to St. Al’s stating that St. Luke’s “would not argue that “the transaction should not be unwound because doing so would be costly or burdensome”).

54. Thus, the cost and complexity of unwinding the transaction is no defense to divestiture.

55. St. Luke’s argues, however, that an unwound Saltzer will be significantly and negatively affected due to the departure of seven surgeons from Saltzer to St. Al’s.

56. While it is true that the loss of the seven surgeons was a financial hardship to Saltzer, *see Trial Tr. at 3235 (L. Ahern)*, they left in large part because of the Acquisition. *See Trial Tr. at 2486-97 (Dr. Williams).*

57. If Saltzer’s weakness (the loss of seven surgeons) was caused by the Acquisition, St. Luke’s cannot raise that weakness as a reason to hold together the Acquisition.

58. Moreover, any financial hardship to Saltzer will be mitigated by St. Luke’s payment of $9 million for goodwill and intangibles as part of the Acquisition, a payment that does not have to be paid back if the Acquisition was undone. *Trial Tr. at 244 (J. Kaiser).*

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59. The Court also rejects St. Luke’s proposal that divestiture be dropped as a remedy in favor of ordering that St. Luke’s and Saltzer negotiate separately with health plans, *Trial Tr.* at 167-68 (Jack Bierig).

60. A similar proposal was rejected in *In re ProMedica Health Sys., Inc.*, No. 9346, 2012 WL 1155392, at *48 (FTC June 25, 2012).

61. In that case, two merging hospitals proposed maintaining two separate negotiating teams that would prevent anticompetitive effects while addressing concerns about the financial viability of one of the hospitals. The F.T.C. rejected the argument, citing case law favoring divestiture. Responding to an argument that the separate negotiating team remedy had been approved in a past case, the F.T.C. noted that the remedy had only been approved because the entities had fully integrated seven years earlier, making divestiture unworkable. The F.T.C. distinguished that past case on the ground that the parties in the case now before it – just like the parties here – had not fully integrated.

62. The Court finds *ProMedica* persuasive and will likewise reject the separate negotiating teams remedy.

**Private Plaintiffs’ Claims**

63. The Private Plaintiffs (but not the Government Plaintiffs) allege anticompetitive effects in four additional markets: (1) general pediatric physician services sold to commercial payors in Nampa; (2) general acute care inpatient hospital services in Ada and Canyon Counties, (3) neurosurgery and orthopedic (“neuro+ortho”)
outpatient surgical facility services in Ada and Canyon Counties, and (4) general surgery outpatient surgical facility services in Ada and Canyon Counties.

64. The Court need not resolve the issues raised by the private plaintiffs because the Acquisition is being unwound due to its effects in the Nampa market for primary physician services.

65. Thus, the Court need not address whether the Acquisition would have violated § 7 in other markets.

Conclusion

66. Health care is at a crisis point. Nationally, quality lags far behind the inexorable rise in prices. This has created a groundswell of demand for change.

67. One change universally recommended is to move away from fee-for-service reimbursement and toward integrated care and risk-based reimbursement, where payment is made on the basis of patient outcomes, not the volume of services.

68. This is a major change and is slowly being implemented.

69. This period of change might be best described as being in an experimental stage, where hospitals and other providers are examining different organizational models, trying to find the best fit.

70. To be part of this experimental wave moving toward integrated care, St. Luke’s and Saltzer agreed on the Acquisition.

71. The Acquisition is an attempt by St. Luke’s and Saltzer to improve the quality of medical care.
72. But the particular structure of the Acquisition – creating such a huge market share for the combined entity – creates a substantial risk of anticompetitive price increases.

74. More specifically, there is a substantial risk that the combined entity will use its dominant market share (1) to negotiate higher reimbursements with health plans, and (2) charge more services at the higher hospital billing rates. This will raise costs to consumers.

75. As discussed above, this has been the result in the past when St. Luke’s has achieved bargaining leverage over health insurers.

76. In a world that was not governed by the Clayton Act, the best result might be to approve the Acquisition and monitor its outcome to see if the predicted price increases actually occurred. In other words, the Acquisition could serve as a controlled experiment.

77. But the Clayton Act is in full force, and it must be enforced. The Act does not give the Court discretion to set it aside to conduct a health care experiment.

78. For all of the reasons set forth above, the Court finds that the Acquisition violates § 7 of the Clayton Act and the Idaho Competition Act.

79. The Court will permanently enjoin the Acquisition under § 7 of the Clayton Act and the Idaho Competition Act.

80. The Court will order St. Luke’s to fully divest itself of Saltzer’s physicians and assets and take any further action needed to unwind the Acquisition.
81. While the plaintiffs ask the Court to order St. Luke’s to notify the Government plaintiffs in advance of any future acquisitions of physician groups, the Court does not find such a remedy appropriate.

82. The Court will file a separate Judgment as required by Rule 58(a).

DATED: January 24, 2014

B. Lynn Winmill
Chief Judge
United States District Court
FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

SAINT ALPHONSOUS MEDICAL CENTER - NAMPA INC.; SAINT ALPHONSOUS HEALTH SYSTEM INC.; SAINT ALPHONSOUS REGIONAL MEDICAL CENTER, INC.; TREASURY VALLEY HOSPITAL LIMITED PARTNERSHIP; FEDERAL TRADE COMMISSION; STATE OF IDAHO, Plaintiffs-Appellees,

and

IDAHO STATESMAN PUBLISHING, LLC; THE ASSOCIATED PRESS; IDAHO PRESS CLUB; IDAHO PRESS-TRIBUNE LLC; LEE PUBLICATIONS INC., Intervenors,

v.

ST. LUKE’S HEALTH SYSTEM, LTD.; ST. LUKE’S REGIONAL MEDICAL CENTER, LTD.; SALZER MEDICAL GROUP, Defendants-Appellants.

No. 14-35173

D.C. Nos.
1:12-cv-00560-BLW
1:13-cv-00116-BLW

OPINION
ST. ALPHONSUS MED. CTR. v. ST. LUKE’S HEALTH SYS.

Appeal from the United States District Court
for the District of Idaho
B. Lynn Winmill, Chief District Judge, Presiding

Argued and Submitted
November 19, 2014—Portland, Oregon

Filed February 10, 2015

Before: Richard R. Clifton, Milan D. Smith, Jr.,
and Andrew D. Hurwitz, Circuit Judges.

Opinion by Judge Hurwitz
SUMMARY

Clayton Act

The panel affirmed the district court’s judgment in favor of the Federal Trade Commission, the State of Idaho, and two local hospitals, holding that the 2012 merger of two health care providers in Nampa, Idaho, violated § 7 of the Clayton Act.

Section 7 of the Clayton Act bars mergers whose effect “may be substantially to lessen competition, or to tend to create a monopoly.” The plaintiff must first establish a prima facie case that a merger is anticompetitive, and the burden then shifts to the defendant to rebut the prima facie case.

The panel held that the district court did not clearly err in determining that Nampa, Idaho, was the relevant geographic market. The panel also held that the district court did not clearly err in its factual findings that the plaintiffs established a prima facie case that the merger will probably lead to anticompetitive effects in that market. The panel further held that a defendant can rebut a prima facie case with evidence that the proposed merger will create a more efficient combined entity and thus increase competition. The panel held that the district court did not clearly err in concluding that the defendant did not rebut the plaintiffs’ prima facie case where the defendant did not demonstrate that efficiencies resulting from the merger would have a positive effect on

* This summary constitutes no part of the opinion of the court. It has been prepared by court staff for the convenience of the reader.
competition. Finally, the panel held that the district court did not abuse its discretion in choosing a divestiture remedy.

COUNSEL


Keely E. Duke, Duke Scanlan Hall PLLC, Boise, Idaho; David A. Ettinger (argued), Honigman Miller Schwartz & Cohn LLP, Detroit, Michigan, for Plaintiffs-Appellees Saint Alphonsus Medical Center-Nampa Inc.; Saint Alphonsus Health System Inc.; Saint Alphonsus Regional Medical Center, Inc.


Lawrence G. Wasden, Attorney General, Brett T. DeLange, Deputy Attorney General, Deborah L. Feinstein, Director, Bureau of Competition, J. Thomas Greene, Peter C. Herrick, Henry C. Su, Boise, Idaho; Jonathan E. Nuechterlein, General Counsel, David C. Shonka, Principal Deputy General Counsel, Joel Marcus (argued), Washington, D.C., for
ST. ALPHONSUS MED. CTR. V. ST. LUKE’S HEALTH SYS.


Barbara D.A. Eyman, Eyman Associates, PC, Washington, D.C., for Amicus Curiae America’s Essential Hospitals.


Joe R. Whatley, Jr., Edith M. Kallas, Whatley Kallas, LLP, New York, New York, for Amici Curiae Economics Professors.


Kamala D. Harris, Attorney General of California, Mark Breckler, Chief Assistant Attorney General, Kathleen E. Foote, Senior Assistant Attorney General, Emilio Varanini, Deputy Attorney General, San Francisco, California; Robert W. Ferguson, Attorney General of Washington, Darwin P.
HURWITZ, Circuit Judge:

This case arises out of the 2012 merger of two health care providers in Nampa, Idaho. The Federal Trade Commission ("FTC") and the State of Idaho sued, alleging that the merger violated § 7 of the Clayton Act, 15 U.S.C. § 18, and state law; two local hospitals filed a similar complaint. Although the district court believed that the merger was intended to improve patient outcomes and might well do so, the judge nonetheless found that the merger violated § 7 and ordered divestiture.

As the district court recognized, the job before us is not to determine the optimal future shape of the country’s health care system, but instead to determine whether this particular merger violates the Clayton Act. In light of the careful factual findings by the able district judge, we affirm the judgment below.

I. Background

A. The Health Care Market in Nampa, Idaho

Nampa, the second-largest city in Idaho, is some twenty miles west of Boise and has a population of approximately 85,000. Before the merger at issue, St. Luke’s Health Systems, Ltd. ("St. Luke’s"), an Idaho-based, not-for-profit health care system, operated an emergency clinic in the city. Saltzer Medical Group, P.A. ("Saltzer"), the largest independent multi-specialty physician group in Idaho, had thirty-four physicians practicing at its offices in Nampa. The only hospital in Nampa was operated by Saint Alphonsus
Health System, Inc. (“Saint Alphonsus”), a part of the multistate Trinity Health system. Saint Alphonsus and Treasure Valley Hospital Limited Partnership (“TVH”) jointly operated an outpatient surgery center.¹

The largest adult primary care physician (“PCP”) provider in the Nampa market was Saltzer, which had sixteen PCPs.² St. Luke’s had eight PCPs and Saint Alphonsus nine. Several other PCPs had solo or small practices.

B. The Challenged Acquisition

Saltzer had long had the goal of moving toward integrated patient care and risk-based reimbursement. After unsuccessfully attempting several informal affiliations, including one with St. Luke’s, Saltzer sought a formal partnership with a large health care system.

In 2012, St. Luke’s acquired Saltzer’s assets and entered into a five-year professional service agreement (“PSA”) with the Saltzer physicians (the “merger” or the “acquisition”).³ Saltzer received a $9 million payment for goodwill. The initial PSA contained hortatory language about the parties’

¹ For simplicity, this opinion sometimes refers to St. Luke’s and Saltzer collectively as “St. Luke’s,” and Saint Alphonsus and TVH collectively as the “Private Hospitals.”

² The district court found that “[a]dult PCP services include physician services provided to commercially insured patients aged 18 and over by physicians practicing internal medicine, family practice, and general practice.”

³ The parties and the district court regarded the PSA as the functional equivalent of an employment agreement, and we assume the same.
desire to move away from fee-for-service reimbursement, but included no provisions implementing that goal. An amended PSA, however, contained some quality-based incentives. The merger did not require Saltzer doctors to refer patients to the St. Luke’s Boise hospital, nor did it require that Saltzer physicians use St. Luke’s facilities for ancillary services.

C. Procedural History

In November 2012, the Private Hospitals filed a complaint in the District of Idaho seeking to enjoin the merger under Clayton Act § 7. The complaint alleged anticompetitive effects in the relevant markets for “primary care physician services,” “general acute-care inpatient services,” “general pediatric physician services,” and “outpatient surgery services.” The district court denied a preliminary injunction, noting that: (1) the PSA did not require referrals to St. Luke’s, minimizing any immediate harm to the Private Hospitals; (2) implementation of the PSA was to take place over time; and (3) the PSA provided a process for unwinding the transaction if it were declared illegal.

In March 2013, the FTC and the State of Idaho filed a complaint in the district court seeking to enjoin the merger pursuant to the Federal Trade Commission Act (“FTC Act”), the Clayton Act, and Idaho law. This complaint alleged

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4 The Private Hospitals filed an amended complaint in January 2013.

5 The Idaho Competition Act is “construed in harmony” with federal antitrust law, Idaho Code §§ 48-102(3), -106, and the district court held that the antitrust analysis is the same for each. The parties do not contend otherwise.
anticompetitive effects only in the adult PCP market. The district court consolidated this case with the one filed by the Private Hospitals, and after a nineteen-day bench trial, found the merger prohibited by the Clayton Act and the Idaho Competition Act because of its anticompetitive effects on the Nampa adult PCP market.\(^6\)

The district court expressly noted the troubled state of the U.S. health care system, found that St. Luke’s and Saltzer genuinely intended to move toward a better health care system, and expressed its belief that the merger would “improve patient outcomes” if left intact. Nonetheless, the court found that the “huge market share” of the post-merger entity “creates a substantial risk of anticompetitive price increases” in the Nampa adult PCP market. Rejecting an argument by St. Luke’s that anticipated post-merger efficiencies excused the potential anticompetitive price effects, the district court ordered divestiture. This appeal followed.

II. Standard of Review

We review the district court’s findings of fact for clear error and its conclusions of law de novo. *Husain v. Olympic Airways*, 316 F.3d 829, 835 (9th Cir. 2002), aff’d, 540 U.S. 644 (2004). The question is whether a finding of fact is “clearly erroneous,” not whether there is a “compelling case” for an alternative finding. *California v. Am. Stores Co.*, 872 F.2d 837, 842 (9th Cir. 1989), rev’d on other grounds, 495 U.S. 271 (1990). The district court’s choice of remedy is reviewed for abuse of discretion. *Theme Promotions, Inc.*

\(^6\) The court therefore did not address the Private Hospitals’ contentions with respect to the other product markets.
v. News Am. Mktg. FSI, 546 F.3d 991, 1000 (9th Cir. 2008) (citing United States v. Alisal Water Corp., 431 F.3d 643, 654 (9th Cir. 2005)).

III. The Clayton Act § 7 Analysis

A. Overview of the Clayton Act

The great Yankee catcher Yogi Berra is reputed (likely apocryphally) to have said that it’s “tough to make predictions, especially about the future.” The Perils of Prediction, Economist, June 2, 2007, at 96. Yet that is precisely what this case requires. Because § 7 of the Clayton Act bars mergers whose effect “may be substantially to lessen competition, or to tend to create a monopoly,” 15 U.S.C. § 18, judicial analysis necessarily focuses on “probabilities, not certainties,” Brown Shoe Co. v. United States, 370 U.S. 294, 323 (1962). This “requires not merely an appraisal of the immediate impact of the merger upon competition, but a prediction of its impact upon competitive conditions in the future; this is what is meant when it is said that the amended § 7 was intended to arrest anticompetitive tendencies in their incipiency.” United States v. Phila. Nat’l Bank, 374 U.S. 321, 362 (1963) (internal quotation marks omitted).

Section 7 claims are typically assessed under a “burden-shifting framework.” Chi. Bridge & Iron Co. v. FTC, 534 F.3d 410, 423 (5th Cir. 2008). The plaintiff must first

7 This quotation is not included in the definitive book of Berra quotations, see Yogi Berra, The Yogi Book: “I Really Didn’t Say Everything I Said!” (1998), and its provenance is at best unclear, see, e.g., The Yale Book of Quotations 92 (Fred R. Shapiro ed., 2006) (attributing a variant to Niels Bohr, but noting that the exact authorship is disputed).
establish a prima facie case that a merger is anticompetitive. See Olin Corp. v. FTC, 986 F.2d 1295, 1305 (9th Cir. 1993) (discussing how plaintiff’s establishment of a prima facie case on statistical evidence was the first step in the analysis). The burden then shifts to the defendant to rebut the prima facie case. See id.; Am. Stores, 872 F.2d at 842 (citing United States v. Marine Bancorporation, Inc., 418 U.S. 602, 631 (1974)). “[I]f the [defendant] successfully rebuts the prima facie case, the burden of production shifts back to the Government and merges with the ultimate burden of persuasion, which is incumbent on the Government at all times.” Chi. Bridge & Iron, 534 F.3d at 423.8

B. The Relevant Market

“Determination of the relevant product and geographic markets is a necessary predicate to deciding whether a merger contravenes the Clayton Act.” Marine Bancorporation, 418 U.S. at 618 (internal quotation marks omitted). Definition of the relevant market is a factual question “dependent upon the special characteristics of the industry involved and we will not disturb such findings unless clearly erroneous.” Twin City Sportservice, Inc. v. Charles O. Finley & Co., 676 F.2d 1291, 1299 (9th Cir. 1982). Although the

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8 The application of this framework in the Ninth Circuit is not rigid. Thus, in determining whether the prima facie case has been rebutted, a district court may consider evidence submitted by the plaintiff in the case-in-chief. See Olin, 986 F.3d at 1305 (finding no burden-shifting error because the FTC had determined that the rebuttal evidence was insufficient to overcome the prima facie showing); see also Chi. Bridge & Iron, 534 F.3d at 424–25 (stating that Olin “allows [a court] to preserve the prima facie presumption if the [defendant] . . . fails to satisfy the burden of production in light of contrary evidence in the prima facie case”).
parties agree that the relevant product market in this case is adult PCPs, St. Luke’s vigorously disputes the district court’s determination that Nampa is the relevant geographic market. We find no clear error in that factual finding.

The relevant geographic market is the “area of effective competition where buyers can turn for alternate sources of supply.” Morgan, Strand, Wheeler & Biggs v. Radiology, Ltd., 924 F.2d 1484, 1490 (9th Cir. 1991) (alteration omitted) (quoting Oltz v. St. Peter’s Cnty. Hosp., 861 F.2d 1440, 1446 (9th Cir. 1988)) (internal quotation marks omitted). Put differently, “a market is the group of sellers or producers who have the actual or potential ability to deprive each other of significant levels of business.” Rebel Oil Co. v. Atl. Richfield Co., 51 F.3d 1421, 1434 (9th Cir. 1995) (quoting Thurman Indus., Inc. v. Pay ‘N Pak Stores, Inc., 875 F.2d 1369, 1374 (9th Cir. 1989)) (internal quotation marks omitted). The plaintiff has the burden of establishing the relevant geographic market. See United States v. Conn. Nat’l Bank, 418 U.S. 656, 669–70 (1974).

A common method to determine the relevant geographic market, and the one used by the district court, is to find whether a hypothetical monopolist could impose a “small but significant nontransitory increase in price” (“SSNIP”) in the proposed market. See Theme Promotions, 546 F.3d at 1002; see also In re Se. Milk Antitrust Litig., 739 F.3d 262, 277–78 (6th Cir. 2014) (describing the relevant geographic market as one in which “buyers . . . respond to a SSNIP by purchasing regardless of the increase”); U.S. Dep’t of Justice & FTC, Horizontal Merger Guidelines (“Merger Guidelines”) § 4
(2010). If enough consumers would respond to a SSNIP by purchasing the product from outside the proposed geographic market, making the SSNIP unprofitable, the proposed market definition is too narrow. See Theme Promotions, 546 F.3d at 1002.

Market definition thus perforce focuses on the anticipated behavior of buyers and sellers. See, e.g., Rebel Oil, 51 F.3d at 1430, 1434–35. In the health care industry, insurance companies effectively act both as buyers and sellers. See FTC v. Freeman Hosp., 69 F.3d 260, 270 n.14 (8th Cir. 1995); Gregory Vistnes, Hospitals, Mergers, and Two-Stage Competition, 67 Antitrust L.J. 671, 672 (2000). Noting that “the vast majority of health care consumers are not direct purchasers of health care—the consumers purchase health insurance and the insurance companies negotiate directly with the providers,” the district court correctly focused on the “likely response of insurers to a hypothetical demand by all the PCPs in a particular market for a [SSNIP].”

The district court found that a hypothetical Nampa PCP monopolist could profitably impose a SSNIP on insurers.

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9 Although the Merger Guidelines are “not binding on the courts,” Olin, 986 F.2d at 1300, they “are often used as persuasive authority,” Chi. Bridge & Iron, 534 F.3d at 431 n.11.

10 This “two-stage model” of health care competition is “the accepted model.” John J. Miles, 1 Health Care & Antitrust L. § 1:5 (2014). In the first stage, providers compete for inclusion in insurance plans. See Vistnes, supra, at 674. In the second stage, providers seek to attract patients enrolled in the plans. See id. at 681–82. Because patients are “largely insensitive” to price, the second stage “takes place primarily over non-price dimensions.” Id. at 682. Thus, antitrust analysis focuses on the first stage. Id. at 692.
Citing testimony that Nampa residents “strongly prefer access to local PCPs,” the court found that “commercial health plans need to include Nampa PCPs in their networks to offer a competitive product.” “Given this dynamic—that health plans must offer Nampa Adult PCP services to Nampa residents to effectively compete—Nampa PCPs could band together and successfully demand a [SSNIP] (or reimbursement increase) from health plans.”

St. Luke’s argues that the district court erred by considering only the current behavior of Nampa consumers, not their likely response to a SSNIP. St. Luke’s is of course correct that geographic market definition involves prospective analysis—it predicts consumer response to a hypothetical price increase. See FTC v. Tenet Health Care Corp., 186 F.3d 1045, 1053–54 (8th Cir. 1999). But that is precisely what the district court did. The court not only examined present Nampa consumer behavior, but also concluded that it would not change in the event of a SSNIP.

This determination was supported by the record. Evidence was presented that insurers generally need local PCPs to market a health care plan, and that this is true in particular in the Nampa market. For example, Blue Cross of Idaho has PCPs in every zip code in which it has customers, and the executive director of the Idaho Physicians Network testified that it could not market a health care network in Nampa that did not include Nampa PCPs. Evidence also indicated that consumers would not change their behavior in the event of a SSNIP. Experts testified that because health care consumers only pay a small percentage of health care costs out of pocket, the impact of a SSNIP likely would not register. Similarly, there was testimony that consumers choose physicians on factors other than price. The court was
unconvinced by evidence that insurers could defend against a SSNIP by steering consumers to non-Nampa PCPs. ¹¹

For similar reasons, there also was no clear error in the district court’s determination that evidence that one-third of Nampa residents travel to Boise for PCPs did not prove that a significant number of other residents would so travel in the event of a SSNIP. Those who traveled generally went to PCPs near their Boise places of employment. Thus, the court reasonably found this statistic not determinative of whether other Nampa residents would be willing to travel.

C. The Plaintiffs’ Case

Once the relevant geographic market is determined, a prima facie case is established if the plaintiff proves that the merger will probably lead to anticompetitive effects in that market. See Olin, 986 F.2d at 1305; see also Chi. Bridge & Iron, 534 F.3d at 423. A prima facie case can be established simply by showing high market share. United States v. Syufy Enters., 903 F.2d 659, 664 n.6 (9th Cir. 1990); see also FTC v. H.J. Heinz Co., 246 F.3d 708, 716 (D.C. Cir. 2001). However, “statistics concerning market share and concentration, while of great significance, [a]re not

¹¹ Extensive evidence was offered about Micron, a Boise employer that created a health care plan including financial incentives for employees to use certain providers; the plan caused a substantial portion of Micron employees residing in Nampa to switch to non-Nampa PCPs. St. Luke’s argues that this evidence proved that Nampa consumers would respond to a SSNIP. But the district court did not clearly err in finding the Micron example unpersuasive. Micron’s cost differentials were much higher than a SSNIP, Boise PCPs were close to work for Micron’s employees, and it was unclear whether other employers would be willing or able to replicate Micron’s program.
conclusive indicators of anticompetitive effects . . .” United States v. Gen. Dynamics Corp., 415 U.S. 486, 498 (1974); see also FTC v. Warner Commc'ns Inc., 742 F.2d 1156, 1163 n.1 (9th Cir. 1984). Thus, plaintiffs in § 7 cases generally present other evidence as part of the prima facie case. See Gen. Dynamics, 415 U.S. at 498 (“[O]nly a further examination of the particular market—its structure, history and probable future—can provide the appropriate setting for judging the probable anticompetitive effect of the merger.” (quoting Brown Shoe, 370 U.S. at 322 n.38)); see also Chi. Bridge & Iron, 534 F.3d at 431 (noting that market share data was “just one element in the Government’s strong prima facie case”); Carl Shapiro, The 2010 Horizontal Merger Guidelines: From Hedgehog to Fox in Forty Years, 77 Antitrust L.J. 49, 50–60 (2010) (noting the trend in merger enforcement to consider factors in addition to market share).

The district court held that the plaintiffs established a prima facie case because of the post-merger entity’s: (1) market share; (2) ability to negotiate higher PCP reimbursement rates with insurers; and (3) ability to “charge more [ancillary] services at the higher hospital billing rates.” The court also found that “entry into the market has been very difficult and would not be timely to counteract the anticompetitive effects of the Acquisition.” St. Luke’s does not challenge the barriers-to-entry finding; we review the others in turn for clear error.

1. Market Share

A commonly used metric for determining market share is the Herfindahl-Hirschman Index (“HHI”). See ProMedica Health Sys., Inc. v. FTC, 749 F.3d 559, 568 (6th Cir. 2014); H.J. Heinz, 246 F.3d at 716. HHI is “calculated by summing
the squares of the individual firms’ market shares,” which “gives proportionately greater weight to the larger market shares.” Merger Guidelines § 5.3. The analysis “consider[s] both the post-merger level of the HHI and the increase in the HHI resulting from the merger.” Id. The Merger Guidelines classify markets as (1) unconcentrated (HHI below 1500); (2) moderately concentrated (HHI between 1500 and 2500); or (3) highly concentrated (HHI above 2500). Id. Mergers that increase the HHI more than 200 points and result in highly concentrated markets are “presumed to be likely to enhance market power.” Id. “Sufficiently large HHI figures establish the FTC’s prima facie case that a merger is anti-competitive.” H.J. Heinz, 246 F.3d at 716.

The district court calculated the post-merger HHI in the Nampa PCP market as 6,219, and the increase as 1,607. St. Luke’s does not challenge these findings. As the district court correctly noted, these HHI numbers “are well above the thresholds for a presumptively anticompetitive merger (more than double and seven times their respective thresholds, respectively).” See ProMedica, 749 F.3d at 568 (noting that a merger with similar HHI numbers “blew through those barriers in spectacular fashion”).

2. PCP Reimbursements

The district court also found that St. Luke’s would likely use its post-merger power to negotiate higher reimbursement rates from insurers for PCP services. Recognizing that the § 7 inquiry is based on a prediction of future actions, see Phila. Nat’l Bank, 374 U.S. at 362, this finding was not clearly erroneous.
Because St. Luke’s and Saltzer had been each other’s closest substitutes in Nampa, the district court found the acquisition limited the ability of insurers to negotiate with the merged entity. Pre-acquisition internal correspondence indicated that the merged companies would use this increased bargaining power to raise prices. An email between St. Luke’s executives discussed “pressur[ing] payors for new directed agreements,” and an exchange between Saltzer executives stated that “[i]f our negotiations w/ Luke’s go to fruition,” then “the clout of the entire network” could be used to negotiate favorable terms with insurers. The court also examined a previous acquisition by St. Luke’s in Twin Falls, Idaho, and found that St. Luke’s used its leverage in that instance to force insurers to “concede to their pricing proposal.”

3. Ancillary Services

The district court’s finding that St. Luke’s would raise prices in the hospital-based ancillary services market is more problematic. The court found that St. Luke’s would “exercise its enhanced bargaining leverage from the Acquisition to charge more services at the higher hospital-based billing rates.” Because insurers and providers typically negotiate for all services as part of the same contract, the district court found that St. Luke’s increased leverage with

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Ancillary services, such as x-rays and diagnostic testing, are sometimes performed by doctors in conjunction with PCP examinations. Before the merger, Saltzer provided many ancillary services at its physicians’ offices. Insurance companies and Medicare often offer higher reimbursements for ancillary services performed at a hospital-based outpatient facility.
respect to PCP services would allow it to demand higher fees for ancillary services.

The problem with this conclusion is that the district court made no findings about St. Luke’s’ market power in the ancillary services market. Absent such a finding, it is difficult to conclude that the merged entity could easily demand anticompetitive prices for such services. Perhaps the court was suggesting that St. Luke’s would engage in tying, “a device used by a seller with market power in one product market to extend its market power to a distinct product market.” *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883, 912 (9th Cir. 2008). Although various antitrust statutes, including Sherman Act §§ 1 and 2, Clayton Act § 3, and FTC Act § 5, address tying, Clayton Act § 7 does not expressly prohibit the practice. A leading antitrust treatise cautions against condemning a merger for potential tying effects as “superfluous and overdeterrent.” Phillip Areeda & Herbert Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and Their Application* (“Areeda”) ¶ 1144a (2010).

Wholly aside from these conceptual difficulties, the factual underpinnings of the district court’s conclusion are suspect. The documents cited by the district court merely state that St. Luke’s hopes to *increase revenue* from ancillary services, not that it plans to charge higher prices. An increase in revenue could occur in a variety of ways not involving increased prices, such as increased Medicare payments or increased volume from Saltzer referrals. The district court did not find that Saltzer physicians would inappropriately label in-house services as hospital-based, or that they would force patients to travel to the St. Luke’s hospital in Boise for services that could be provided in-house in Nampa. And the court did not identify any past actions that would allow it to
predict that St. Luke’s would act anticompetitively in the future in the ancillary services market. Indeed, in post-merger negotiations with Blue Shield, St. Luke’s did not do so. We thus find that the ancillary services finding is not supported by the record.

4. The Prima Facie Case

But absent the ancillary services finding, the district court’s conclusion that a prima facie case was established is amply supported by the record. “Section 7 does not require proof that a merger or other acquisition has caused higher prices in the affected market. All that is necessary is that the merger create an appreciable danger of such consequences in the future.” Hosp. Corp. of Am. v. FTC, 807 F.2d 1381, 1389 (7th Cir. 1986).

The extremely high HHI on its own establishes the prima facie case. See H.J. Heinz, 246 F.3d at 716; United States v. Baker Hughes, Inc., 908 F.2d 981, 982–83 & n.3 (D.C. Cir. 1990). In addition, the court found that statements and past actions by the merging parties made it likely that St. Luke’s would raise reimbursement rates in a highly concentrated market. See Hosp. Corp., 807 F.2d at 1388–89 (expressing concern that a history of cooperation among hospitals could lead to collusion when a merger caused the market to become more concentrated). And, the court’s uncontested finding of high entry barriers “eliminates the possibility that the reduced competition caused by the merger will be ameliorated by new competition from outsiders and further strengthens the FTC’s case.” H.J. Heinz, 246 F.3d at 717.

The facts found by the district court are similar to those in other cases in which a prima facie violation of § 7 was
established. See, e.g., Chi. Bridge & Iron, 534 F.3d at 431–32 (high HHI, limited rivals, high entry barriers, and customer perception); Lucas Auto. Eng’g, Inc. v. Bridgestone/Firestone, Inc., 140 F.3d 1228, 1236–37 (9th Cir. 1998) (reversing summary judgment for defendant because undisputed facts showed high market share and “insurmountable barriers to entry”); FTC v. Univ. Health, Inc., 938 F.2d 1206, 1219–20 & n.27 (11th Cir. 1991) (high market concentration, high entry barriers, and evidence that defendants intended to eliminate competition with the merger); Am. Stores, 872 F.2d at 841–43 (high market share, and insufficient evidence of low entry barriers to rebut the prima facie case). The district court did not clearly err in its factual findings, which adequately support its ultimate conclusion that the plaintiffs established “a prima facie case that the Acquisition is anti-competitive.”

D. The Rebuttal Case

Because the plaintiffs established a prima facie case, the burden shifted to St. Luke’s to “cast doubt on the accuracy of the Government’s evidence as predictive of future anti-competitive effects.” Chi. Bridge & Iron, 534 F.3d at 423. The rebuttal evidence focused on the alleged procompetitive effects of the merger, particularly the contention that the merger would allow St. Luke’s to move toward integrated care and risk-based reimbursement.13

13 The district court found that a core reason for high health care costs is the prevalent fee-for-service reimbursement model, based on the apparently uncontested opinions of expert witnesses. Experts have recommended moving toward integrated care and risk-based reimbursement. “In an integrated delivery system, [PCPs] and specialty physicians work as a team, with PCPs managing patient care and specialty physicians consulting and providing care as needed.” Risk-based
1. The Post-Merger Efficiencies Defense

The Supreme Court has never expressly approved an efficiencies defense to a § 7 claim. See *H.J. Heinz*, 246 F.3d at 720. Indeed, *Brown Shoe* cast doubt on the defense:

Of course, some of the results of large integrated or chain operations are beneficial to consumers. Their expansion is not rendered unlawful by the mere fact that small independent stores may be adversely affected. It is competition, not competitors, which the Act protects. But we cannot fail to recognize Congress’ desire to promote competition through the protection of viable, small, locally owned business. Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets. It resolved these competing considerations in favor of decentralization. We must give effect to that decision.

370 U.S. at 344. Similarly, in *FTC v. Procter & Gamble Co.*, the Court stated that “[p]ossible economies cannot be used as a defense to illegality. Congress was aware that some mergers which lessen competition may also result in reimbursement (also known as capitation) means that “providers receive reimbursement from insurers in the form of a set amount for each patient rather than a payment for each service rendered. The set amount is based on the average expected health care utilization for the patients given such factors as their age and medical history.” “Capitation motivates providers to consider the costs of treatment as they will share in the savings if they can keep actual costs below the set amount they receive.”
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... economies but it struck the balance in favor of protecting competition.” 386 U.S. 568, 580 (1967).

Notwithstanding the Supreme Court’s statements, four of our sister circuits (the Sixth, D.C., Eighth, and Eleventh) have suggested that proof of post-merger efficiencies could rebut a Clayton Act § 7 prima facie case. See ProMedica, 749 F.3d at 571; H.J. Heinz, 246 F.3d at 720–22; Tenet, 186 F.3d at 1054–55; Univ. Health, 938 F.2d at 1222–24. The FTC has also cautiously recognized the defense, noting that although competition ordinarily spurs firms to achieve efficiencies internally, “a primary benefit of mergers to the economy is their potential to generate significant efficiencies and thus enhance the merged firm’s ability and incentive to compete, which may result in lower prices, improved quality, enhanced service, or new products.” Merger Guidelines § 10; see also Oliver E. Williamson, Economies as an Antitrust Defense Revisited, 125 U. Pa. L. Rev. 699, 699 (1977) (“Sometimes . . . a merger will . . . result in real increases in efficiency that reduce the average cost of production of the combined entity below that of the two merging firms.”). However, none of the reported appellate decisions have actually held that a § 7 defendant has rebutted a prima facie case with an efficiencies defense; thus, even in those circuits that recognize it, the parameters of the defense remain imprecise.

14 Some courts have attempted to explain why the Supreme Court cases do not recognize an efficiencies defense, see, e.g., H.J. Heinz, 246 F.3d at 720 n.18 (arguing that the “possible economies” language in Proctor & Gamble does not ban an actual efficiencies defense), but others have simply stated that the defense exists without addressing the language in Brown Shoe and its progeny, see, e.g., ProMedica, 749 F.3d at 571.
The status of the defense in this circuit remains uncertain. A quarter of a century ago, we rejected an efficiencies defense in *RSR Corp. v. FTC*, 602 F.2d 1317, 1325 (9th Cir. 1979). *RSR*, however, involved an argument that the merger would allow the defendant to compete more efficiently *outside* the relevant market. *Id.* More recent cases focus on whether efficiencies in the relevant market negate the anticompetitive effect of the merger in that market. See *Univ. Health*, 938 F.2d at 1222. Even after *RSR*, several district courts in this circuit have suggested that there could be such a defense. See, e.g., *United States v. Bazaarvoice, Inc.*, No. 13-cv-00133-WHO, 2014 WL 203966, at *64, *72–73 (N.D. Cal. Jan. 8, 2014); *United States v. Oracle Corp.*, 331 F. Supp. 2d 1098, 1174–75 (N.D. Cal. 2004); but see *California v. Am. Stores Co.*, 697 F. Supp. 1125, 1132–33 (C.D. Cal. 1988) (finding that *RSR* barred an efficiencies defense), rev’d on other grounds, 872 F.2d 837, rev’d on other grounds, 495 U.S. 271.

We remain skeptical about the efficiencies defense in general and about its scope in particular. It is difficult enough in § 7 cases to predict whether a merger will have future anticompetitive effects without also adding to the judicial balance a prediction of future efficiencies. Indeed, even then-Professor Bork, a sharp critic of Clayton Act enforcement actions, see, e.g., Robert H. Bork and Wade S. Bowman, Jr., *The Crisis in Antitrust*, 65 Colum. L. Rev. 363, 373 (1965), rejected the efficiencies defense, calling it “spurious” because it “cannot measure the factors relevant to consumer welfare, so that after the economic extravaganza was completed we would know no more than before it began,” Robert H. Bork, *The Antitrust Paradox: A Policy at War with Itself* 124 (1978). Judge Richard Posner has regularly expressed similar views. See Richard A. Posner,
Antitrust Law 133 (2d ed. 2001) ("I said back then that there should be no general defense of efficiency. I still think this is right. It is rarely feasible to determine by the methods of litigation the effect of a merger on the costs of the firm created by the merger."); Richard A. Posner, Antitrust Law: An Economic Perspective 112 (1976) ("I would not allow a generalized defense of efficiency."); cf. Frank H. Easterbrook, The Limits of Antitrust, 63 Tex. L. Rev. 1, 39 (1984) ("[N]either judges nor juries are particularly good at handling complex economic arguments . . .").

Nonetheless, we assume, as did the district court, that because § 7 of the Clayton Act only prohibits those mergers whose effect "may be substantially to lessen competition," 15 U.S.C. § 18, a defendant can rebut a prima facie case with evidence that the proposed merger will create a more efficient combined entity and thus increase competition. For example, if two small firms were unable to match the prices of a larger competitor, but could do so after a merger because of decreased production costs, a court recognizing the efficiencies defense might reasonably conclude that the transaction likely would not lessen competition. See Merger Guidelines § 10 ("Merger-generated efficiencies may enhance competition by permitting two ineffective competitors to form a more effective competitor, e.g., by combining complementary assets. . . [I]ncremental cost reductions may reduce or reverse any increases in the merged firm’s incentive to elevate price.").

Because we deal with statutory enforcement, the language of the Clayton Act must be the linchpin of any efficiencies defense. The Act focuses on "competition," so any defense must demonstrate that the prima facie case "portray[s] inaccurately the merger’s probable effects on competition."
In other words, a successful efficiencies defense requires proof that a merger is not, despite the existence of a prima facie case, anticompetitive.

Courts recognizing the defense have made clear that a Clayton Act defendant must “clearly demonstrate” that “the proposed merger enhances rather than hinders competition because of the increased efficiencies.” United States v. Long Island Jewish Med. Ctr., 983 F. Supp. 121, 137 (E.D.N.Y. 1997). Because § 7 seeks to avert monopolies, proof of “extraordinary efficiencies” is required to offset the anticompetitive concerns in highly concentrated markets. See H.J. Heinz, 246 F.3d at 720–22; see also Merger Guidelines § 10 (“Efficiencies almost never justify a merger to monopoly or near-monopoly.”). The defendant must also demonstrate that the claimed efficiencies are “merger-specific,” see United States v. H & R Block, Inc., 833 F. Supp. 2d 36, 89–90 (D.D.C. 2011), which is to say that the efficiencies cannot readily “be achieved without the concomitant loss of a competitor,” H.J. Heinz, 246 F.3d at 722; see also Merger Guidelines § 10 & n.13. Claimed efficiencies must be verifiable, not merely speculative. See, e.g., FTC v. CCC Holdings Inc., 605 F. Supp. 2d 26, 74–75 (D.D.C. 2009); Oracle, 331 F. Supp. 2d at 1175; see also Merger Guidelines § 10.


St. Luke’s argues that the merger would benefit patients by creating a team of employed physicians with access to Epic, the electronic medical records system used by St. Luke’s. The district court found that, even if true, these predicted efficiencies were insufficient to carry St. Luke’s’ burden of rebutting the prima facie case. We agree.
It is not enough to show that the merger would allow St. Luke’s to better serve patients. The Clayton Act focuses on competition, and the claimed efficiencies therefore must show that the prediction of anticompetitive effects from the prima facie case is inaccurate. See Univ. Health, 938 F.2d at 1222 (finding efficiencies relevant to the prediction of “whether the acquisition would substantially lessen competition”). Although the district court believed that the merger would eventually “improve the delivery of health care” in the Nampa market, the judge did not find that the merger would increase competition or decrease prices. Quite to the contrary, the court, even while noting the likely beneficial effect of the merger on patient care, held that reimbursement rates for PCP services likely would increase. Nor did the court find that the merger would likely lead to integrated health care or a new reimbursement system; the judge merely noted the desire of St. Luke’s to move in that direction.

The district court expressly did conclude, however, that the claimed efficiencies were not merger-specific. The court found “no empirical evidence to support the theory that

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15 St. Luke’s argues that once a defendant comes forward with proof of efficiencies, the burden shifts to the plaintiff to show that there are ways of achieving those efficiencies without the merger. This tracks the Sherman Act analysis. See, e.g., Bhan v. NME Hosp., Inc., 929 F.2d 1404, 1412–14 (9th Cir. 1991). But, in Clayton Act § 7 cases, after a plaintiff has made a prima facie case that a merger is anticompetitive, the burden of showing that the claimed efficiencies cannot be “attained by practical alternatives,” Merger Guidelines § 10 n.13, is properly part of the defense, see Olin, 986 F.2d at 1305 (explaining that it is the defendant’s “burden to rebut a prima facie case of illegality”). That burden, moreover, is not unduly onerous, as the defendant need not disprove alternatives that are “merely theoretical.” Merger Guidelines § 10.
St Luke’s needs a core group of employed primary care physicians beyond the number it had before the Acquisition to successfully make the transition to integrated care,” and that “a committed team can be assembled without employing physicians.” The court also found that the shared electronic record was not a merger-specific benefit because data analytics tools are available to independent physicians.

These factual findings were not clearly erroneous. Testimony highlighted examples of independent physicians who had adopted risk-based reimbursement, even though they were not employed by a major health system. The record also revealed that independent physicians had access to a number of analytic tools, including the St. Luke’s Epic system.

But even if we assume that the claimed efficiencies were merger-specific, the defense would nonetheless fail. At most, the district court concluded that St. Luke’s might provide better service to patients after the merger. That is a laudable goal, but the Clayton Act does not excuse mergers that lessen competition or create monopolies simply because the merged entity can improve its operations. See Proctor & Gamble, 386 U.S. at 580. The district court did not clearly err in concluding that whatever else St. Luke’s proved, it did not demonstrate that efficiencies resulting from the merger would have a positive effect on competition.

IV. Remedy

“The key to the whole question of an antitrust remedy is of course the discovery of measures effective to restore competition.” United States v. E. I. du Pont de Nemours & Co., 366 U.S. 316, 326 (1961). “[T]he relief must be directed to that which is necessary and appropriate . . . to eliminate the
effects of the acquisition offensive to the statute . . . and assure the public freedom from its continuance.” *Ford Motor Co. v. United States*, 405 U.S. 562, 573 n.8 (1972) (internal citation and quotation marks omitted). Section 7 remedies should not be punitive, but “courts are authorized, indeed required, to decree relief effective to redress the violations, whatever the adverse effect of such a decree on private interests.” *E. I. du Pont*, 366 U.S. at 326.

The customary form of relief in § 7 cases is divestiture. *See id.* at 330 (noting that most litigated Clayton Act § 7 cases “decreed divestiture as a matter of course”); *see also ProMedica*, 749 F.3d at 573; *RSR*, 602 F.2d at 1325–26; *Ash Grove Cement Co. v. FTC*, 577 F.2d 1368, 1379–80 (9th Cir. 1978). Divestiture is the “most important of antitrust remedies,” and “should always be in the forefront of a court’s mind when a violation of § 7 has been found.” *E. I. du Pont*, 366 U.S. at 330–31; *see also id.* at 329 (“The very words of § 7 suggest that an undoing of the acquisition is a natural remedy.”). This is especially true when the government is the plaintiff. *See Am. Stores*, 495 U.S. at 280–81 (“[I]n Government actions divestiture is the preferred remedy for an illegal merger or acquisition.”).

St. Luke’s nonetheless argues that the district court erred in ordering divestiture because (1) divestiture will not actually restore competition; (2) divestiture eliminates the transaction’s procompetitive benefits; and (3) a proposed conduct remedy was preferable. We find no abuse of discretion in the district court’s choice of remedy.

Although divestiture may generally be the most straightforward way to restore competition, *E. I. du Pont*, 366 U.S. at 331, a district court must consider whether it will
effectively do so under the facts of each case. “A primary concern is whether the offending line of commerce, if disassociated from the merged entities, can survive as a viable, independent entity.” FTC v. PepsiCo, Inc., 477 F.2d 24, 29 n.8 (2d Cir. 1973). St. Luke’s argues that Saltzer would no longer be able to compete post-divestiture, and that divestiture therefore would not restore competition in the Nampa PCP market.

The district court had ample basis, however, for rejecting that contention. Indeed, in opposing a preliminary injunction, St. Luke’s assured the court that divestiture was feasible. Moreover, Saltzer’s employees were assured by management that they would have their jobs no matter the result of the litigation, and a number of them testified that Saltzer would be viable as an independent entity. The district court also noted that “any financial hardship to Saltzer will be mitigated by St. Luke’s payment of $9 million for goodwill and intangibles as part of the Acquisition . . . .”

Nor did the district court abuse its discretion in its consideration of the costs and benefits of divestiture. The court expressly determined that divestiture was appropriate because any benefits of the merger were outweighed by the anticompetitive concerns. See Am. Stores, 872 F.2d at 843. The Supreme Court has specifically stated that “it is well settled that once the Government has successfully borne the considerable burden of establishing a violation of law, all doubts as to the remedy are to be resolved in its favor.” E. I. du Pont, 366 U.S. at 334.

Finally, the district court did not abuse its discretion in choosing divestiture over St. Luke’s’ proposed “conduct remedy”—the establishment of separate bargaining groups to
Divestiture is “simple, relatively easy to administer, and sure,” E. I. du Pont, 366 U.S. at 331, while conduct remedies risk excessive government entanglement in the market, see U.S. Dep’t of Justice, Antitrust Division Policy Guide to Merger Remedies § II n.12 (2011) (noting that conduct remedies need to be “tailored as precisely as possible to the competitive harms associated with the merger to avoid unnecessary entanglements with the competitive process”). The district court, moreover, found persuasive the rejection of a similar proposal in In re ProMedica Health System, Inc., No. 9346, 2012 WL 1155392, at *48–50 (FTC March 28, 2012), adopted as modified, 2012 WL 2450574 (FTC June 25, 2012). Even assuming that the district court might have been within its discretion in opting for a conduct remedy, we find no abuse of discretion in its declining to do so. See ProMedica, 749 F.3d at 572–73 (holding that the FTC did not abuse its discretion in choosing divestiture over a proposed conduct remedy).

V. Conclusion

For the reasons stated above, we **AFFIRM** the judgment of the district court.

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16 Conduct remedies include “firewall, non-discrimination, mandatory licensing, transparency, and anti-retaliation provisions, as well as prohibitions on certain contracting practices.” U.S. Dep’t of Justice, Antitrust Division Policy Guide to Merger Remedies § II.B (2011); see also Areeda ¶ 990d.
Staples-Office Depot Merger Analysis

Professor Carl Shapiro
Preview of Conclusions and Analysis
Staples-Office Depot Merger Analysis
Follows Tested Approach

1. **Relevant Market:**
   Where might the merger alter competitive conditions?

2. **Market Shares:**
   What are customers’ significant options?

3. **Competitive Effects:**
   Is Office Depot a unique check on price and quality?

4. **Entry and Expansion:**
   Will other options emerge to save the day for large customers?

5. **Efficiencies:**
   Will merger-specific cost savings counteract loss of competition?

6. **Proposed Divestiture:**
   Will the divestiture create an entity to replace Office Depot?
Staples Dominates in Office Depot’s Win-Loss Data with 833 Appearances

2013-2015 (N = 1253)

Note: Competitors listed have at least 5 appearances. There are 30 competitors with 2 to 4 appearances, and 126 competitors mentioned in total.
Source: Exhibit 10, Shapiro Report.
Staples Dominates in Office Depot’s Win-Loss Data with 240 Wins
2013-2015 ($N = 1253$)

Note: Competitors listed have at least 2 wins. In total, 40 competitors are mentioned.
Source: Exhibit 10, Shapiro Report.
Office Depot Dominates in Staples Win-Loss Data with 214 Appearances

2012-2014 (N = 393)

Note: Competitors listed have at least 2 appearances. In total, 43 competitors are mentioned.

Source: Exhibit 11, Shapiro Report.
Office Depot Dominates in Staples Win-Loss Data with 142 Wins
2012-2014 (N = 393)

Note: Competitors listed have at least 2 wins. In total, 27 competitors are mentioned.

Source: Exhibit 11, Shapiro Report.
### AEP: Outcome of 2015 RFP Process: Savings

<table>
<thead>
<tr>
<th></th>
<th>Office Supplies</th>
<th>Paper</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reduction from RFQ process</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reduction from Demand Process</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increased savings from Rebate</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed Price for 3 yrs.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>10% off all orders for 90 days</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Savings</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Total Savings for Office Supplies & Paper**

“The final step was to conduct a demand negotiation or counter-proposal with Staples and Office Depot. The main issue with Staples was—what the team believed to be—deceptive pricing tactics used in the RFQ. Staples refused to accept this point. In the end, the incumbent supplier (OfficeMax, which was acquired by Office Depot) came in with a better cost profile and agreed to more of our demand points.”

*Source: AEP, PX07366.*
Large Customer Attributes

Customer Profiles and Behaviors (Private Sector)

<table>
<thead>
<tr>
<th>Segment</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;$24K</td>
<td>Low sophistication, responds to promotions/gifts. SMB</td>
</tr>
<tr>
<td>$24 - 75K</td>
<td>Price conscious, focuses on small core with overall value. SMB</td>
</tr>
<tr>
<td>$75 - 150K</td>
<td>Centralized decisions, de-centralized purchasing (disconnect of perceived value). SMB</td>
</tr>
<tr>
<td>$150 - 250K</td>
<td>Fairly sophisticated buying process, expectations for cost savings. SMB</td>
</tr>
<tr>
<td>$250 - 500K</td>
<td>More sophisticated processes, centralized purchasing, approval processes, vendor consolidation, rebates and some contractual obligations. Large</td>
</tr>
<tr>
<td>$500K - 1M</td>
<td>Formal RFPs, centralized purchasing, approval processes, awareness and desire for up front money/conversion incentives &amp; rebates. Large</td>
</tr>
<tr>
<td>&gt;$1M</td>
<td>Sophisticated sourcing and buying with formal RFIs/RFPs, sensitivity to end of change, expectation of conversion incentives and rebates. Global</td>
</tr>
<tr>
<td>GPOs</td>
<td>Aggregate group purchasing defined by end-user memberships, revenue-share rebates. GPO Buying Group =</td>
</tr>
</tbody>
</table>

Sources: PX05183 (ODP) at 018.
Large Customer RFPs
Price Elements

Demand Management
Staples will analyze current product usage and develop a core product list that offers immediate savings. Your Strategic Account Manager will regularly review your core list to identify continuous opportunities where Staples can offer better value on the products you use most. Our industry-leading buying power and strong supplier relationships give us the flexibility to find the most cost-effective solutions for your needs.

Itemized Prices on Core Products

16.4 Outline best practices for pricing core items throughout the world. LONG ANSWER + ATTACHMENT

To drive the highest end-user participation, Core pricing should be global in scope, but country-specific, based on each participating countries’ laws, regulations, product selection, required services, operational costs and market-competitive pricing.

21.9 Please provide your rebate % based on the following tiers:
   21.9.2 Annual US Sales from $0 to $1,999,999.99 = %
   21.9.4 Annual US Sales from $2,000,000 to $2,749,999.99 = %
   21.9.6 Annual US Sales above $2,750,000 = %

Volume Rebates

Sources: PX04484 (SPLS).
Large Customer RFPs  
Cost Management

Compliance

Compliance Savings
One of the easiest ways to manage costs is simply to support compliance to your Staples program. Prior to program launch and on an ongoing basis, our Field Marketing team will work with [REDACTED] to conduct communication campaigns to drive greater awareness and acceptance of your Staples program.

We also help support program compliance through our extensive Staples retail network. With more than 1,500 convenient U.S. locations to choose from, your end-users can make same day, emergency purchases without going outside your established office supply program.

Order Size

Minimizing Small Orders
Small, inefficient orders can add significant program costs by increasing the number of POs, invoices and deliveries you must process.

Monitoring

23.4 [REDACTED] has retained Dryden Procurement Technologies, LLC for the sole purpose of insuring all pricing and discount structures agreed to through the RFP and subsequent award and agreement with the selected supplier are met and the program remains at optimal levels throughout the term. In addition, supplier agrees to pay to Dryden an annual commodity management fee for the term of the agreement.

Sources: PX04484 (SPLS).
Large Customer RFPs
Service Attributes and Capabilities

Distribution Network & Wholesaler Dependence

11.7 Will [ ] be serviced by company owned distribution centers, or will some areas be serviced through either a dealer network or a wholesaler? M/C

Company-owned distribution centers

Staples offers [ ] fast, accurate and efficient delivery by operating one of the most extensive and technologically-advanced distribution networks in the industry. Through our strategically-located fulfillment centers

18.1 What is your standard shipment and delivery time? (Please detail out variances for all countries).
Attach a file. ______________________ U.S. ______________________ Next Day

Minimized Wholesaler Dependence

Staples’ inventories throughout our network of fulfillment centers represent the most popular brands that customers demand. Our product inventories represent more than 95% of the items sold everyday. As a result, we have been able to minimize our dependence on wholesaler product inventories, resulting in higher fill rates and more competitive pricing since we are not paying an inflated cost for the product.

E-Procurement

17.1 Describe the features and benefits of your Internet ordering solution. LONG ANSWER + ATTACHMENT

Staples has the unique expertise to customize an e-procurement solution to help better control your costs, streamline your ordering process, increase program compliance and minimize your time spent on procurement.

Integration Capabilities

Staples has extensive expertise in electronic procurement implementations and can integrate seamlessly with all major third-party e-procurement applications, including Ariba, Oracle and others. We will leverage the industry’s

Sources: PX04484 (SPLS).
Relevant Market
Cluster Market Approach

- Virtually each type of product is a distinct relevant market
  - Not functionally interchangeable (e.g., pens and binders)
  - Impractical to analyze each separately

- If competitive conditions are similar across different product types:
  - Appropriate to use cluster market
  - Aggregate distinct product markets into a single market for purposes of competitive analysis
# Average Number of SKUs Purchased by Large Customers

## 2014

<table>
<thead>
<tr>
<th>Product Category</th>
<th>Staples</th>
<th>Office Depot</th>
<th>OfficeMax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consumable Office Supplies</td>
<td>4,685</td>
<td>4,786</td>
<td>4,198</td>
</tr>
<tr>
<td>All Products</td>
<td>8,511</td>
<td>7,783</td>
<td>5,681</td>
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</table>

*Source: Exhibit 2, Shapiro Report.*
Consumable Office Supplies

<table>
<thead>
<tr>
<th>Commercial Portfolio</th>
<th>Actuals</th>
<th>Forecast</th>
<th>Mid-Market</th>
<th>Actuals</th>
<th>Forecast</th>
</tr>
</thead>
<tbody>
<tr>
<td>BOSS</td>
<td>P10</td>
<td>YTD</td>
<td>Qtr 4F</td>
<td>Full Year</td>
<td></td>
</tr>
<tr>
<td>Facilities</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Furniture</td>
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<tr>
<td>Tech</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Print/Propto</td>
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<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total BOSS</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CORE</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Paper</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Supplies</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ink &amp; Toner</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total CORE</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Sales</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| Total                |         |          |            |          |          |

- Commercial Portfolio:
  - P10 sales were up.
  - YTD sales growth is led by strong results in BOSS.
  - CORE sales YTD are better than planned sales in Supplies category offsets softness in Paper and Ink & Toner.

- Mid-Market Portfolio:
  - P10 sales were up.
  - YTD sales growth is led by BOSS.
  - CORE sales YTD are leading the way.
  - CORE sales YTD have grown led by Supplies category up.

CDC data consists of Adjusted Gross Sales which is directionally equivalent to SA OP sales only (excludes costwide, sta, spa, lonesource)
3. Targeted Customers and Price Discrimination

When examining possible adverse competitive effects from a merger, the Agencies consider whether those effects vary significantly for different customers purchasing the same or similar products. Such differential impacts are possible when sellers can discriminate, e.g., by profitably raising price to certain targeted customers but not to others. The possibility of price discrimination influences market definition (see Section 4), the measurement of market shares (see Section 5), and the evaluation of competitive effects (see Sections 6 and 7).

When price discrimination is feasible, adverse competitive effects on targeted customers can arise, even if such effects will not arise for other customers. A price increase for targeted customers may be profitable even if a price increase for all customers would not be profitable because too many other customers would substitute away. When discrimination is reasonably likely, the Agencies may evaluate competitive effects separately by type of customer. The Agencies may have access to information unavailable to customers that is relevant to evaluating whether discrimination is reasonably likely.

For price discrimination to be feasible, two conditions typically must be met: differential pricing and limited arbitrage.

*Source*: Horizontal Merger Guidelines § 3.
Hypothetical Monopolist Test ("HMT")
Depends on a Threshold Recapture Rate

• Using 5% price increase, HMT is satisfied if:

\[
\text{Recapture Rate} > \frac{10\%}{\text{Profit Margin} + 10\%}
\]

• Profit Margin estimates range = [□% to □%]

• Leads to Threshold Recapture Rate = [□% to □%]
Market Shares
Consumable Office Supplies Market Shares

Fortune 100 Customers, 2014

- **Staples, 47.3%**
- **Office Depot, 31.7%**
- **Veritiv, 5.2%**
- **Georgia Pacific, 1.6%**
- **Domtar, 0.8%**
- **Lindemeyer, 0.5%**
- **W.B. Mason, 0.2%**
- **Unreported Leakage Adjustment, 2.2%**

Source: Exhibit R1B, Shapiro Reply Report.
Consumable Office Supplies Market Shares

*Fortune 100 Customers, 2014*

- **Staples, 47.3%**
- **Office Depot, 31.7%**
- **Veritiv, 5.2%**
- **Georgia Pacific, 1.6%**
- **Domtar, 0.8%**
- **Lindenmeyr, 0.5%**
- **W.B. Mason, 0.2%**
- **Unreported Leakage Adjustment, 2.2%**

*Source: Exhibit R1B, Shapiro Reply Report.*
### Consumable Office Supplies Market Shares: Core v. Paper

*Fortune 100 Customers, 2014*

<table>
<thead>
<tr>
<th>Supplier</th>
<th>Consumable Office Supplies</th>
<th>Core</th>
<th>Paper</th>
</tr>
</thead>
<tbody>
<tr>
<td>Staples</td>
<td>47.3%</td>
<td>48.4%</td>
<td>46.2%</td>
</tr>
<tr>
<td>Office Depot</td>
<td>31.7%</td>
<td>38.3%</td>
<td>25.2%</td>
</tr>
<tr>
<td>Other Suppliers</td>
<td>21.0%</td>
<td>13.3%</td>
<td>28.6%</td>
</tr>
<tr>
<td>Staples + Office Depot</td>
<td>79.0%</td>
<td>86.7%</td>
<td>71.4%</td>
</tr>
</tbody>
</table>

*Sources: Exhibits R1B, R3A, and R3B, Shapiro Reply Report.*
## Market Concentration Measures

### Fortune 100 Customers, 2014

<table>
<thead>
<tr>
<th>Measure</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Pre-Merger:</strong></td>
<td></td>
</tr>
<tr>
<td>Staples Share</td>
<td>47%</td>
</tr>
<tr>
<td>Office Depot Share</td>
<td>32%</td>
</tr>
<tr>
<td>HHI</td>
<td>3,274</td>
</tr>
<tr>
<td><strong>Post-Merger:</strong></td>
<td></td>
</tr>
<tr>
<td>Staples &amp; Office Depot Share</td>
<td>79%</td>
</tr>
<tr>
<td>HHI</td>
<td>6,274</td>
</tr>
<tr>
<td><strong>Increase in HHI</strong></td>
<td>3,000</td>
</tr>
</tbody>
</table>

*Source: Exhibit R6, Shapiro Reply Report.*
Market Concentration Measures
2017 Projection
*Fortune 100 Customers*

*Note:* Assumes Amazon Business meets 2017 projected revenue in full.

Primary Vendor Relationship Shares

Consumable Office Supplies, 2014

Source: Exhibit R2, Shapiro Reply Report.
## Primary Vendor Relationships

### Consumable Office Supplies, 2014

<table>
<thead>
<tr>
<th>Supplier</th>
<th>Sales</th>
<th>Customer Count</th>
<th>Shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>Office Depot</td>
<td>$924,256,982</td>
<td>587</td>
<td>45.1%</td>
</tr>
<tr>
<td>Staples</td>
<td>$873,219,854</td>
<td>529</td>
<td>42.6%</td>
</tr>
<tr>
<td></td>
<td>$77,274,000</td>
<td>38</td>
<td>3.8%</td>
</tr>
<tr>
<td></td>
<td>$65,557,363</td>
<td>15</td>
<td>3.2%</td>
</tr>
<tr>
<td></td>
<td>$19,081,752</td>
<td>19</td>
<td>0.9%</td>
</tr>
<tr>
<td></td>
<td>$15,024,355</td>
<td>10</td>
<td>0.7%</td>
</tr>
<tr>
<td></td>
<td>$12,200,000</td>
<td>2</td>
<td>0.6%</td>
</tr>
<tr>
<td></td>
<td>$10,371,447</td>
<td>5</td>
<td>0.5%</td>
</tr>
<tr>
<td></td>
<td>$9,843,000</td>
<td>2</td>
<td>0.5%</td>
</tr>
<tr>
<td></td>
<td>$7,345,863</td>
<td>2</td>
<td>0.4%</td>
</tr>
<tr>
<td></td>
<td>$7,150,000</td>
<td>3</td>
<td>0.3%</td>
</tr>
<tr>
<td></td>
<td>$6,213,871</td>
<td>5</td>
<td>0.3%</td>
</tr>
<tr>
<td></td>
<td>$4,050,000</td>
<td>7</td>
<td>0.2%</td>
</tr>
<tr>
<td></td>
<td>$2,210,615</td>
<td>4</td>
<td>0.1%</td>
</tr>
<tr>
<td></td>
<td>$1,994,727</td>
<td>2</td>
<td>0.1%</td>
</tr>
<tr>
<td></td>
<td>$1,794,816</td>
<td>2</td>
<td>0.1%</td>
</tr>
<tr>
<td></td>
<td>$1,570,311</td>
<td>2</td>
<td>0.1%</td>
</tr>
<tr>
<td></td>
<td>$1,440,025</td>
<td>2</td>
<td>0.1%</td>
</tr>
<tr>
<td></td>
<td>$1,423,862</td>
<td></td>
<td>0.1%</td>
</tr>
<tr>
<td></td>
<td>$1,357,722</td>
<td>1</td>
<td>0.1%</td>
</tr>
<tr>
<td></td>
<td>$1,313,327</td>
<td>2</td>
<td>0.1%</td>
</tr>
<tr>
<td></td>
<td>$1,071,715</td>
<td>1</td>
<td>0.1%</td>
</tr>
<tr>
<td></td>
<td>$1,060,067</td>
<td>2</td>
<td>0.1%</td>
</tr>
<tr>
<td></td>
<td>$1,037,654</td>
<td>2</td>
<td>0.1%</td>
</tr>
<tr>
<td></td>
<td>$1,017,628</td>
<td>1</td>
<td>0.0%</td>
</tr>
<tr>
<td></td>
<td>$672,164</td>
<td>1</td>
<td>0.0%</td>
</tr>
<tr>
<td></td>
<td>$592,464</td>
<td>1</td>
<td>0.0%</td>
</tr>
<tr>
<td></td>
<td>$568,265</td>
<td>1</td>
<td>0.0%</td>
</tr>
<tr>
<td></td>
<td>$568,181</td>
<td>1</td>
<td>0.0%</td>
</tr>
<tr>
<td></td>
<td>$0</td>
<td>0</td>
<td>0.0%</td>
</tr>
<tr>
<td></td>
<td>$0</td>
<td>0</td>
<td>0.0%</td>
</tr>
<tr>
<td></td>
<td>$0</td>
<td>0</td>
<td>0.0%</td>
</tr>
<tr>
<td></td>
<td>$0</td>
<td>0</td>
<td>0.0%</td>
</tr>
<tr>
<td>Staples + Office Depot</td>
<td>$1,797,476,836</td>
<td></td>
<td>87.6%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$2,051,282,031</strong></td>
<td></td>
<td>100.0%</td>
</tr>
</tbody>
</table>
### Primary Vendor Relationship Shares: Core & Paper

#### 2014

<table>
<thead>
<tr>
<th>Supplier</th>
<th>Consumable Office Supplies</th>
<th>Core</th>
<th>Paper</th>
</tr>
</thead>
<tbody>
<tr>
<td>Office Depot</td>
<td>45.1%</td>
<td>50.8%</td>
<td>42.0%</td>
</tr>
<tr>
<td>Staples</td>
<td>42.6%</td>
<td>43.2%</td>
<td>39.1%</td>
</tr>
<tr>
<td>Other Suppliers</td>
<td>12.4%</td>
<td>6.0%</td>
<td>19.0%</td>
</tr>
<tr>
<td><strong>Staples + Office Depot</strong></td>
<td><strong>87.6%</strong></td>
<td><strong>94.0%</strong></td>
<td><strong>81.0%</strong></td>
</tr>
</tbody>
</table>

*Sources: Exhibits R2, R4A, and R4B, Shapiro Reply Report.*
## Primary Vendor Relationship Shares

### Consumable Office Supplies, 2014

<table>
<thead>
<tr>
<th>Supplier</th>
<th>$500K Threshold</th>
<th>$250K Threshold</th>
</tr>
</thead>
<tbody>
<tr>
<td>Office Depot</td>
<td>45.1%</td>
<td>45.1%</td>
</tr>
<tr>
<td>Staples</td>
<td>42.6%</td>
<td>42.6%</td>
</tr>
<tr>
<td>Other Suppliers</td>
<td>12.4%</td>
<td>12.3%</td>
</tr>
<tr>
<td><strong>Staples + Office Depot</strong></td>
<td><strong>87.6%</strong></td>
<td><strong>87.7%</strong></td>
</tr>
</tbody>
</table>

*Note: There are 1,249 and 2,490 total relationships in the $500K and $250K thresholds, respectively.*

*Sources: Exhibits R2 and R5, Shapiro Reply Report.*
## Fortune 100 Customers with Insufficient Responses

**2014**

<table>
<thead>
<tr>
<th>Customer</th>
<th>Purchases from Staples &amp; Office Depot</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$8,097,555</td>
</tr>
<tr>
<td></td>
<td>$7,107,940</td>
</tr>
<tr>
<td></td>
<td>$5,036,345</td>
</tr>
<tr>
<td></td>
<td>$4,071,583</td>
</tr>
<tr>
<td></td>
<td>$3,819,645</td>
</tr>
<tr>
<td></td>
<td>$3,514,480</td>
</tr>
<tr>
<td></td>
<td>$2,772,447</td>
</tr>
<tr>
<td></td>
<td>$2,320,590</td>
</tr>
<tr>
<td></td>
<td>$1,867,901</td>
</tr>
<tr>
<td></td>
<td>$1,756,689</td>
</tr>
<tr>
<td></td>
<td>$1,453,456</td>
</tr>
<tr>
<td></td>
<td>$1,277,653</td>
</tr>
<tr>
<td></td>
<td>$1,158,978</td>
</tr>
<tr>
<td></td>
<td>$1,141,995</td>
</tr>
<tr>
<td></td>
<td>$527,149</td>
</tr>
<tr>
<td></td>
<td>$517,134</td>
</tr>
<tr>
<td></td>
<td>$425,473</td>
</tr>
<tr>
<td></td>
<td>$202,589</td>
</tr>
<tr>
<td></td>
<td>$11,414</td>
</tr>
</tbody>
</table>

**Average** $2,477,948  
**Median** $1,756,689

*Source: Exhibit E-3, Shapiro Report.*
Consumable Office Supplies Market Shares
Fortune 100 Customers, 2014

Source: Exhibit R1B, Shapiro Reply Report.
## Fortune 100 Customers with Discretionary Leakage

<table>
<thead>
<tr>
<th>Customer Estimate</th>
<th>Percentage Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>&quot;Immaterial&quot;</td>
<td>10%</td>
</tr>
<tr>
<td></td>
<td>1.1%</td>
</tr>
<tr>
<td></td>
<td>0.7%</td>
</tr>
<tr>
<td></td>
<td>4.8%</td>
</tr>
<tr>
<td>&quot;De minimis&quot;</td>
<td>&quot;De minimis&quot;</td>
</tr>
<tr>
<td></td>
<td>&quot;De minimis&quot;</td>
</tr>
<tr>
<td></td>
<td>&quot;De minimis&quot;</td>
</tr>
<tr>
<td>&quot;[Q]uite limited...by exception&quot;</td>
<td>1%</td>
</tr>
<tr>
<td></td>
<td>&lt;3%</td>
</tr>
<tr>
<td>&quot;De minimis&quot;</td>
<td>&quot;De minimis&quot;</td>
</tr>
<tr>
<td></td>
<td>3.3%</td>
</tr>
<tr>
<td></td>
<td>&lt;5%</td>
</tr>
<tr>
<td></td>
<td>&lt;5%</td>
</tr>
<tr>
<td>&quot;De minimis&quot;</td>
<td>1.1%</td>
</tr>
<tr>
<td>&quot;De minimis&quot;</td>
<td>&quot;De minimis&quot;</td>
</tr>
<tr>
<td></td>
<td>10%</td>
</tr>
<tr>
<td></td>
<td>11%</td>
</tr>
<tr>
<td>&quot;Not material&quot;</td>
<td>&quot;De minimis&quot;</td>
</tr>
<tr>
<td></td>
<td>&lt;3%</td>
</tr>
<tr>
<td></td>
<td>&lt;5%</td>
</tr>
</tbody>
</table>

*Source: Exhibit RC-3, Shapiro Reply Report.*
## Retail Price Premiums Relative to Large-Customer Contract Prices

### 2014

<table>
<thead>
<tr>
<th>Supplier</th>
<th>In-Store Price Premium</th>
<th>Online Price Premium</th>
</tr>
</thead>
<tbody>
<tr>
<td>Staples</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Office Depot</td>
<td></td>
<td></td>
</tr>
<tr>
<td>OfficeMax</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Note:** Price premiums are based on a basket of actual purchases by large customers in 2014.

**Sources:** Exhibits 6A-6F, Shapiro Report.
Amazon.com Sales in Fortune 100 Market Shares Compared with Amazon Data Submission

- Amazon purchases in F100 share data may appear in 3 places:

<table>
<thead>
<tr>
<th>Supplier Name</th>
<th>$ Purchases</th>
<th>% Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>AMAZON</td>
<td>$1,131,860</td>
<td>0.3%</td>
</tr>
<tr>
<td>OTHER - supplier not specified</td>
<td>$9,714,296</td>
<td>2.3%</td>
</tr>
<tr>
<td>Unreported leakage adjustment</td>
<td>$9,519,097</td>
<td>2.2%</td>
</tr>
</tbody>
</table>

$20.4 million
Customers may have reported “Amazon” explicitly, or captured it within a measure of “other” purchases.

Source: AMAZON001158.xlsx; Exhibit R1B, Shapiro Reply Report.
Unilateral Competitive Effects
Customers Recognize Staples and Office Depot as Closest Competitors

• (June, 2015): “Only two B2B providers, Staples and Office Depot, are left in the Office Supplies space since the merger of Office Depot and OfficeMax.”

• (April, 2014): “Only two providers can support requirements, Staples and Office Depot”

• (November, 2013): “The Big Three are soon to become the Big Two, and will make up 75% of total market share”

Sources: See Shapiro Rpt. at 26 (citing PX07008, PX07001, PX07010).
Staples and Office Depot Recognize They Are Closest Competitors

• Staples (November, 2013): “There are only two real choices for customers. US or Them.”

• Office Depot (March, 2014): “only 2 primary players in the Enterprise space.”

• Office Depot (February, 2015): “I am sure you have heard the news today regarding the Staples acquisition…. I thought it was odd after the Max/Depot merger that global and large national organizations had basically only two options for office supplies. If this deal is approved that will dwindle to one. For companies wanting savings, new terms, or additional incentives now is the time to ink those details in a long term contract. [sic] with Depot.”

Sources: See Shapiro Rpt. at 24-25, 40 (citing PX04082, PX05250, PX07175).
Win-Loss Data Analyses

• **Frequencies**
  – Competitor Appearances: in how many bids did each competitor appear?
  – Competitor Wins: how many bids did each competitor win?

• **Switching Analyses**
  – When Staples or Office Depot lose, who wins those bids?
  – Where do Staples’ and Office Depot’s wins come from?
Types of Win-Loss Data

- Office Depot Win-Loss data
- Staples Win-Loss data
- Office Depot Top Wins/Top Losses data
- Staples Top Wins/Top Losses data
- Fortune 100 RFP data
# Large Customer Annual Retention Rates

<table>
<thead>
<tr>
<th>Supplier</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Staples</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Office Depot</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>OfficeMax</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Note:* Customers are considered retained if current year purchases are >50% of prior year purchases.

*Sources:* Exhibits 16A-16C, Shapiro Report.
Staples and Office Depot Dominate in Fortune 100
RFP Data Appearances

$N = 52$

- Staples: 52
- Office Depot: 47
- W.B. Mason: 4
- Innovative Office Solutions: 3
- American Product Distributors: 2
- Fastenal: 2
- Xpedx / Veritiv: 2

Note: Based on most recent event at each Fortune 100 customer, 2012-2015. In total, 45 suppliers are mentioned.
Source: Exhibit R7A, Shapiro Reply Report.
Staples Dominates in Office Depot’s Win-Loss Data with 833 Appearances

2013-2015 (N = 1253)

Note: Competitors listed have at least 5 appearances. There are 30 competitors with 2 to 4 appearances, and 126 competitors mentioned in total.

Source: Exhibit 10, Shapiro Report.
Office Depot Dominates in Staples Win-Loss Data with 214 Appearances

2012-2014 (N = 393)

Note: Competitors listed have at least 2 appearances. In total, 43 competitors are mentioned.

Source: Exhibit 11, Shapiro Report.
Staples and Office Depot Dominate in Fortune 100 RFP Data with 50 Wins Out of 52

\[ N = 52 \]

Note: Based on most recent event at each Fortune 100 customer, 2012-2015.

Source: Exhibit R7A, Shapiro Reply Report.
Staples Dominates in Office Depot’s Win-Loss Data with 240 Wins
2013-2015 (N = 1253)

Note: Competitors listed have at least 2 wins. In total, 40 competitors are mentioned.
Source: Exhibit 10, Shapiro Report.
Office Depot Dominates in Staples Win-Loss Data with 142 Wins
2012-2014 (N = 393)

Note: Competitors listed have at least 2 wins. In total, 27 competitors are mentioned.
Source: Exhibit 11, Shapiro Report.
# Office Depot and Staples Losses to Competitors

*Fortune 100 Win-Loss Data, 2012-2015*

<table>
<thead>
<tr>
<th>Incumbent</th>
<th>Winner</th>
<th>Number of Bids</th>
<th>Share of Incumbent Losses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Office Depot</td>
<td>Staples</td>
<td>7.0</td>
<td>100%</td>
</tr>
<tr>
<td></td>
<td>Other Suppliers</td>
<td>0.0</td>
<td>0%</td>
</tr>
<tr>
<td>Staples</td>
<td>Office Depot</td>
<td>5.0</td>
<td>91%</td>
</tr>
<tr>
<td></td>
<td>Other Suppliers</td>
<td>0.5</td>
<td>9%</td>
</tr>
</tbody>
</table>

*Source: Exhibit R7B, Shapiro Reply Report.*
Most of Office Depot’s Losses Are to Staples

Office Depot Win-Loss Data, 2013-2015

- Staples, 78.1%
- Other Suppliers, 21.9%

N = 78

Source: Exhibit 13, Shapiro Report.
Most of Staples’ Losses Are to Office Depot

*Staples Win-Loss Data, 2012-2014*

- **Office Depot,** 81.3%
- **Other Suppliers,** 18.7%

\[N = 35\]

*Source:* Exhibit 15, Shapiro Report.
Each Company’s Top Losses Are to the Other
2012-2015

Staples’ Top 50 Losses Went To:
- Office Depot, 80%
- Others, 20%

Office Depot’s Top 50 Losses Went To:
- Staples, 72%
- Others, 28%

Sources: Exhibits 17-18, Shapiro Report.
Each Company’s Top Wins Are From the Other
2012-2015

Staples' Top 50 Wins Came From:
- Office Depot, 80%
- Others, 20%

Office Depot's Top 50 Wins Came From:
- Staples, 77%
- Others, 23%

Sources: Exhibits 19-20, Shapiro Report.
All-Channel U.S. Sales of Consumable Office Supplies

_Millions of Dollars, 2014_

*Source: Exhibit R9, Shapiro Reply Report.*
Estimate of a COGS Gap
Between W.B. Mason and Office Depot

- Based on estimates from OfficeMax-Office Depot merger, doubling in scale lowers COGS by \( \boxed{\%} \).

- W.B. Mason would need to double roughly \( \boxed{\times 2} \) times to match Office Depot’s scale – implying a \( \boxed{6.0\%} \) gap.
8. Powerful Buyers

The Agencies consider the possibility that powerful buyers may constrain the ability of the merging parties to raise prices. This can occur, for example, if powerful buyers have the ability and incentive to vertically integrate upstream or sponsor entry, or if the conduct or presence of large buyers undermines coordinated effects. However, the Agencies do not presume that the presence of powerful buyers alone forestalls adverse competitive effects flowing from the merger. Even buyers that can negotiate favorable terms may be harmed by an increase in market power. The Agencies examine the choices available to powerful buyers and how those choices likely would change due to the merger. Normally, a merger that eliminates a supplier whose presence contributed significantly to a buyer’s negotiating leverage will harm that buyer.

Source: Horizontal Merger Guidelines § 8.
OfficeMax Losses Prior to Merger with Office Depot

in Office Depot Presentation to FTC, 2013

Opportunities for >$150K and >$1M B2B Accounts, 2008-2013

OMX Hunters B2B Accounts
Over $150,000
(n = 273)

- Office Depot, 16%
- Staples, 61%
- Other Suppliers, 23%

OMX Hunters B2B Accounts
Over $1,000,000
(n = 65)

- Staples, 72%
- Office Depot, 11%
- Other Suppliers, 17%

Source: Office Depot OfficeMax Presentation to FTC on Competition for Contract Sales to Large and National Customers, September 13, 2013, pp. 18, 21.
Office Depot Losses Prior to Merger with OfficeMax in Office Depot Presentation to FTC, 2013


Source: Office Depot OfficeMax Presentation to FTC on Competition for Contract Sales to Large and National Customers, September 13, 2013, pp. 18, 21.
Runner-Ups for Office Depot Wins Prior to Merger with OfficeMax

in Office Depot Presentation to FTC, 2013


Source: Office Depot OfficeMax Presentation to FTC on Competition for Contract Sales to Large and National Customers, September 13, 2013, p. 40.
Entry & Expansion
Entry Must Be Timely, Likely, and Sufficient

9. Entry
The Agencies examine the timeliness, likelihood, and sufficiency of the entry efforts an entrant might practically employ.

9.3 Sufficiency
Even where timely and likely, entry may not be sufficient to deter or counteract the competitive effects of concern. For example, in a differentiated product industry, entry may be insufficient because the products offered by entrants are not close enough substitutes to the products offered by the merged firm to render a price increase by the merged firm unprofitable. Entry may also be insufficient due to constraints that limit entrants' competitive effectiveness, such as limitations on the capabilities of the firms best placed to enter or reputational barriers to rapid expansion by new entrants. Entry by a single firm that will replicate at least the scale and strength of one of the merging firms is sufficient. Entry by one or more firms operating at a smaller scale may be sufficient if such firms are not at a significant competitive disadvantage.

Source: Horizontal Merger Guidelines § 9.
## Large Customer Annual Retention Rates

<table>
<thead>
<tr>
<th>Supplier</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Staples</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Office Depot</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>OfficeMax</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Note: Customers are considered retained if current year purchases are >50% of prior year purchases.*

*Sources: Exhibits 16A-16C, Shapiro Report.*
Large Customers Are Sticky

- As Ron mentioned at the bank meeting, a high percentage of our large and mid-sized customers are covered by contracts and these customers tend to exhibit high retention rates due to our integration into their businesses and IT systems.
Other Market Participants Have Higher COGS

- **W.B. Mason:** "I believe that no other vendor can consistently compete effectively with Staples or Office Depot on the cost of goods. They purchase far more volume from manufacturers than any other vendor. From my experience as a buyer of office supplies from manufacturers, I know Staples’ and Office Depot’s unmatched scale leads to unmatched buying power. WBM, as the third-largest office supplies vendor in the country, has some ability to obtain discounts from manufacturers, but not as much as Staples and Office Depot, so our cost of goods is higher."

- **[Masked]:** "In terms of overall purchase volume, it is generally true that the more a customer buys, the better the overall pricing and program incentive. As a result, Office Depot and Staples typically receive better combined pricing and program incentives based on their mix of purchases (less commodity/higher value mix) than do smaller independent dealers. Further, independent dealers often require additional services (e.g., catalog support, marketing programs, digital platform support, etc.), which must be covered in the overall transactional pricing and incentive programs that they receive."

- **[Masked]:** "Based on my experience working for [Masked] for over a decade, I am familiar with the difference in COGS that large companies like Staples and Office Depot can negotiate with manufacturers compared to [Masked]. Although it varies based on the commodity and manufacturer, I estimate that Staples and Office Depot are able to obtain a net cost differential (including back-end rebates) of about 5% to 25% lower."

*Sources:* [Masked]
Purchasing Cost Advantages Are Driven by Manufacturer-Direct Purchasing

Share of Procurement from Manufacturers

- Staples
- Office Depot
- W.B. Mason
- HiTouch
- Guernsey

Sources: PX04629 (Staples); PX05424 (Office Depot).

Less than 50%
Staples Touts Benefits of Minimal Reliance on Wholesalers to Customers

secondary Staples FCs or our wholesalers. As the world’s largest office supplier, Staples has a supply chain model that sources directly from manufacturers, especially on our top selling items. More than 90% of Staples sales to our customers are fulfilled from our network of fulfillment centers, or is shipped directly from a manufacturer to our customers. Only a very small percentage of our existing sales come from wholesalers.

This contrasts with many dealers that fulfill principally from wholesaler facilities. This “dealer model” requires that products travel through three different steps in the supply chain before they get to the customer – manufacturer, wholesaler, local dealer – which translates into three different markups when developing a customer’s end price. In sourcing directly from manufacturers, Staples bypasses one stop in the supply chain. This translates to one less markup – and, ultimately – savings to our customers.

Minimized Wholesaler Dependence

Staples’ inventories throughout our network of fulfillment centers represent the most popular brands that customers demand. Our product inventories represent more than 95% of the items sold everyday. As a result, we have been able to minimize our dependence on wholesaler product inventories, resulting in higher fill rates and more competitive pricing since we are not paying an inflated cost for the product.

Sources: PX04484 (Staples); PX04641 (Staples).
## Dispersion of Locations

### Staples, Office Depot & OfficeMax Customers

#### 2014

<table>
<thead>
<tr>
<th>Vendor</th>
<th>Customer Group</th>
<th>Average Counts</th>
<th>Average Distance to Center (Miles)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Zip Codes</td>
<td>States</td>
</tr>
<tr>
<td>Staples</td>
<td>All Customers</td>
<td>5</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>Large Customers</td>
<td>552</td>
<td>29</td>
</tr>
<tr>
<td>Office Depot</td>
<td>All Customers</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Large Customers</td>
<td>582</td>
<td>27</td>
</tr>
<tr>
<td>OfficeMax</td>
<td>All Customers</td>
<td>10</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>Large Customers</td>
<td>461</td>
<td>23</td>
</tr>
</tbody>
</table>

**Sources:** Exhibits 4A-4B, Shapiro Report.
Distribution Network Cost Disadvantage

- **W.B. Mason**: “In addition, I believe that Staples’ and Office Depot’s nationwide networks of distribution centers and their high sales volume results in costs that are far lower than vendors that must rely more (or entirely) on wholesalers for distribution.

  Outside of this area, we rely entirely on Essendant, and our costs are much higher. This results, on average, in net profit margins [redacted] for sales outside of Masonville.”

- **[Redacted]**: “Essendant, the office products wholesaler, is the principal third party upon which we rely to serve out-of-market customer locations. Specifically, we rely on Essendant to pick and pack orders from its own warehouses and deliver those orders to out-of-market customer locations either directly or through third-party couriers. This distribution method is more costly compared to when we deliver products from our own warehouses. Essendant generally charges us delivery fees of between 7% and 13% of our total costs of goods for the order. By comparison, within our geographic footprint, our delivery costs usually only total about 3.50% of our costs of goods.”

- **[Redacted]**: “Because we lack the distribution assets outside of our primary operating region [redacted] must rely on third parties to serve these customers’ locations. . . . [redacted] uses [redacted] network of member-dealers, wholesalers such as Essendant or S.P. Richards, or common carriers like FedEx and UPS to complete these deliveries. Relying on wholesalers and common carriers, however, is more costly than when we deliver direct from one of our eight warehouses.”

- **[Redacted]**: “Relying on wholesalers like Essendant and S.P. Richards for packaging and delivery services costs [redacted], on average, 5% more than if it was delivering to its own customers.”

- **[Redacted]**: “Additionally, [redacted] has difficulty serving customers [redacted] because our delivery costs with third-party couriers, UPS, and FedEx are twice as high as delivery using our own trucks. This significant cost difference makes it cost-prohibitive for [redacted] to compete for a customer where a majority of the customer’s orders will be delivered [redacted].”

*Sources: PX03021 ¶ 24 (W.B. Mason)*
Time and Costs to Build Distribution Centers

• **W.B. Mason**: “It would take at least [redacted] years to expand into that many new markets, and even that pace would entail a serious increase in our usual rate of expansion.”

• [redacted]: “[redacted] preferred expansion model is to acquire smaller dealers,” and “[e]ven this expansion model takes time and resources, [they] have only executed three such acquisitions in the last 10 years.”

• [redacted]: explains that “‘greenfield’ entry (i.e., building a new distribution center in a new area) is time consuming, financially risky, expensive, and logistically challenging[;]” the distribution center they added in 2001 cost over $5 million.

Sources: PX03021 Decl. ¶ 36 (W.B. Mason); [redacted]
Primary Vendor Relationship Shares

Consumable Office Supplies, 2014

Source: Exhibit R2, Shapiro Reply Report.
Staples Dominates in Office Depot’s Win-Loss Data with 833 Appearances

2013-2015 (N = 1253)

Note: Competitors listed have at least 5 appearances. There are 30 competitors with 2 to 4 appearances, and 126 competitors mentioned in total. 

Source: Exhibit 10, Shapiro Report.
Office Depot Dominates in Staples Win-Loss Data with 214 Appearances

2012-2014 (N = 393)

Note: Competitors listed have at least 2 appearances. In total, 43 competitors are mentioned.

Source: Exhibit 11, Shapiro Report.
Primary Vendor Relationship Shares

Consumable Office Supplies, 2014

Source: Exhibit R2, Shapiro Reply Report.
Competitor Views on Expansion

- **[Redacted]:** "**[Redacted]** has no specific plans to expand into any new markets."

- **[Redacted]:** "Even if Staples merged with Office Depot and the combined firm raised prices significantly (by 10%, for example), we would not alter our expansion plans. We currently do not have any excess physical capacity."

- **[Redacted]:** "**[Redacted]** has no material plans to pursue large national or multiregional customers, like Fortune 1000 companies. **[Redacted] does not have the resources to expand our geographic footprint or invest in the services necessary to compete for these large customers, and I do not see **[Redacted] making these investments within the foreseeable future."

- **[Redacted]:** "**[Redacted]** focuses on customers smaller than [the Fortune 1000], mostly within our primary operating region."

- **[Redacted]:** "**[Redacted]** has no foreseeable plans to materially expand our business to pursue large national or multiregional accounts, such as Fortune 500 companies."

- **[Redacted]:** "**[Redacted]** would find it prohibitively expensive to make the investments necessary to compete for large business customers the way Staples and Office Depot do today."

- **[Redacted]:** "**[Redacted]** lack of a national sales and distribution network has impeded our ability to win national accounts. . . . More often than not, we choose not to bid on national accounts, because . . . it is an exercise in futility."

Sources: [Redacted]
Ability of Consortia to Expand
Primary Vendor Relationship Shares

*Consumable Office Supplies, 2014*

*Source:* Exhibit R2, Shapiro Reply Report.
# Manufacturer Market Shares

## Largest Vendors to Staples and Office Depot

*Fortune 100 Customers, 2014*

<table>
<thead>
<tr>
<th>Vendor</th>
<th>$ Sales</th>
<th>% Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>GP OPERATIONS HOLDINGS (GEORGIA-PACIFIC)</td>
<td>$6,740,000</td>
<td>1.57%</td>
</tr>
<tr>
<td>DOMTAR INC</td>
<td>$3,361,399</td>
<td>0.78%</td>
</tr>
<tr>
<td>INTERNATIONAL PAPER</td>
<td>$270,400</td>
<td>0.06%</td>
</tr>
<tr>
<td>AVERY DENNISON</td>
<td>$147,866</td>
<td>0.03%</td>
</tr>
<tr>
<td>ACCO BRANDS</td>
<td>$31,474</td>
<td>&lt; 0.01%</td>
</tr>
<tr>
<td>NEENAH PAPER INC</td>
<td>$34</td>
<td>&lt; 0.01%</td>
</tr>
<tr>
<td>3M CORPORATION</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>BIC CORPORATION</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>SANFORD CORP</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>SOUTHCOAST PAPER</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>SOUTHCOAST SOLUTIONS LLC</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>TST IMPRESO, INC</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

| Total | $10,551,174 | 2.44% |

*Source: Exhibit RE-3, Shapiro Reply Report.*
Efficiencies
Efficiencies Framework

10. Efficiencies

The Agencies credit only those efficiencies likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects. These are termed merger-specific efficiencies. Only alternatives that are practical in the business situation faced by the merging firms are considered in making this determination. The Agencies do not insist upon a less restrictive alternative that is merely theoretical.

Efficiencies are difficult to verify and quantify, in part because much of the information relating to efficiencies is uniquely in the possession of the merging firms. Moreover, efficiencies projected reasonably and in good faith by the merging firms may not be realized. Therefore, it is incumbent upon the merging firms to substantiate efficiency claims so that the Agencies can verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved (and any costs of doing so), how each would enhance the merged firm’s ability and incentive to compete, and why each would be merger-specific.

Source: Horizontal Merger Guidelines § 10.
Proposed Remedy
Proposed Remedy is Insufficient

- Proposed divestiture contingent on customers willing to assign contracts and Staples and Essendant agreeing to transition services agreement
- Essendant will not compete with Staples and Office Depot for large customers
- Essendant will be dependent on Staples
- Essendant lacks attributes to serve large customers
Staples-Office Depot Merger Analysis

Summary of Opinions

1. Relevant Market:
The sale and distribution of consumable office supplies to large customers in the United States.

2. Market Shares:
Staples and Office Depot have a combined share of at least 79% in the relevant market.

3. Competitive Effects:
Price increases likely as Staples and Office Depot compete vigorously with one another and other competitors are distant alternatives.

4. Entry and Expansion:
Entry by new suppliers, or expansion by existing market participants, will not be timely, likely, and sufficient to deter or counteract a post-merger price increase by Staples.

5. Efficiencies:
Not likely to be passed through even if verifiable and merger specific.

6. Proposed Divestiture:
Inadequate remedy that will not alleviate the anticompetitive harm.
The Proposed Merger of Staples and Office Depot:
Lessons from History and New Competitive Concerns

July 22, 2015

Randy M. Stutz*

I. Introduction

The proposed combination of Staples and Office Depot presents the Federal Trade Commission (FTC) with a host of merger review challenges. The transaction follows closely on the heels of the Office Depot/OfficeMax merger in 2013 and would complete a rapid 3-1 consolidation of the office supply superstore (OSS) market. Both retail and business-to-business customers may be significantly affected by the proposed transaction. The deal puts front and center the question whether evolving alternative business models for the sale of consumable office supplies are a viable substitute for OSSs. It also raises issues that the Commission recently addressed in the successfully enjoined merger of national broadline foodservice distributors Sysco and U.S. Foods – namely that a merger of the only two rivals in a national market may have adverse unilateral effects in a targeted customer market.

The American Antitrust Institute (AAI) is concerned that the proposed transaction may substantially lessen competition in the market for the sale of consumable office supplies to large multi-regional or national customers on a contract basis (hereinafter “enterprise customer market” or “enterprise market”). In particular, we are concerned that the proposed transaction threatens substantial unilateral anticompetitive effects that alternative supply responses could not ameliorate, and that harm to customers in this market will be passed on to consumers. Some of these harms implicate unique dimensions of quality competition involving cyber security and supply chain stability. We also raise questions as to whether rapid 3-1 consolidation threatens to reverse recent positive competitive developments in the retail office supply market, as well as the competitive significance of merging the only “omnichannel” retailers principally devoted to office supplies.

The analysis in this white paper is based on our review of publicly available information and conversations with industry experts and analysts. Because we do not have access to confidential or proprietary information that the Commission collects in the course of its investigation, we draw no conclusions as to whether the merger violates Section 7 of the Clayton Act. However, our analysis

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* Randy M. Stutz is Associate General Counsel of the American Antitrust Institute (AAI). AAI President Diana Moss assisted in the drafting of this white paper, and AAI Research Fellow Arthur Durst provided valuable research assistance and assisted in drafting Section II. Various AAI Board members and Staff also contributed guidance and original thinking. The AAI is an independent and non-profit education, research and advocacy organization devoted to advancing the role of competition in the economy, protecting consumers, and sustaining the vitality of the antitrust laws. See www.antitrustinstitute.org.

1730 RHODE ISLAND AVE., NW • SUITE 1100 • WASHINGTON, DC 20036
PHONE: 202-536-3408
http://www.antitrustinstitute.org
makes clear that the proposed merger warrants very close scrutiny by the Commission. Major themes that emerge from this analysis include:

- The Commission should determine whether there is a distinct relevant product market for the sale of consumable office supplies to large “enterprise” office supply customers on a contract basis, and if so, who participates in this market. This is consistent with the Commission’s successful approach to defining targeted customer markets in *Sysco v. Fed. Trade Comm’n*.

- The enterprise contract market likely is a relevant antitrust market because enterprise customers have no viable substitutes for the product and service offerings provided by OSSs. The next largest rivals are distant to Staples and Office Depot and are unable to compete on the scale and scope of the merging parties. Moreover, the merging firms may be the only participants in this market, because potential supply-side responses likely would fail to defeat a post-merger price increase in the market.

- The proposed transaction threatens substantial unilateral anticompetitive effects in the enterprise market, and possibly also in the broader market for all contract customers. Potential anticompetitive harm arises not only from the loss of ordinary head-to-head competition between the merging firms, which is substantial, but also from the loss of competition to provide superior cyber security to contract customers and by increased supply chain fragility resulting from elimination of any redundancy in the OSS channel. Potential anticompetitive effects are unlikely to be mitigated by repositioning or new entry.

- In its 2013 review of the Office Depot/OfficeMax merger, the Commission likely did not go far enough in distinguishing among competitive dynamics within and across the retail distribution channels through which OSSs provide products to end consumers. Although competition in the pure online retail channel is likely disciplined by national competition from Amazon and others, there are competitive concerns in the traditional superstore channel and in the emergence of omnichannel stores that warrant careful attention.

II. Background

Staples and Office Depot agreed to a $6.3 billion merger in February 2015, just fifteen months after Office Depot absorbed the merging firms’ long-time rival OfficeMax. The nation’s two remaining OSSs currently compete to sell office supplies, office furniture and technology products to businesses pursuant to long-term contracts, and to consumers through retail stores, catalogs, and online. Staples is reportedly the fourth largest online retailer behind Amazon, Apple and Wal-Mart, while Office Depot is sixth.\(^1\) The proposed transaction would move the merged firm ahead of Wal-Mart into third, with a combined $15.53 billion in web sales.\(^2\)


\(^2\) *Id.*
Staples first sought to acquire Office Depot in 1997, but the Commission intervened and sued to block the deal in federal district court. In a landmark antitrust ruling, Judge Hogan enjoined the transaction based on the Commission’s powerful economic evidence.3 Compelled by the Commission’s demonstration of likely unilateral price effects, the court defined a relevant antitrust market for the sale of consumable office supplies sold through OSSs. In particular, the court highlighted econometric evidence showing significant percentage differences in pricing depending on how many OSSs were in a given geographic market.

Fast forward 16 years. In 2013, when Office Depot sought to acquire OfficeMax, the Commission cleared the transaction in its entirety, without divestitures.4 The Commission found that the market for the retail sale of consumable office supplies had broadened as a result of competition from mass merchants and warehouse clubs, coupled with the emergence of the online retail channel. The evidence and supporting econometric analysis suggested that OSSs had abandoned their price zones from the late 1990s in favor of national and/or local pricing schemes that accounted for non-OSS competition. The Commission therefore concluded the transaction was unlikely to substantially lessen competition in the retail market.

In addition to the retail market, however, the Commission’s 2013 investigation revealed a relevant market for the commercial sale of consumable office supplies to businesses through long-term contracts (hereinafter “broader contract market” or “all contract customers market”). Today, these business-to-business contract sales account for approximately 35-40% of the merging firms’ total sales. Staples serves this market with its Staples Advantage and Quill brands, and Office Depot with its Business Solutions Division (BSD). Staples Advantage has approximately 270,000 customers ranging from mid-size businesses (20 or more employees) to Fortune 1000 multinational corporations and federal and state government institutions. It serves about half of the organizations listed on the Fortune 1000 and more than 65% of the Fortune 100.5

Leading up to, and after, the Office Depot/OfficeMax merger, the contract channel has been growing as the retail channel has been declining. Prior to Office Depot/Office Max, industry analysts described the contract channel as “where the upside is” and where “the real money is in this business,” because the contract channel “is more protected, while retail is under pressure from Amazon, discounters, and over-storing.”6 At the time, Staples acknowledged in a 2012 earnings call discussion that the contract market generally and the enterprise market in particular were lucrative and very competitive, yet “disciplined” in terms of pricing.7 In the years since 2012, the commercial

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7 See Staples Management Discusses Q1 2012 Results – Earnings Call Transcript, SEEKING ALPHA (May 16, 2012), http://seekingalpha.com/article/5094951-staples-management-discusses-q1-2012-results-earnings-call-transcript (“There are instances where there is some competitive pricing in the lower-margin enterprise account area . . . . We have -- very disciplined there. . . . And again, we’re going to continue to be very disciplined. And if you look at our profit growth in the quarter, it was driven by Contract because of the great discipline that we have continued to maintain in that business.”) (quoting Joseph Doody, President of North American Delivery).
segment has been Staples’ only segment with sales growth and has provided the company’s highest income as a percentage of sales.8

This white paper examines the business of selling consumable office supplies through both negotiated contracts and retail outlets. We explore the competitive impact of the proposed transaction through an analysis of several markets. In Section III, we discuss the merger’s impact in the broader contract market identified by the Commission in 2013, with particular attention to the question whether there is a distinct relevant market for enterprise contract customers. This section discusses competitive effects on price, choice and quality competition, and it raises questions regarding cyber security competition and supply chain fragility. Section IV analyzes the merger’s impact in the broader retail market identified by the Commission in 2013, including the merits of considering effects on online competition, traditional brick-and-mortar office superstore competition, and omnichannel store competition. This section focuses on potential competitive effects on price, quality and choice in the merged firm’s sales through traditional office superstores and through omnichannel stores in the retail market.

III. The Contract Market

The Commission described the contract market it identified in its 2013 review of the Office Depot/OfficeMax merger as “the sale of consumable office supplies to businesses and other customers on a contract basis.”9 It found that customers transact with office suppliers on a contract basis to “receive discounted pricing based on actual or anticipated purchase volume” and “to order office products at previously negotiated prices.”10 It found that demand in this contract market comes from “[m]any businesses and public entities,” including “small and medium-sized businesses” as well as “large multi-regional or national customers.”11

In analyzing this broad market for all contract customers, the Commission concluded that Office Depot/OfficeMax was unlikely to substantially lessen competition for five reasons: (1) there were “dozens, if not hundreds,” of suppliers capable of serving small and medium-sized contract customers in this market; (2) there was evidence that the merging firms had lost contract business to non-OSSs (where non-OSSs were capable of competing); (3) there was evidence that large contract customers sometimes negotiated separately for individual office products within the office supplies category (like paper and toner); (4) the merging firms were rarely each other’s closest competitors for large contract customers; and (5) the merged firm would continue to face strong competition for large contract customers from Staples, as well as non-OSS competitors (where non-OSSs were capable of competing).12

Since this first foray into the broader contract market, however, the Commission has not had an opportunity to make two additional, important determinations. The first is whether there is a distinct relevant product market for the sale of consumable office supplies to large multi-regional or national “enterprise” contract customers. The second is who is capable of competing in such a market.

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8 Staples Inc., Annual Report (Form 10-K) 2015 (at B-7, B-8).
9 Closing Statement, supra note 4.
10 Id.
11 Id.
12 Id.
In 2013, the Commission foreshadowed the possibility that enterprise contract customers may form a distinct relevant market, noting that such customers may have “demanding purchasing requirements and, as a result, fewer potential suppliers capable of meeting their needs.” However, at the time, the Commission appeared convinced that some combination of Staples and non-OSSs would sufficiently discipline the new Office Depot. The Commission expressly did not assess whether large enterprise contract customers form a distinct relevant product market, and if so, who participates in the market.

### A. Market Definition Here Should Be Informed by Sysco/U.S. Foods and Office Depot/OfficeMax

The current proposed combination of Staples and Office Depot requires a deeper analysis of the competition to serve large enterprise contract customers. To be sure, the Commission may find that the transaction may substantially lessen competition in the broader contract market, which includes contract customers of all sizes. According to one report, the merging firms have a combined 70-75% share of the “overall corporate office supply market.” However, if the enterprise contract market is a distinct relevant product market, the proposed transaction seems significantly more likely to substantially lessen competition. In defining relevant markets here, the Commission should follow the same longstanding principles it successfully advanced in *Fed. Trade Comm’n v. Sysco*.

#### 1. Customers in Defined Markets Versus Markets Defined By Customers

Judge Mehta’s opinion in *Sysco* includes an important discussion of the sometimes confused analytical treatment courts have given groups of customers that may be differently situated economically within defined relevant product markets. As the *Sysco* court recognized, there has been controversy where the Commission is said to have tried to define relevant product markets without regard to customers, but to have conceded that only one subset of customers in the market likely would switch in response to a small but significant and non-transitory increase in price (SSNIP), while another subset of customers likely would not. However, there is no controversy where the Commission has instead defined a relevant product market *by reference* to the subset of customers that likely would switch in response to a SSNIP.

The *Sysco* court correctly observed that a product and customer can “converge” to form a distinct relevant product market, including, for example, when the “customer’s requirements operate to
define the product offering itself.”19 Quoting the Horizontal Merger Guidelines, the court stated that “[i]f a hypothetical monopolist could profitably target a subset of customers for price increases, the Agencies may identify relevant markets defined around those targeted customers, to whom a hypothetical monopolist would profitably and separately impose at least a SSNIP.”20 “Ultimately,” Judge Mehta explained, “the court here need not resolve the Whole Foods disagreement over defining a market around a ‘core’ customer. That is because the ordinary factors that courts consider in defining a market—the Brown Shoe practical indicia and the Merger Guidelines’ SSNIP test—support a finding that broadline distribution to national customers is [itself] a relevant product market.”21

In 2013, the Commission defined only a broad market for sales to all contract customers and stated that it “focused on” large national and multi-regional customers within that market.22 Here, consistent with Sysco, the Commission should instead determine whether there is a distinct relevant product market for the sale of consumable office supplies to these enterprise contract customers, notwithstanding that there may also be a broader relevant market for the sale of consumable office supplies to contract customers of all sizes.23

2. Enterprise Contract Customers Have Requirements that OSSs Uniquely Fill

AAI encourages the Commission to examine very carefully whether the merged firm would have the ability and incentive to impose a SSNIP in the enterprise contract market. We are concerned that the merging firms may be meaningfully insulated from competition in this market because of their enormous purchasing power, integrated centralized purchasing and delivery systems, dedicated sales support, and technological advantages. If that is the case, then enterprise customers may have very few or no viable alternatives to Staples and Office Depot in purchasing office supplies on a contract basis.

Perhaps the most pressing concern in this market is that Staples and Office Depot have unrivaled purchasing power, which they can leverage against smaller manufacturers of office products. Because small office supply manufacturers rely heavily on OSSs to continue placing large orders for a variety of office products, OSSs are able to extract favorable terms in their negotiations. Consequently, the merging firms have been able to offer unparalleled volume discounts and rebates.

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19 Id. at *72-73 (emphasis added).
20 Id. at *72 (quoting U.S. Dept’t of Justice & Fed. Trade Comm’n, Horizontal Merger Guidelines § 4.1.4 (2010) [hereinafter Horizontal Merger Guidelines]); see also Horizontal Merger Guidelines § 4.1.4 (“The Agencies also often consider markets for targeted customers when prices are individually negotiated and suppliers have information about customers that would allow a hypothetical monopolist to identify customers that are likely to pay a higher price for the relevant product. If prices are negotiated individually with customers, the hypothetical monopolist test may suggest relevant markets that are as narrow as individual customers . . . .”).
21 Sysco, 2015 U.S. Dist. LEXIS 83482 at *76-77.
22 Closing Statement, supra note 4.
23 Because the analysis in this letter focuses on defining a relevant product market by reference to the demands of large, geographically dispersed customers, we do not include a detailed discussion of the relevant geographic market. See Horizontal Merger Guidelines § 4.2.2 (“When the hypothetical monopolist could discriminate based on customer location, the Agencies may define geographic markets based on the locations of targeted customers. Geographic markets of this type often apply when suppliers deliver their products or services to customers’ locations. Geographic markets of this type encompass the region into which sales are made.”); id. at note 7 (“For customers operating in multiple locations, only those customer locations within the targeted zone are included in the market.”). We do discuss geographical considerations in the context of supply responses in Section III.A.3.
to their own contract customers. Our understanding is that rebates offered by Staples and Office Depot are substantially higher than the next largest potential competitors.

These enormous direct pricing advantages are bolstered by substantial indirect pricing advantages. Although large customers sometimes source a small number of office supply products independently, such as paper and toner, most rely very heavily or exclusively on having a centralized, multi-regional office supply purchasing system to realize additional savings. Where large customers operate nationally or across multiple geographic regions, integrated centralized ordering and purchasing systems are necessary to reduce costs. This occurs through monitoring firm-wide spending, maximizing volume discounts, “rationalizing” SKUs (i.e., working toward reducing overall variety of SKUs and thereby increasing per-SKU ordering volume, which helps capitalize on volume discounts), and avoiding added expense and prohibitive impracticalities associated with a morass of different ordering, invoicing, payment and delivery practices across local manufacturers and suppliers in different geographic regions.

Finally, the merging firms appear to have unique technological scale advantages, and specifically the ability to customize integrated e-commerce infrastructure to meet the varying needs of large customers and their idiosyncratic internal ordering and payment systems. Office Depot’s Business Solutions Division, which has a dedicated technology division, advertises that it can meet its largest customers’ unique computing requirements by “follow[ing] your billing specifications to support your company’s unique operation.” Office Depot employs “state-of-the-art reporting technology” to monitor spending, with a dedicated e-commerce website and Customer Integration Team. Staples Advantage has advertised, among other things, its “E-Procurement expertise” and ability to “customize an e-procurement solution” to control costs, streamline ordering, increase program compliance and save users’ time, as well as its dedicated Account Managers.

Publicly available information does not confirm whether the merging firms’ enormous purchasing power, centralized purchasing and delivery systems, technological advantages, and the deep volume discounts and direct and indirect cost-savings they engender, would prevent enterprise office supply purchasers from switching suppliers in response to a post-merger price increase. However, we encourage the Commission to answer this question by compiling an RFP/bidding database and

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26 See id. at 1-5, (discussing reduced purchased costs, higher procurement process efficiency, reduced purchase-to-pay costs, and reduced noncompliance costs that come with supplier consolidation).


conducting aggregate diversion analysis, as it did in Sysco. Detailed information on RFP/bidding results also would shed important light on the severity of unilateral effects threatened by the merger, which is another important issue discussed infra.

3. Patchwork Approaches, National Supplier Co-operatives, and Firms in Adjacent Markets Likely Do Not Count as Enterprise Market Participants

If the Commission does find a relevant product market for the sale of consumable office supplies to enterprise contract customers, a critical question is which suppliers participate in the market. If there are alternative suppliers in the enterprise market or suppliers that would enter the market in response to a post-merger price increase, then the risk that the proposed transaction may substantially lessen competition is diminished.

As the Commission recognized in its 2013 Closing Statement, several supply alternatives to OSSs are capable of serving small and medium-sized customers, as well as some proportion of larger customers. We encourage the Commission to look closely into whether any of these alternatives would constrain a combined Staples/Office Depot in the enterprise market. Based on a review of publicly available information, it seems likely they would not.

In Office Depot/OfficeMax, the Commission relied heavily on the disciplining force of Staples, which was a strong #1 in the broader contracting channel at the time. In addition, however, the Commission determined that the merged firm would be further constrained because some proportion of large customers also would be able to source (or threaten to source) office supplies (1) directly from manufacturers, (2) using multiple smaller suppliers, some of which operate regionally, like W.B. Mason, or (3) using multiple distributors and wholesalers to create expanded distribution networks (hereinafter collectively, “patchwork approaches”).

While some of the patchwork-approach alternatives to OSSs may suffice in some measure for some larger customers, publicly available information suggests it is highly doubtful they can be effectively employed (or threatened) in the enterprise market. First, sourcing directly to manufacturers or using multiple smaller suppliers necessarily means foregoing substantial volume discounts from the merging firms. At the same time, enterprise contract customers would incur large cost increases associated with inefficiencies in having to work with the different ordering, invoicing, payment and delivery systems of distinct manufacturers and suppliers in a multitude of different regions. Moreover, unless and until these customers develop their own proprietary or third party alternative solutions, decentralization eliminates an enterprise customer’s practical ability to seek additional indirect cost savings through SKU rationalization, firm-wide-spend monitoring across different geographic regions, and otherwise.

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30 See infra Section III.B.; see also Horizontal Merger Guidelines § 6.1 (“[d]iversion ratios between products sold by one merging firm and products sold by the other merging firm can be very informative for assessing unilateral price effects”).
31 See Horizontal Merger Guidelines § 5.1 (“Firms that are not current producers in a relevant market, but that would very likely provide rapid supply responses with direct competitive impact in the event of a SSNIP, without incurring significant sunk costs, are also considered market participants.”); id. (“if the relevant market is defined around targeted customers, firms that produce relevant products but do not sell them to those customers may be rapid entrants if they can easily and rapidly begin selling to the targeted customers.”).
A patchwork approach might theoretically provide the nationwide geographic coverage required by enterprise customers. But it is unlikely to come close to matching the purchasing power of integrated OSSs, which buy volume not only for their substantial contract business involving customers of all sizes, but also to meet multi-billion dollar demand for online and brick-and-mortar retail sales. In addition, it seems highly unrealistic to expect a geographically dispersed jumble of dealers and suppliers of different sizes and sophistications to match OSSs in consistency, reliability, quality, technological ability, and customer service.

The customer switching costs associated with substituting a patchwork approach for an OSS are likely enormous. According to the results of a Staples-sponsored case study of the Guild Mortgage Company, the costs of substituting a patchwork approach for Staples Advantage can run to $30,000 per month, or $360,000 annually. Consequently, on a hypothetical $1 million annual contract with Guild, the merged firm apparently would be able to impose a price increase equivalent to as much as $350,000, or 35%, without losing sales to a patchwork approach. Accordingly, it seems extremely unlikely that the actual or threatened use of a patchwork approach would defeat a SSNIP by the merged firm in the enterprise market.

In Office Depot/Office Max, the Commission also noted that OSSs might be further disciplined by supplier co-operatives capable of serving large customers, and that the merged firm might face potential competition from suppliers in adjacent markets for janitorial and industrial products. We think both are unlikely here.

Nationwide co-operatives of small suppliers can provide an integrated alternative to a patchwork approach, may have the ability to provide the nationwide geographic coverage that enterprise customers require, and appear be to working toward comparable technological offerings. And co-operatives have the advantage of being in the market now and actively competing for large customers. However, co-operatives’ near total inability to constrain the OSSs is evident in their demonstrable lack of success in the enterprise market. Publicly available information suggests that, with rare exceptions, the national co-operatives have consistently lost out to OSSs because of substantial purchasing power disadvantages and other inefficiencies that have prevented them from

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32 See Saving Time and Money Through Consolidation, What’s New in Spend Management 20, My Purchasing Center (Staples Advantage Sponsored Case Study), http://www.mypurchasingcenter.com/files/4714/0354/8637/Staples_Advantage_eGuide_5.pdf (last visited July 20, 2015) (“Guild has gone from managing 20 suppliers to 1, and has reduced the number of invoices they process per week by 80 percent. Consolidation in the office supply category alone has resulted in $30,000 in savings per month through improved product standardization. And workload has been reduced by 40 hours a month.”); see also Staples Advantage Brochure, available at http://www.staplesadvantage.com/assets-sa-unification/pdfs/capabilities-brochure.pdf. (“Managing multiple suppliers could be costing your organization hundreds or even thousands of dollars. Instead, a comprehensive supply program from a single provider will provide negotiating power and cost-efficiencies.”).

33 We encourage the Commission to interview procurement officers at Guild, as well as other companies that have switched from a patchwork approach to an OSS platform or vice versa, regarding the challenges of substituting a patchwork approach for an OSS.

34 Closing Statement, supra note 4.

35 Point Nationwide, for example, advertises that “We have a Microsoft based, state-of-the-art ERP system that provides visibility and flexibility. We provide scalable and customizable reporting, billing, and delivery solutions via one platform at Internet speed across the nation.” Point Nationwide, About Us, https://www.poin7nationwide.com/about-us.html (last visited July 20, 2015). But it does not appear to be PunchOut certified. See infra note 37.

36 See Horizontal Merger Guidelines § 9 (“The Agencies consider the actual history of entry into the relevant market and give substantial weight to this evidence.”).
constraining what were once the “big three” and are now the “big two.” Publicly available information thus suggests they would stand no chance at all against the “big one.”

At first blush, rapid entry or potential competition from large suppliers in adjacent markets, such as industrial and janitorial supplies, may appear to pose a competitive threat. These firms likely can provide ample nationwide geographic coverage, may use very similar or overlapping e-procurement technology solutions,37 and likely have existing sales relationships with many enterprise customers who make contract purchases in several categories. Moreover, these customers would stand to realize internal efficiencies by working with a single supplier for all of their office supply needs in addition to industrial or janitorial needs.38 However, to be credited in merger analysis, rapid entrants must be “very likely [to] provide rapid supply responses with direct competitive impact . . . without incurring significant sunk costs,” while entry by potential competitors must be “timely, likely and sufficient in magnitude, character and scope.”39 Here, each seems doubtful.

To compete effectively for enterprise customers, these adjacent firms would not only have to enter the market nationally across a huge number of different office supply categories, but they would have to invest enormously in those categories to become capable of offering comparable volume discounts and rebates. They would also have to invest heavily in re-branding their entire business and learning how to adequately deliver a different set of unique products and services to enterprise office supply customers, which would likely exceed reasonable boundaries of inventory management given the huge number of products across both industries.

We are not aware of any firm that has ever even tried to fully compete as both an OSS and a comparably large industrial or janitorial supplier simultaneously, and certainly none that has ever done so successfully.40 While there is some evidence of entry by industrial and janitorial supply firms and OSS’s in each others’ businesses at the margins, neither has expanded to compete in the other’s market beyond the margins, and sophisticated large customers continue to do contract business with both kinds of firms despite the prospect of additional savings through supplier consolidation.41 We see no evidence to suggest that large suppliers in adjacent industrial and

37 A variety of third parties offer e-procurement software solutions that allow procurement officers to purchase products on the Internet by connecting them through intermediaries. Ariba, a subsidiary of SAP, markets a solution called “PunchOut” to enterprise-level suppliers and customers. When buyers and sellers integrate into the PunchOut platform, a buyer can access the seller’s inventory from within its own procurement system and place orders and gather pertinent information. At present the merging firms are the only two office supply sellers that are “Ariba Ready” at the highest “Platinum” level. However, Grainger is also an Ariba Ready Platinum Seller. See ARIBA, Ariba Ready Platinum Sellers, http://www.ariba.com/suppliers/subscriptions-and-pricing/b2b-e-commerce/ariba-ready-platinum (last visited July 20, 2015). The extent to which the Ariba product alone, or another similar product, might serve as a viable substitute for an OSS platform’s solutions and services is not apparent based on our review of publicly available information.

38 See MITCHELL & SAWCHUK, supra note 25 at 3 (encouraging firms to try to seek cost savings by consolidating suppliers even beyond traditional categories, such as by relying on industrial suppliers for office supplies or vice versa).

39 Horizontal Merger Guidelines §§ 5.1, 9.

40 See id. § 9 (“The Agencies consider the actual history of entry into the relevant market and give substantial weight to this evidence.”).

41 See Horizontal Merger Guidelines § 9.3 (entry that is sufficient must “replicate at least the scale and strength of one of the merging firms”); c.f. U.S. Dept’ of Justice & Fed. Trade Comm’n, Commentary on the Horizontal Merger Guidelines 31 (2006) (“The Agencies rarely find evidence that repositioning would be sufficient to prevent or reverse what otherwise would be significant anticompetitive unilateral effects from a differentiated products merger. Repositioning of a differentiated product entails altering consumers’ perceptions instead of, or in addition to, altering its physical properties. The former can be difficult, especially with well-established brands, and expensive efforts at doing so typically pose a significant risk of failure and thus may not be undertaken.”).
janitorial supply markets ever have or ever will serve as a rapid entrant or potential competitive constraint on OSSs in the enterprise market, except at the margins.42

4. Amazon Business Likely Does Not Count as an Enterprise Market Participant

The Commission did not identify any other actual or potential alternative sources of supply for the broader contracting channel in 2013. Here, however, it will likely consider the potential disciplining force of Amazon’s business-to-business marketplace. Amazon launched an online business-to-business wholesale platform for office supplies and other products called “Amazon Supply” in April 2012, which it rebranded and relaunched as “Amazon Business” in April 2015.43 With its vast network of wholesale fulfillment centers, Amazon likely could provide nationwide geographic coverage (and timely shipping) to enterprise customers on par with, or approaching, the OSSs. Although it may not have existing enterprise relationships comparable to those of adjacent firms in industrial or janitorial supplies, Amazon appears to be working toward providing adequate technological solutions, and as an e-commerce superpower, it likely brings talent, capital, and expertise to the task.44 Furthermore, because its marketplace is bolstered by a large network of competing third-party sellers, it also likely has the capacity to offer deep inventory across a broad class of office supply categories.

Notwithstanding these capabilities, however, in the near term Amazon Business is at best likely to be a potentially disruptive force for the merged firm’s business-to-business Quill customers, not its enterprise contract customers. That is because Amazon cannot meet either of what the Commission identified as contract customers’ core needs: to “receive discounted pricing based on actual or anticipated purchase volume” and to “order office products at previously negotiated prices.”45

First, although Amazon may have tremendous purchasing power as a firm, it likely has no prospects of ever matching (or perhaps ever coming close to matching) the OSSs’ purchasing power in the office supply category. At present Amazon obviously lacks the necessary demand to buy large volume, but in the long run it is unlikely ever to generate this demand, even if it is successful. Amazon’s own business model is to offload much of its demand to a network of third-party sellers who are welcomed onto its platform in exchange for a percentage of their sales. Consequently, it

42 Of course, enterprise customers could incorporate an industrial or janitorial supplier’s limited line of office supplies as part of a patchwork approach, but as discussed supra, patchwork approaches are inexorably a losing proposition because of substantial foregone volume discounts and far too many inefficiencies that likely make it unrealistic for enterprise customers to switch away from an OSS in response to a SSNIP. See supra Section III.A.3.
45 Closing Statement, supra note 4.
seems unlikely that Amazon will ever be able to offer especially large volume discounts at all, let alone on par with the OSSs. Indeed, information we collected as part of our research indicates that large enterprise customers are unlikely to consider Amazon a credible alternative to the merging parties to meet their unique demand for office supply products and services.

Second, because Amazon cannot negotiate on behalf of its third-party sellers, it has no ability to offer contract service. To be sure, Amazon could go after the contract business of enterprise customers on its own, but without its network of third-party sellers, Amazon is a smaller competitor in the office supply space. And to do so it would likely have to depart from its longstanding business model and embrace all the encumbrances of contract selling, including dedicated support staff and customer service, and working much more closely with customers one-on-one. This seems highly unlikely at a time when Amazon is just entering the business-to-business market in earnest, it has no experience or past history of making contract sales, and there is tremendous “low hanging fruit” in ordinary (i.e. non-contract) online wholesale sales.

Looking far ahead, even if Amazon were to quickly and successfully scale up its new platform in the office supply market and vastly improve its integration and technological capabilities, it would likely still be many years before Amazon could demonstrate the kind of pricing, availability and service stability and consistency needed to induce enterprise customers into a shift away from an established business model. It would be speculative to expect Amazon will constrain the merged firm in the enterprise contract market in the near term.46

B. The Proposed Merger Threatens a Range of Anticompetitive Effects, Including Higher Prices and Lower Quality, Diminished Data Security, and Diminished Supply-Channel Stability

The primary anticompetitive threat posed by Staples/Office Depot is the loss of head-to-head competition between the two merging firms in either the enterprise market or the broader contract market. This is a very different scenario than Office Depot/OfficeMax, where the Commission found that the merging firms were rarely each other’s closest competitors in the broader contracting market, and the merged firm would continue to face strong competition from Staples.47 Here, publicly available information suggests the enterprise market (and perhaps the better part of the broader contract market) is dominated by the two merging firms, that they are by far each other’s closest competitors, and that one is nearly always the runner up to the other when both submit contract bids in response to requests for proposals from enterprise customers.48

As discussed above, there may well be a relevant product market for the sale of consumable office supplies to large enterprise customers, and it is possible that none of the conceivable candidates for substitution can be counted as market participants that would constrain the merged firm. If that is

46 Of course, Amazon Business could be part of a patchwork approach, but the inefficacy of patchwork approaches has already been established. See supra Section III.A.3 & note 42.
47 Closing Statement, supra note 4.
48 See Horizontal Merger Guidelines § 6.1 (“The extent of direct competition between the products sold by the merging parties is central to the evaluation of unilateral price effects. Unilateral price effects are greater, the more the buyers of products sold by one merging firm consider products sold by the other merging firm to be their next choice.”); id. § 6.2 (unilateral effects in markets characterized by bargaining and negotiation “are likely in proportion to the frequency or probability with which, prior to the merger, one of the merging sellers had been the runner-up when the other won the business. These effects also are likely to be greater, the greater advantage the runner-up merging firm has over other suppliers in meeting customers' needs. These effects also tend to be greater, the more profitable were the pre-merger winning bids.”).
the case, the proposed transaction is a merger to monopoly that should be easily condemned. 49 However, even if there are additional market participants in the enterprise market, or in the entire contract market, the merger still may threaten a range of significant unilateral anticompetitive effects.

Most obvious is that without its closest competitor, Staples will not have to compete nearly as hard on price or non-price terms to win or keep the business of enterprise and other contract customers. As discussed above, those customers demand the requisite mix of purchasing power, geographic coverage, technological integration, stability, and volume discounting that OSSs provide. With the loss of competition will inevitably come higher prices and diminished quality and service.

Given the role of volume discounting in the enterprise market, price effects from the merger require particularly close scrutiny. Because there is no precedent for a nationwide OSS monopoly, the Commission does not have a perfect natural experiment to make a direct comparison based on past experience. However, it can seek other useful evidence of price effects by reviewing previous transactions, including not just Office Depot/OfficeMax, but also Staples/Corporate Express in 2009. Subsequent to that merger, Staples apparently offered ultimatums to former Corporate Express customers and refused service to those who would not meet its terms. 50 Any price increases or degradation in service that may have resulted from previous acquisitions by either merging firm would constitute powerful evidence of post-merger adverse effects under the Horizontal Merger Guidelines. 51 The AAI urges the Commission to interview former Corporate Express customers who received ultimatums from Staples and avail itself of any other information that may lead to direct evidence of anticompetitive price effects.

The Commission also should consider harm along various dimensions of quality competition. For example, there is cause for concern that the proposed transaction threatens harm to cyber security and privacy competition between the merging firms. In an expansive e-commerce environment, OSSs and other providers must compete hard to be the most secure stewards of sensitive data for all of their customers. In December 2014, Staples was victimized by a massive retail data breach caused by malware believed to be uploaded through point-of-sale terminals at many of its retail locations. It responded by emphasizing in press releases that “Staples is committed to protecting customer data,” and “in light of Staples’ commitment to protecting its customers,” it offered a variety of complimentary identity protection, credit monitoring, and identity theft services to affected customers. 52 Both before and after the recent retail breach, the merging firms have competed on security and privacy in the contract market as well. 53

49 See id. § 6.0.
50 See Staples, Inc., Q3 2009 Earnings Call Transcript, SEEKING ALPHA (Dec. 1, 2009, 3:34 PM), http://seekingalpha.com/article/176001-staples-inc-q3-2009-qtr-end-10-31-09-earnings-call-transcript (“Selectively we have given ultimatums to [some former Corporate Express] customers to change their behaviors or we in fact walk away. There have been some of those. In some cases some of those have gone to our competitors. That doesn’t worry us.”) (quoting Joseph Doody, President of North American Delivery).
51 See Horizontal Merger Guidelines § 2.1.2 (historical events that are “informative regarding the competitive effects of the merger” include “recent mergers . . . in the relevant market”).
53 Office Depot has emphasized in advertising to BSD customers, for example, that its “dedicated, secure website offers a fast, convenient and secure way to order everyday office products.” OFFICE DEPOT, Learn about BSD: Service Capabilities, https://business.officedepot.com/specialLinks.do?ID=servicecapab&TITLE=Service+Capabilities&template=login (last visited July 20, 2015). Staples has emphasized to contract customers overseas that “We know that when ordering
Eliminating Office Depot eliminates any non-price competition between the merging firms to win business through the provision of superior cyber security to enterprise and other contract customers. To be sure, every online business has independent incentives to meet high cyber security and privacy standards for reasons that have nothing to do with competition. And if cyber security competition is robust in the retail market, contract customers may stand to benefit indirectly from that competition. But to the extent the merging firms compete to win business by exceeding cyber security expectations for contract customers in particular, that valuable competition would be lost after the merger.

Another threatened non-price harm is the introduction of extreme fragility into what is likely the only supply channel capable of serving enterprise customers. The formation of a single monopoly OSS will have a whipsaw effect on enterprise customers, because it not only creates a stronger, more dominant supplier, but it simultaneously creates a weaker, more fragile supply channel, by eliminating all remaining redundancy in the channel. In the event of a short or long term disruption to the merged firm’s operations, enterprise customers likely would have no ability to switch to a stable alternative capable of meeting their needs. If Staples Advantage customers rather than retail customers were to be impacted by another data breach, for example, these customers likely would be put to the Hobson’s choice of continuing to make sensitive data available on a compromised platform or else enduring a serious internal disruption for not being able to adequately source office supplies.

As AAI has argued in other contexts, “[s]upply chains featuring only a few competitors and high entry barriers at critical junctures are excessively exposed to the risk of disruption and collapse following an exogenous shock,” such as “input-market disruptions, political events, weather, or quality control problems.” Post-merger, enterprise customers likely would bear the full risk of this exposure in a monopolized OSS channel, and therefore would be forced to internalize the increased risk of the channel’s collapse.

Even if the Commission determines there is not a distinct relevant product market for the sale of office supplies to enterprise customers, or that such a market includes additional market participants beyond OSSs, increased fragility in the OSS channel nonetheless threatens significant

online you need a secure ordering environment; you need to have confidence that your payment transactions and personal information are protected. We work closely with specialists in online payment and data protection to ensure all of your transactions are safe and secure. Our information privacy policy and eBusiness expertise means your transactions have the highest security levels, whether you use our online Webshop or a third party procurement platform.” STAPLES, Staples Advantage Secure Ordering: Protecting Your Privacy Online, http://www.staples.eu/what-we-do/staples-advantage/secure-ordering/ (last visited July 20, 2015).

See supra section III.A.2-4.


anticompetitive effects. The Commission should inquire, for example, whether the remaining alternative supply channels would even have the capacity to meet market demand in the event of a disruption to the merged firm. If they would not, or if a temporary or long term disruption to the only firm in the OSS channel (and hence to the channel itself) would result in significant cost increases and inefficiencies, the broader contract market would be exposed and forced to internalize the increased risk of collapse. The Commission should ensure that allowing the proposed transaction would not expose the nation’s business-to-business supply of office products to this kind of systemic failure.

C. Entry

If there is a relevant market for enterprise customers, and repositioning by existing firms is unlikely to counteract the proposed transaction’s anticompetitive effects in this market (or the broader contract market), the Commission will consider whether new entry would be timely, likely, and sufficient in magnitude, character and scope so as to discipline any post-merger price increase. In 1997, Judge Hogan concluded that barriers to new OSS entry were insurmountably high. He explained:

A new office superstore would need to open a large number of stores nationally in order to achieve the purchasing and distribution economies of scale enjoyed by the three existing firms. Sunk costs would be extremely high. Economies of scale at the local level, such as in the costs of advertising and distribution, would also be difficult for a new superstore entrant to achieve since the three existing firms have saturated many important local markets.57

If anything has changed since Judge Hogan’s opinion, barriers to new OSS entry have become significantly higher, because new challenges in the retail market make it much harder to enter both the retail and contract markets. First, there are now two remaining OSSs that dominate the retail market. Second, the retail market presents very little opportunity for growth, as revenues and margins have been declining while traditional superstores continue to close in record numbers. Meanwhile, pens, paper, ink, toner and other traditional office products are becoming increasingly obsolete for retail (though not necessarily business) customers, and the market as a whole is being widely written off by analysts, which is why OSSs are looking for growth in the contract channel and in products and services other than traditional office supplies. New OSS entry is likely impossible.

Perhaps a new OSS entrant might operate exclusively online, or exclusively in the contract market, in which case it would avoid costs associated with achieving a large retail footprint nationally. However, such an entrant would still have to acquire or build a vast network of distribution facilities nationally, and it would be extremely difficult if not impossible for such an entrant to rapidly achieve the necessary economies of scale to compete with the merged firm in saturated markets. With a fraction of the merged firm’s purchasing power prior to generating the necessary demand, a new “online-only” or “contract-only” entrant would have no meaningful prospects of winning enterprise business from the merged firm. Even if such hypothetical entry would be sufficient in magnitude, character and scope, which it likely would not, entry barriers would be extremely high.

Of course, if a new entrant were to enter only partially, offering a limited line of office supplies rather than the full line offered by OSSs, it too could avoid significant upfront costs. However, as discussed supra in the context of identifying market participants in the enterprise market, a partial entrant offering a limited line of office supplies is likely incapable of meaningfully competing, except

as part of a patchwork approach. And patchwork approaches are likely unrealistic for enterprise customers because of substantial foregone volume discounts and direct and indirect cost-savings.\textsuperscript{58} Partial entry likely would be insufficient in magnitude, character and scope to discipline the merged firm.\textsuperscript{59}

### D. Efficiencies

Staples has stated that it expects the strategic combination of the merging firms “to deliver at least $1 billion of synergies by third full fiscal year post-closing,” as well as “[o]perational efficiencies and cost savings” that will accelerate Staples’ strategic plan, along with the ability “to optimize [its] retail footprint, minimize redundancy, and reduce costs.”\textsuperscript{60} It predicts the transaction will be “[a]ccretive to [Earnings Per Share] in first year post-closing after excluding one-time integration and restructuring costs and purchase accounting adjustments.”\textsuperscript{61}

Efficiencies are unlikely to rescue the proposed transaction because “[e]fficiencies almost never justify a merger to monopoly or near-monopoly.”\textsuperscript{62} Even in a broader contract market, however, the proposed transaction is very unlikely to meet the agencies’ high bar for efficiencies claims. Efficiencies must be merger-specific, verifiable, and quantifiable to be cognizable.\textsuperscript{63} And while “claims substantiated by analogous past experience” may be credited, “[p]rojections of efficiencies may be viewed with skepticism” for a number of reasons.\textsuperscript{64}

First, while the AAI does not have access to the internal projections submitted by the merging firms, sweeping and vague efficiencies claims raise natural questions as to whether they would be merger-specific and demonstrably reduce marginal costs. Given the size of the standalone companies, it is fair to assume that both Staples and Office Depot have already achieved sizeable scale economies. While any claimed economies of coordination and improved opportunities for dynamic efficiency (i.e. innovation) are appealing in theory, it is well known that they are difficult to verify and to validate as merger-specific.\textsuperscript{65}

Second, “efficiencies are most likely to make a difference in merger analysis when the likely adverse competitive effects, absent the efficiencies, are not great.”\textsuperscript{66} When potential adverse competitive effects may be substantial, “extraordinarily great cognizable efficiencies would be necessary to prevent the merger from being anticompetitive,” and “the more they must be passed through to

\textsuperscript{58} See supra section III.A.3 & notes 42, 46.

\textsuperscript{59} See Horizontal Merger Guidelines § 9.3 (entry that is sufficient must “replicate at least the scale and strength of one of the merging firms”); id. (entry is insufficient where products offered by entrants “are not close enough substitutes to the products offered by the merged firm to render a price increase by the merged firm unprofitable,” such as where there are “limitations on the capabilities of the firms best placed to enter” or “reputational barriers to rapid expansion by new entrants”); cf. U.S. Dept’t of Justice & Fed. Trade Comm’n, Commentary on the Horizontal Merger Guidelines 31 (2006) (discussing the challenges of repositioning).

\textsuperscript{60} STAPLES, Staples Inc. Announces Acquisition of Office Depot Inc., Slide Presentation at 7 (Feb. 4, 2015), http://investor.staples.com/phoenix.zhtml?c=96244&p=irol-eventDetails&EventId=5184237 (scroll to “Supporting Materials” and download “Presentation”).

\textsuperscript{61} Id.

\textsuperscript{62} Horizontal Merger Guidelines § 10.

\textsuperscript{63} Id.

\textsuperscript{64} Id.


\textsuperscript{66} Horizontal Merger Guidelines § 10.
customers,” principally in the form of lower prices. In light of the competitive problems discussed supra, the proposed transaction is unlikely to pass this test. In the enterprise market in particular, but also in the broader contract market, the merged firm would have little incentive to pass on any gains from the merger. If the bulk of claimed cost synergies are fixed-cost savings, they are much more likely to go to shareholders, as opposed to being passed on to consumers, in the short run. And even if savings were passed on in the longer run, they should not be assumed to benefit consumers in markets where there is probable competitive harm.

Third, cognizable efficiencies are assessed net of the costs incurred in achieving them. There is mounting, demonstrable evidence that mergers often create difficult system integration problems, particularly as mergers of larger and larger systems have been proposed and poorly executed. As a result, integration costs are often underestimated and integration times protracted, which should reduce a priori efficiencies estimates at the time of merger review. That is certainly true here.

Not just in office supplies, but in many important industries throughout the United States, skepticism toward mega deals claiming cost efficiencies, consumer benefits, and enhanced investment and innovation is increasingly appropriate. A 2004 McKinsey study found that 70 percent of examined mergers failed to achieve expected revenue synergies, and managers in 40 percent failed to fully deliver on estimated cost savings. As managers struggle with the complexity of integrating large and complex operations, merged firms can fall short of efficiencies targets and lose customers in the process – thus sacrificing revenue synergies. Many of these problems reduce claimed efficiencies and increase integration costs. They may even go the step further of creating merger-related inefficiencies or spillovers in the form of consumer inconvenience and degraded quality. Such failures are likely to be felt by consumers through higher prices, lower quality, and less innovation. We encourage the Commission to be highly skeptical of claimed efficiencies in Staples/Office Depot.

E. Remedies

The merger agreement reportedly includes a provision obligating Staples to divest assets that delivered up to $1.25 billion of Office Depot’s domestic revenues in 2014 as a condition of securing antitrust approval. However, divestitures that would adequately replace the competition lost in the enterprise market do not seem feasible. Indeed, the Commission should be extremely skeptical of a

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67 Id. In the 1997 Staples case, the court concluded that the magnitude of the likely pass-through rate was insufficient to rebut the presumption that the proposed merger would substantially lessen competition. See Fed. Trade Comm’n v. Staples, Inc., 970 F. Supp. 1066, 1090 (D.D.C. 1997).

68 See Horizontal Merger Guidelines § 10.


70 MOSS, supra note 70.


72 Christofferson et. al, supra note 69.

divestiture package designed to transform a regional supplier into a legitimate national enterprise competitor.

In 2014, Staples reported $16 billion in domestic sales and 51 domestic distribution facilities, while Office Deport reported $12.1 billion in domestic sales and 66 domestic distribution facilities. W.B. Mason, the next largest regional supplier, reportedly has only $1.5 billion in total annual sales, and according to a map on its website, it has 28 warehouses in 23 states.

Post-merger, and prior to divestitures, Staples therefore would have a $28.1-billion-to-$1.5-billion revenue advantage over W.B. Mason, and a 117-to-28 distribution facility advantage. These disparities have grave implications for the ability of any proposed remedy to restore competition in light of economies of scale in the enterprise market.

For perspective, consider that the district court in Sysco had grave concerns about a divestiture package where a putative buyer would have nearly one half the merged firm’s $48.2 billion in post-divestiture sales and one-third of the merged firm’s over 100 post-divestiture distribution centers. The court concluded that the putative buyer, post-divestiture, would have faced “a significant disadvantage in competing for national customers.”

In contrast, the merged firm here would have to divest over $8 billion in domestic sales and nine distribution facilities to W.B. Mason just to get to the nearly-one-half-sales and one-third-distribution-center ratios that the Sysco court definitively rejected. A proposed divestiture package that would not obviously derail the transaction, including the full amount of the $1.25 billion commitment in the merger agreement, seems likely to be severely inadequate if there is a distinct relevant product market for enterprise contract customers.

IV. The Retail Channel

The Commission’s 2013 Closing Statement concluded that the Office Depot/OfficeMax merger was unlikely to substantially lessen competition in the retail market. First, the Commission found that mass merchants like Wal-Mart and Target and warehouse clubs like Costco and Sam’s Club had proliferated and expanded their product offerings and sales of office supplies. Second, online sellers like Amazon had taken away substantial in-store sales. In the wake of these developments, the Commission found that OSS price zones and retail pricing were no longer dictated by the presence of other local OSSs. Instead, the Commission found that a majority of OSS products were being priced nationally, and products priced locally were accounting for non-OSS competition.

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78 Publicly information does clarify the viability of a divestiture remedy in an all contract customers market.
79 Closing Statement, supra note 4.
The Commission did not address certain distinguishing factors among the different retail channels through which OSSs sell their products, however. Staples and Office Depot sell retail office products online, in traditional superstores, and via “omnichannel” stores, which offer a personalized buying experience that attempts to seamlessly deliver information, discount and reward offers, and products and services across all channels. Omnichannel retailing also offers sellers unique insights into customer behavior through the ability to combine big data analytics with insights from in-store sales. While the merging firms’ pure-online business likely faces adequate competition from Amazon and other online retailers, the impact of the proposed transaction on the sale of office products through both traditional and omnichannel superstores requires closer scrutiny.

A. The Transaction Is a Merger to Monopoly in Local Geographic Markets Where Traditional OSSs Are Unconstrained by Online and Non-OSS Competition

AAI encourages the Commission to explore whether relevant markets for the sale of consumable office supplies through traditional OSSs, as defined in Fed. Trade Comm’n v. Staples in 1997, may exist in certain local geographic markets after 3-1 consolidation. In 2013, the Commission was able to measure the disciplining effect that online and non-OSS competition was having on traditional OSSs primarily in two- and three-firm local geographic markets. Here, the Commission should measure the disciplining effect of online and non-OSS competition in two-firm versus monopoly OSS markets, both before and after the Office Depot/OfficeMax transaction was cleared. Measuring pricing by OSSs in local geographic markets where one of the merging firms maintained a traditional OSS monopoly during the years before and after the Office Depot/Office Max merger, relative to pricing by OSSs in two- or three-firm local geographic markets during that time, would be instructive.

Where Staples and Office Depot have resorted to national pricing schemes or otherwise succumbed to competitive price discipline from online and non-OSS competition, the important question is whether the merged firm would have the ability and incentive to depart from these disciplined schemes to extract supracompetitive profits from local monopolies. The Commission should be particularly concerned if the merged firm would have the ability to switch to local monopoly retail pricing in local geographic markets that are under-served by non-OSS alternatives, such as rural areas where other mass merchants do not carry a full line of office supplies and customers may not have Internet access or be able to rely on prompt online delivery.

The Commission should explore whether the merged firm would have the ability and incentive to institute a dual strategy to price competitively in local markets that are more susceptible to online and non-OSS competition and to extract monopoly profits in local markets that are less susceptible to online and non-OSS competition. Indeed, the merging firms apparently were pursuing cross-


channel price discrimination online and in stores tied to both geography and the presence of other OSSs as recently as 2012.82

Post-merger, if Staples would find it economically rationale to switch away from disciplined pricing schemes to take advantage of traditional OSS monopolies in local geographic markets, consumers and small businesses in these markets stand to be heavily victimized by higher prices, diminished quality and diminished choice. For these customers, the merger could represent a return to the “bad old days” of the late 1990s, when OSSs had demonstrable local pricing power relative to the presence of other OSSs, except now it would be an even more pernicious monopoly market structure.83 The Commission should be wary of the risk that approving the proposed transaction would facilitate this de-evolution in local geographic markets that are underserved by online and non-OSS alternatives.

B. The Commission Should Evaluate the Competitive Effects of Merging the Two Leading Omnichannel Suppliers of Office Products

In 2013, the Commission correctly recognized that “in-store and online channel boundaries are blurring as OSS[s] seek to create a seamless customer experience by offering in-store pickup for online orders and using in-store Internet kiosks to order products online.”84 However, the Commission did not address whether this development is a potentially important driver of differentiation between the OSSs and some of their brick-and-mortar and online counterparts.

Business and marketing experts recognize that we are currently in the early stages of a transition from single- and dual-channel retailing to omnichannel retailing.85 Omnichannel retailers are developing distinctive competitive strategies that separate them from traditional and pure-online retailers,86 and studies are beginning to show that they may have advantages, as well.87 The merging firms happen to be two of the leaders in this ongoing transition and the only two omnichannel

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82 See id. (“Statistically speaking, by far the strongest correlation [in Staples’ online-pricing formula] involved the distance to a rival’s store from the center of a ZIP Code. That single factor appeared to explain upward of 90% of the pricing pattern.”); id. (“In the Journal’s tests, ZIP Codes whose center was farther than 20 miles from a Staples competitor saw higher prices 67% of the time. By contrast, ZIP Codes within 20 miles of a rival saw the high price least often, only 12% of the time.”); id. (“Staples.com showed higher prices most often—86% of the time—when the ZIP Code actually had a brick-and-mortar Staples store in it, but was also far from a competitor’s store.”); id. (“Prices varied for about a third of the more than 1,000 randomly selected Staples.com products tested. The discounted and higher prices differed by about 8% on average.”).

83 As discussed supra, this market also is protected by extremely high entry barriers. Unlike in the enterprise contract channel, however, divestitures might ordinarily be a suitable remedy. However, because the proposed transaction is a merger to monopoly in the retail OSS market, it may be impossible to find a suitable buyer.

84 Closing Statement, supra note 4.


86 See id. (“To succeed in an omnichannel environment, retailers should adopt new strategies in areas such as pricing, designing the shopping experience and bundling relationships with customers.”).

87 See David R. Bell et al., How to Win in an Omnichannel World, MIT Sloan Mgmt. Rev., Fall 2014, available at http://sloanreview.mit.edu/article/how-to-win-in-an-omnichannel-world/ (discussing results of regression analyses showing that eyeglass seller Warby Parker’s transition from only-only to multi-channel distribution strategy resulted in 9% increase in total sales, a significant decline in returns and associated shipping costs, and overall increased efficiency).
retailers principally devoted to the office supplies market. Although certain mass merchants and warehouse clubs have successfully begun transitioning to omnichannel retailing as well, they face distinct challenges in offering an integrated experience across a wider array of product categories. Moreover, several of the firms the Commission identified as competitive constraints in 2013 have not transitioned to omnichannel retailing at all. Amazon, in particular, has not meaningfully transitioned away from its pure-online model, nor have many other online sellers.

AAI encourages the Commission to examine the competitive effects of the merging firms’ advantage as omnichannel retailers relative to many of the retail competitors identified in 2013. If further advances in omnichannel retailing lead to greater qualitative differences in the shopping experience at the merged firm, not to mention the merged firm’s insight into customer behavior and ability to implement superior dynamic pricing and price discrimination strategies, the proposed transaction may have substantial and longlasting anticompetitive effects in retail markets, which the Commission would not have anticipated in 2013. This risk may be even more acute as the office products industry moves to incorporate consumer electronics, office furniture, and other items customers may want to touch, feel or test in person before purchasing online or in store, whether for pick-up or delivery. Omnichannel retailing strategies hold the most promise for these very products, and the merged firm can be expected to try to maintain its advantage going forward.

* * *

For all of these reasons, AAI encourages the Commission to give particularly close scrutiny to the proposed combination of Staples and Office Depot.
Anthem and Cigna, the nation’s second and third largest medical health insurance carriers, have agreed to merge. They propose to create the single largest seller of medical healthcare coverage to large commercial accounts, in a market in which there are only four national carriers still standing. The United States Department of Justice, eleven states, and the District of Columbia have sued to stop the merger, and they have carried their burden to demonstrate that the proposed combination is likely to have a substantial effect on competition in what is already a highly concentrated market. Therefore, the Court will not permit the merger to go forward.

Judgment will be entered in favor of the plaintiffs on their first claim, and the merger will be enjoined due to its likely impact on the market for the sale of health insurance to “national accounts” – customers with more than 5000 employees, usually spread over at least two states – within the fourteen states where Anthem operates as the Blue Cross Blue Shield licensee. So the Court does not need to go on to decide the question of whether the combination will also affect competition in the sale to national accounts within the larger geographic market consisting of the entire United States. The Court also does not need to rule on the allegations in plaintiffs’ second
claim that the merger will harm competition downstream in a different product market: the sale of health insurance to “large group” employers of more than 100 employees in thirty-five separate local regions within the Anthem states. But the evidence has shown that the proposed acquisition will have an anticompetitive effect on the sale of health insurance to large groups in at least one of those markets: Richmond, Virginia. Finally, given the ruling against the merger, the Court need not reach the allegations in the complaint that the merger will also harm competition upstream in the market for the purchase of healthcare services from hospitals and physicians in the same 35 locations.

What follows is a summary of the Court’s opinion and its order in the case. The Court finds first that the market for the sale of health insurance to national accounts is a properly drawn product market for purposes of the antitrust laws, and that the fourteen states in which Anthem enjoys the exclusive right to compete under the Blue Cross Blue Shield banner comprise a relevant geographic market for that product.

The evidence demonstrated that large national employers have a unique set of characteristics and needs that drive their purchasing processes and decisions, and that the industry as a whole recognizes national accounts as a distinct market. Witness after witness agreed that there are only four national carriers offering the broad medical provider networks and account management capabilities needed to serve a typical national account. Notably, both Anthem and Cigna have established business units devoted to national accounts, and these separate profit and loss centers each have their own executives, sales teams, and customer service personnel. While various brokers and insurance carriers may draw differing lines to define the boundaries of a “national account,” the government’s use of 5000 employees as the threshold is consistent with how both Anthem and Cigna identify the accounts within their own companies. Moreover, when
measured against the appropriate legal standard, the government’s definition was sufficient to include reasonable substitutes and to fairly capture the competitive significance of other products.

The geographic market also passes the legal test since the Blue Cross Blue Shield Association rules have a significant impact on the commercial conditions governing the sale of medical coverage to national accounts, and Anthem’s exclusive territory is where the acquisition will have a direct and immediate effect on competition.

Next, the Court finds that plaintiffs have established that the high level of concentration in this market that would result from the merger is presumptively unlawful under the U.S. Department of Justice and Federal Trade Commission Horizontal Merger Guidelines, which courts regularly consult for guidance in these cases. The evidence has also shown that the merger is likely to result in higher prices, and that it will have other anticompetitive effects: it will eliminate the two firms’ vigorous competition against each other for national accounts, reduce the number of national carriers available to respond to solicitations in the future, and diminish the prospects for innovation in the market.

Within the national accounts market, health benefits coverage is a differentiated product, which means that individually customized policies are sold to customers one at a time – in this case, through a bid solicitation process. National account customers evaluate responses to their requests for proposals based upon a number of factors, including the amount of the fees charged by each carrier for claims administration services; the quality and breadth of the carrier’s medical provider network; the extent of the discounts the carrier has negotiated with those providers; whether the carrier is willing to guarantee that the customer’s medical costs will not increase by more than a particular percentage; and other features of interest to any particular customer. The expert testimony as well as the firms’ internal documents reflect that while Anthem tends to enjoy
superior discounts, the two companies are competing head-to-head with respect to many of the other aspects of their offerings, all of which can factor into the employer’s total cost per employee for medical benefits.

The defense came forward with evidence to rebut the presumption, shifting the burden back to the government, but the Court concludes based on the entire record that plaintiffs have carried their burden to show that the effect of the acquisition may be to substantially lessen competition in violation of Section 7 of the Clayton Antitrust Act. Defendants insist that customers face an array of alternatives, and that there are many new entrants poised to shake up the market. But entering the commercial health insurance market is not such an easy proposition. And while third party administrators and new insurance ventures being launched by strong local healthcare systems may be attractive to smaller or more localized customers, it became quite clear from the evidence that the larger a company gets, and the more geographically dispersed its employees become, the fewer solutions are available to meet its network and administrative needs. Thus, regional firms and new specialized “niche” companies that lack a national network are not viable options for the vast majority of national accounts, and they will not ameliorate the anticompetitive effects of this merger.

While defense economists theorized that large customers are free to “slice” their insurance business and contract with multiple carriers to cover different geographic regions and employee preferences, the record shows that there are substantial costs and administrative burdens associated with fragmentation, so employers do not elect to do it very often. The national accounts that do slice tend to use no more than two companies, usually chosen from among the big four national carriers and possibly a particularly strong regional option, such as Kaiser, the uniquely popular health maintenance organization in California. Anthem and its experts made much of the advent
of private exchanges – sets of prepackaged plans that afford customers the opportunity to offer their employees a choice of several options – but those have proved to be largely just another vehicle for delivering the major national carriers’ products to the market. The defense repeatedly drew attention to the existence of third party administrators, provider-sponsored plans, and other specialty firms that have recently begun to populate the insurance marketplace. But to the extent these so-called new entrants and competitors are owned by, teamed with, rent networks from, or funnel business to the big four national carriers, they do not alter the competitive landscape, and in fact, they represent multiple additional arenas where the constriction of competition will be felt.

Anthem has taken the lead in defending the transaction, and it contends that any anticompetitive effects will be outweighed by the efficiencies it will generate. It points, in part, to substantial general and administrative (“G&A”) cost savings that have been projected to be achieved through the combination of the two companies. And the centerpiece of its defense is its contention that Anthem and Cigna national account customers will save a combined total of over $2 billion in medical expenditures because Cigna members will be able to access the more favorable discounts that Anthem has negotiated with its provider network, Anthem members will have the benefit of any lower rates that Cigna has obtained, and those costs are paid directly by the employers. In short, Anthem maintains that the overriding benefit of the merger is that the new company will be able to deliver Cigna’s highly regarded value-based products at the lower Anthem price.

But the claimed medical cost savings are not cognizable efficiencies since they are not merger-specific, they are not verifiable, and it is questionable whether they are “efficiencies” at all. And the projected G&A efficiencies suffer from significant verification problems as well.
The law is clear that a defendant must both substantiate any claimed efficiencies and demonstrate that they are “merger-specific,” which means that it must show that the savings cannot be accomplished by either company alone in the absence of the proposed merger. But here, Anthem and Cigna have already obtained the provider discounts alone. The medical network savings are not merger-specific because they are based upon the application of existing discounts to an existing patient population that the companies have already delivered to the providers; the calculations do not depend upon the expectation that the volume of patients will increase by virtue of the merger.

Furthermore, it is plain that the companies do not have to merge for customers to be able to access Anthem’s lower provider rates: any customers that value the discounts above other aspects of the contractual arrangement can choose Anthem as their carrier today. As the Anthem executives responsible for the integration agreed, one of the most likely mechanisms to be employed to achieve the savings – the “rebranding” of Cigna customers as Blue customers – is no different from Anthem’s ongoing marketing of its products on a daily basis. Also, there is nothing stopping Anthem from improving its wellness programs, or any other offerings that Cigna now does better, on its own.

It is also questionable whether Anthem’s ability to drive a hard bargain with providers by virtue of its size can be characterized as an “efficiency” at all. The Guidelines define an efficiency as something that would enable the combined firm to achieve lower costs for a given quantity and quality of product. Here, the combined firm will not be selling healthcare. Its “product” in the national accounts market – as Anthem has emphasized since the first day of the trial – is “ASO” or “administrative services only” contracts, which include claims administration, claims adjudication, and access to a network of health providers. So there is no evidence that the claimed
network savings will arise because the cost of what the merged firm produces, and what it sells in the relevant market, will go down.

Anthem characterizes this scenario as a supply-side efficiency resulting from the merger, but it has not shown that there is anything about the mere combination of the carriers’ two pools of patients that will enable doctors or hospitals to treat patients more expeditiously or at a lower cost. Since the medical cost savings will not be accomplished by streamlining the two firms’ operations, creating a better product that neither carrier can offer alone, or even by enabling the providers to operate more efficiently, they do not represent any “efficiency” that will be introduced into the marketplace.

Anthem is asking the Court to go beyond what any court has done before: to bless this merger because customers may end up paying less to healthcare providers for the services that the providers deliver even though the same customers are also likely to end up paying more for what the defendants sell: the ASO contracts that are the sole product offered in the market at issue in this merger. It asks the Court to do this because it is the insurers that negotiate the in-network provider discounts, access to those rates is part of what the customers are buying when they buy health insurance, and medical costs account for the overwhelming portion of any customer’s total healthcare expenditure. In short, Anthem is encouraging the Court to ignore the risks posed by the proposed constriction in the health insurance industry in the relevant market on the grounds that consumers might benefit from the large size of the new company in other ways at the end of the day. But this is not a cognizable defense to an antitrust case; the antitrust laws are designed to protect competition, and the claimed efficiencies do not arise out of, or facilitate, competition. Moreover, Anthem’s own documents reveal that the firm has considered a number of ways to
capture the network savings for itself and not pass them through to the customers as it insisted in
court that it would.

Anthem argues that even if expanding access to provider discounts does not technically
qualify as an antitrust efficiency that can offset anticompetitive effects on a dollar-for-dollar basis,
it is a factor to be taken into consideration in assessing the overall impact of a merger in a market
where it is universally acknowledged that growing costs must be controlled. In short, the Court
should decide that the pressure the merger would place on providers would be beneficial to
consumers in general. But the record created for this case did not begin to provide the information
needed to reveal whether all providers, no matter their size, location, or financial structure, are
operating at comfortable margins well above their costs, as Anthem’s expert suggested, or whether
Anthem’s use of its market power to strong-arm providers would reduce the quality or availability
of healthcare as the plaintiffs alleged. And the trial did not produce the sort of record that would
enable the Court to make – nor should it make – complex policy decisions about the overall
allocation of healthcare dollars in the United States.

More important, Anthem has not been able to demonstrate that its plan is achievable or that
it will benefit consumers as advertised. One of the other key strategies Anthem intends to employ
to generate the claimed savings is to unilaterally invoke provisions in provider contracts that
require physicians or facilities to extend Anthem’s discounted fee schedule to Anthem’s affiliates.
But even the Anthem executives have expressed doubts that the providers will take this lying down,
and they have acknowledged that they have no plan in hand for whether they will proceed by
rebranding on the customer side, by renegotiating contracts on the provider side, or by enforcing
these affiliate clauses in any particular situation.
There was also considerable testimony that an enforced reduction in fees paid to providers through rebranding or contractual mechanisms could erode the relationships between insurers and providers. It would also reduce the collaboration that industry participants agree is an essential aspect of the growing trend to move from a pure fee-for-service based system to a more value-based model as a means of both lowering the cost and improving the outcome of the delivery of healthcare in this country. And here, the Court cannot fail to point out that it is bound to consider all of the evidence in the record in connection with the question of whether the merger will benefit competition, and in this case, that includes the doubt sown into the record by Cigna itself.

This brings us to the elephant in the courtroom. In this case, the Department of Justice is not the only party raising questions about Anthem’s characterization of the outcome of the merger: one of the two merging parties is also actively warning against it. Cigna officials provided compelling testimony undermining the projections of future savings, and the disagreement runs so deep that Cigna cross-examined the defendants’ own expert and refused to sign Anthem’s Findings of Fact and Conclusions of Law on the grounds that they “reflect Anthem’s perspective” and that some of the findings “are inconsistent with the testimony of Cigna witnesses.” Anthem urges the Court to look away, and it attempts to minimize the merging parties’ differences as a “side issue,” a mere “rift between the CEOs.” But the Court cannot properly ignore the remarkable circumstances that have unfolded both before and during the trial.

The documentary record and the testimony reflect that the pre-merger integration planning that is necessary to capture any hoped-for synergies is stalled and incomplete. Much of the work has not proceeded past the initial stage of identifying goals and targets to actually specifying the steps to be taken jointly to implement them. Moreover, the relationship between the companies is marked by a fundamental difference of opinion over the effect the Anthem strategy to impose
lower rates on providers and move members away from Cigna’s network will have on the collaborative model of care that is central to the Cigna brand. Both Cigna witnesses and providers have testified that effective collaboration requires more of the physicians and hospitals, and they expect to be paid for it, and the engagement with members to improve behaviors that can affect wellness requires an investment of resources on the part of the insurer. All of this raises serious questions about when, how, and whether the medical savings can be achieved, whether the G&A savings can be verified, and whether there is any basis in the record to believe in the rosy vision being put forward by Anthem of a new national carrier that delivers the Cigna product at the Anthem price.

In sum, the theme of Anthem’s defense is that its greater ability to command discounts from providers will save customers money at the end of the day. At the same time, Cigna says that its collaboration with providers will save customers money at the end of the day. Plaintiffs take the position that customers should continue to have a choice between these options, and the Court agrees.

While Anthem has also moved to incorporate quality and cost savings incentives into its provider contracts, Cigna has sought to differentiate itself with its approach towards reducing costs by increasing health. Its message is that better information and clinical management on the provider side, along with encouraging behaviors that support health on the patient side, can reduce a patient’s need to be hospitalized or undergo expensive medical procedures at all, and that this decrease in utilization will reduce the total medical cost per employee over time. For this reason, some customers prefer Cigna notwithstanding its discount disadvantage, and there was some testimony from medical personnel that the approach is working. Eliminating this competition from the marketplace would diminish the opportunity for the firms’ ideas to be tested and refined, when
this is just the sort of innovation the antitrust rules are supposed to foster. Considering all of these circumstances, and for all of the reasons set forth in greater detail in the Memorandum Opinion docketed separately, the Court is persuaded that the merger should not take place.

Upon consideration of the applicable law, the evidence presented at trial, the argument of the parties, and the entire record before the Court, the Court concludes that the effect of the proposed merger of Anthem, Inc. and Cigna Corp. may be “substantially to lessen competition” in violation of section 7 of the Clayton Act, 15 U.S.C. § 18. Specifically, the proposed merger is likely to lessen competition substantially in the market for the sale of commercial health insurance to national account customers in the fourteen Anthem territories and in the market for the sale of commercial health insurance to large group customers in the Richmond, Virginia market.

It is therefore

ORDERED that the merger of Anthem Inc. and Cigna Corp., as reflected in their merger agreement dated July 23, 2015, is ENJOINED.

The Memorandum Opinion accompanying this Order contains references to materials that were discussed in open court but remain sealed at the request of one of the parties or third parties providing information. For this reason, the full opinion is being docketed under seal at this time. In drafting the opinion, the Court has endeavored to avoid the disclosure of the substance of any business sensitive material, and it is the Court’s strong preference to place the entire opinion on the public record as soon as possible. Therefore, it is

FURTHER ORDERED that each party shall file notice with the Court by close of business February 9, 2017 of whether it has any objection to the Court unsealing the Memorandum
Opinion docketed on this date in its entirety and if so, specifying what portions it believes should remain under seal and why.

AMY B. JACKSON
United States District Judge

DATE: February 8, 2017