MERGER PITFALLS IN PRACTICE:
THREE CASE STUDIES*

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1. INTRODUCTION

Although the United States Merger Guidelines ("Guidelines") present a detailed blueprint for competition analysis, implementation errors can lead to enforcement actions against potentially pro-competitive transactions. In our merger monograph, we reviewed antitrust enforcement under the Guidelines and highlighted a series of ten Pitfalls. Used proactively, the Pitfalls construct prevents an unfocused and potentially costly approach to merger review by calling attention early on to the most likely weaknesses of the process. The construct limits the potential analytical disparity that may emerge as a result of the breadth and latitude that typifies the interaction of merger law with naturally evolving economic theory.

In this paper, we advocate the Pitfalls construct as a complement to traditional merger analysis and one that is most valuable when used at the outset of a merger review. To illustrate the applicability, relevance, and generality of the Pitfalls approach, we examine three recent enforcement decisions. The first is from Venezuela, the second is from Brazil, and the third is from the

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* Significant portions of this article reflect the authors' own analysis. Their underlying approach is explained in The Economic Analysis of Mergers and Pitfalls in Merger Analysis: The Dirty Dozen, which is fully cited in footnote 13.

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United States. Despite their relevance, it is important to recognize that Pitfall violations are not always linked to enforcement mistakes.

We discuss ten Pitfalls:

1. Assuming that High Concentration Causes Competitive Problems

2. Accepting Simplistic Structural Analyses of Collusion

3. Dismissing Efficiencies as Speculative

4. Focusing on the Responses of Infra-marginal Firms

5. Misapplying the Five Percent Market Definition Price Test

6. Basing a Unilateral Theory only on Market Share

7. Requiring Evidence on Actual Entry

8. Substituting Complaints or Hot Documents for Analysis


10. Naively Balancing Efficiencies and Anti-competitive Effects

The Guidelines represent a structured approach used by the Antitrust Divisions of the Department of Justice ("DOJ") and the Federal Trade Commission ("FTC") to evaluate the competitive effects of any horizontal merger. The Guidelines also have served

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as the model for a number of the regulations and procedures used by the Latin American antitrust agencies in their enforcement mission. 2 Mergers generally play an important role in a market economy; they penalize ineffective management and facilitate the efficient flow of investment capital and the redeployment of productive capital. 3 By regulating mergers, competition policy can affect the evolution of a market economy. 4

The Guidelines articulate the analytical framework that enforcement agencies use to determine if a merger is likely to substantially decrease competition. 5 By focusing on the economic interests of the various actors in the marketplace, the Guidelines predict whether a merger is likely to create, enhance, or facilitate the exercise of market power and whether any anti-competitive effect would be offset by efficiencies. 6 Clearly, the adoption of


4 See Peter C. Carstensen, How to Assess the Impact of Antitrust on the American Economy: Examining History or Theorizing?, 74 IOWA L. REV. 1175 (1989) (arguing that antitrust law may have played a positive role in contributing to improved market efficiency in certain instances).


6 The key issue in agency review of mergers and non-merger investigations is whether the government intends to challenge the proposed transaction or behavior. The uncertainty undergoing most agency review often has a chilling effect on the market and certain practices, and most transactions proceed only after they are cleared by the agencies.
the Guidelines represents a commitment to an economic basis for antitrust policy. Based on this framework, information for a Guidelines analysis is gathered through a detailed market study during which the antitrust enforcers survey a wide range of industry participants, review internal documents of the merging parties, and occasionally undertake statistical market analysis.

The government’s concern for the competitive consequences of mergers will foster a continued examination of appropriate antitrust methodology. Certainly, to the extent that some of these enforcement initiatives do not improve economic welfare, they typically are, and will continue to be, discarded. Still, novel initiatives in antitrust enforcement often derive from advances in economic theory, evolving social mores, changing economic conditions, and political currents. Not surprisingly, given the relative paucity of merger reviews by the bench, a number of implementation or interpretation problems with the Guidelines have appeared over the years, creating the potential for inappropriate applications of merger policy.

7 For an alternative position, see CLYDE WAYNE CREWS JR., CEI ANTITRUST REFORM PROJECT, ANTITRUST POLICY AS CORPORATE WELFARE (July 1997) (arguing that antitrust laws hobble dynamic market processes and infringe on individuals) and DOMINICK ARMENTANO, ANTITRUST AND MONOPOLY: ANATOMY OF A POLICY FAILURE (1982) (questioning the effectiveness of antitrust policy in improving consumer welfare).


9 See Richard M. Steuer, Counseling Without Case Law, 63 ANTITRUST L.J. 823 (1995); see also Spencer Weber Waller, Prosecution by Regulation: The Changing Nature of Antitrust Enforcement, 77 OR. L. REV. 1383, 1394-95 (1998) (criticizing the process whereby the agencies make antitrust law without going to court and explaining that “[t]he centrality of the agencies, rather than the
Some of these Pitfalls may be linked to the failure to sufficiently change the Guidelines in response to an improved understanding of competition, while others stem from the failure of the merger analyst to understand the spirit of the economic analysis implicit in the Guidelines and their revisions.\textsuperscript{10} In an international setting, where antitrust law represents an important, albeit new, vision furthering the gains of market liberalization and reform processes, additional analytical and practical hazards may inevitably enter the practice of antitrust.\textsuperscript{11}

In this paper, we examine three merger cases using the "Pitfalls" framework\textsuperscript{12} originally presented by the authors in \textit{The Economic Analysis of Mergers}.\textsuperscript{13} The taxonomical approach embodied by the Pitfalls analysis minimizes the cost and use of resources devoted to merger analysis by focusing on the most controversial and problematic areas likely to arise in an investigation. Thus, a Pitfalls approach may shorten the time and scope of investigations, minimize the likelihood of enjoining potentially efficiency-enhancing acquisitions, and reduce the cost of antitrust reviews.

courts, defines the new antitrust regulatory mode that dominates the current government enforcement of the antitrust laws”).


\textsuperscript{11} Venezuela’s agency, for example, conducts its investigations against a backdrop of price controls, currency instability, social and political unrest, and difficulties with gathering data. Peru’s experience reveals that episodes of high inflation drown out changes in relative prices and that institutional structures may not be changing at the same pace as macroeconomic phenomena. See Dennis Carlton, \textit{The Disruptive Effect of Inflation on the Organization of Markets, in Inflation Causes and Effects} 139 (Robert Hall, ed., 1982). See generally Robert M. Feinberg \& Mieke Meurs, \textit{Privatization and Antitrust in Eastern Europe: The Importance of Entry}, 39 ANTITRUST BULL. 797, 808-09 (1994) ("[R]apid changes in the structure of prices, forms of ownership, and sources of demand have made it difficult for . . . profits to operate as a signal for entry in the way they do in the established market-based economies . . .").

\textsuperscript{12} It is important to note that the Pitfalls present potential misapplications of the Guidelines' construct. A correct application of the Guidelines may reach the same conclusion as an incorrect one, and thus Pitfall violations are not sufficient conditions for enforcement mistakes.

The paper is structured as follows. At the outset, we introduce various application problems with the Guidelines, discussed in a series of ten points, with the earlier entries focusing on issues that have been partially addressed by revisions in the Guidelines. Each point or pitfall is presented with a brief introduction followed by a succinct commentary on the analytical problem.14

Next, the Pitfalls are illustrated through a discussion of three cases dealing with government decisions on mergers. The analysis of the Venezuelan case, concerning Coke/Pepsi, and the Brazilian case, concerning Anheuser-Busch/Antarctica, are based on the decisions issued by the internal tribunals of each agency. Conversely, in the U.S. case, concerning Staples/Office Depot, the federal court merger decision is used to illustrate various Pitfalls. We chose these three cases largely because they are well known and controversial within both the antitrust community and the general press. We conclude with a brief summary and some policy implications.

2. UNDERSTANDING THE PITFALLS

The evaluation of the likely competitive effects of a proposed merger or acquisition is one of the more complicated tasks facing antitrust regulators because almost all of the analysis is, by necessity, forward-looking. The Guidelines offer a structured approach to solve this merger enforcement problem. By gathering information on a market and using the construct of a hypothetical price increase, it is possible to predict the profitability, and hence the likelihood, of an anti-competitive effect.15 The final stage balances efficiencies with the expected anti-competitive effects to generate the appropriate regulatory response.

Although the Guidelines' technique is relatively straightforward, misinterpretations are possible and can lead to incorrect policy decisions. Based on the authors' combined experience, case law, and learned commentary, we have compiled a list of ten

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14 For a more thorough discussion of the Guidelines, see COATE & RODRIGUEZ, ECONOMIC ANALYSIS, supra note 13.

15 The basic Guidelines' hypothetical studies the profitability of various actions in response to a small, but significant price increase (usually taken to be five percent) by the merging parties and, oftentimes, others. This construct is used to define the product and geographic markets and plays a role in entry and competitive analysis. Moreover, given all of the information from a Guidelines' analysis, it is possible to use the same basic procedure to evaluate the likely profitability of a five percent (or smaller) price increase involving the merging parties.
common errors in the application of the Guidelines' construct. These issues are briefly described below. It is important to note that the identification of a Pitfall will not necessarily highlight an enforcement mistake. Instead, it is necessary to adjust the merger analysis and generate a new conclusion.

2.1. Assuming High Herfindahls Cause Competitive Problems

As written, the Guidelines state that a transaction which increases the Herfindahl-Hirschman Index ("HHI") by 100 points to a level over 1800 is likely to create or enhance market power or facilitate its exercise.\(^\text{16}\) Although the Guidelines recognize that this presumption may be overcome by other factors, it is important to understand that the critical Herfindahl statistics generally are based on historical U.S. case law and have not been updated.\(^\text{17}\) Given the recent decisions by the courts, the Guidelines' presumption is of no real value.\(^\text{18}\) In reality, an investigation of a merger raising the Herfindahl 100 points to 1800 is likely to quickly close.\(^\text{19}\) Overall, Herfindahl statistics are primarily useful in defining safe harbors in which no enforcement is necessary.

2.2. Accepting Simplistic Structural Analysis of Collusion

The analysis of collusion under the Guidelines follows traditional oligopoly theory. The Guidelines suggest that the likelihood of collusion depends on (1) the capability of a group of firms to reach an agreement on terms of coordination that are profitable to their members and (2) the ability of a group of firms both to detect deviations from such an agreement and to punish

\(^\text{16}\) The HHI is calculated by taking the squares of the firms' market shares.

\(^\text{17}\) For more details on the case law, see Donald I. Baker & William Blumenthal, The 1982 Guidelines and Preexisting Law, 71 CAL. L. REV. 311 (1983). The basic theory implies that the higher the Herfindahl index and the fewer the number of firms that compete in the market, the more likely collusive conduct is to occur. This concept is based on a very simple oligopoly theory in which the number of competitors affects the performance of the market.

\(^\text{18}\) See Malcolm B. Coate, Economics, the Guidelines and the Evolution of Merger Policy, 37 ANTITRUST BULL. 997, 1023 (1992) ("Efficiencies and other structural factors can defeat a presumption to challenge a merger when Herfindahls are well over 1,800.").

any firm found to violate the agreement. Historically, analysts have evaluated long laundry lists of structural and behavioral factors linked to these questions, while the conclusion on the likely competitive effect of a merger was significantly influenced by concentration. Although the Guidelines highlight a few factors, such as information, pricing patterns, heterogeneity, and market characteristics, as particularly important, the analysis of the ease of collusion does not explain how the collusive outcome evolves. For an oligopoly concern to be valid, the merger must change an aspect of market structure that facilitates a price increase.

2.3. Dismissing Efficiencies as Speculative

The Guidelines explicitly recognize an efficiency defense for an otherwise anti-competitive merger, but also suggest that relevant efficiencies must be both demonstrated by the available evidence and be specific to the transaction under review. Many analysts have advocated a high evidentiary standard that has proved almost impossible to meet. In particular, efficiency evidence was required to be clear and convincing, and alternative mechanisms were not allowed to achieve the cost savings. Such a policy would significantly downgrade, or even effectively repeal, the efficiency defense.


Examples of efficiencies that could be demonstrated by the available evidence include economies of scale from more efficient production runs, transportation cost savings from changes in location of production, and economies of scope from better integration of manufacturing assets. Examples of merger-specific efficiencies include scale economies that represent the best way of loading a plant, transportation cost savings due to a specific reallocation of production schedules, and economies of scope that exploit particular types of reorganizations only available to the merger partners.

For a discussion of the various suggestions, see Donald G. McFetridge, *The Efficiencies Defense in Merger Cases*, in THE ECONOMICS OF THE ANTITRUST PROCESS 89 (Malcolm B. Coate & Andrew N. Kleit eds., 1996) (examining the current requirements for mounting a successful efficiencies defense in an other-
ciency standard of proof, efficiencies should be judged by the same probability standards that are applied to competitive effects.

2.4. Focusing on the Responses of Infra-marginal Firms

The Guidelines base their analysis of market definition, competitive effects, and entry on hypothetical responses of various customers and firms. For example, a product market fails if a sufficient number of customers would switch to substitutes; a cartel fails if a sufficient number of firms would increase output; and entry is likely if new firms could profitably compete in the market.25 Of course, merger analysis is not a popularity contest or an opinion poll. The basic principles of the competitive analysis mandate that the relevant information be gathered from the marginal players in the market.26 This may require the merger analyst to survey all of the relevant decision makers or identify an algorithm to focus the investigation on the marginal players.

2.5. Misapplying the Five Percent Market Definition Price Test

The Guidelines base market definition on an analysis of the hypothetical responses to a significant and nontransitory price increase on the part of all the firms in the potential market. Although a five percent price increase is suggested as the usual standard, it would be incorrect to accept this level in all cases. For example, in numerous situations, market rigidities suggest that customers will not switch among suppliers, much less products, in response to the five percent price increase test. To properly apply the Guidelines analysis, the hypothetical must be developed to ensure that customers will switch to other products in the same potential market in response to a price increase. If customers appear unwilling to switch to a rival's product, then the mag-
2.6. Basing a Unilateral Theory Only on Market Share

The Guidelines suggest that a transaction may allow a firm to unilaterally raise the price of one or both of its products above the pre-merger level. If the products are differentiated, the Guidelines highlight a competitive concern if the post-merger share of the acquiring firm exceeds 35 percent. Empirical simulation models generally predict a price increase from any horizontal merger in a differentiated product market, with the concern increasing with market share. Overall, the application of unilateral effects theories have created the impression that the Guidelines have imposed almost a per se prohibition against mergers that create relatively large firms. In reality, it is the structure of competition in the differentiated market that affects the likelihood of an anti-competitive effect. Market share is not necessarily relevant; instead, product positioning is important. A merger between the only two significant firms that serve a specific niche potentially causes concern if that niche involves a substantial amount of commerce.

2.7. Requiring Evidence on Actual Entry

The Guidelines base entry analysis on a hypothetical study of investment opportunities (after first determining that the entry would be timely). Although the entry section highlights the importance of scale economies and sunk costs, the approach can easily evolve into a survey of expected market decisions. Given

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28 See Gregory J. Werden & Luke M. Froeb, *The Effects of Mergers in Differentiated Products Industries: Logit Demand and Merger Policy*, 10 J.L. ECON. & ORG. 407 (1994). The logit model defines a particular demand structure in which the various differentiated products are substitutes for at least some consumers. Holding the combined share of the firms constant, a merger between two firms with a symmetric distribution of market share generates more competitive issues than a merger between a large and small firm.

that the surveyed firms are not actively studying entry, they are unable to appropriately respond to hypothetical questions concerning the likelihood of their entry. Of course, this response problem is the specific issue the Guidelines structure was designed to avoid. Instead of asking for intentions, the Guidelines focus on relevant information and infer the answer from the entry on the weight of the evidence.

2.8. Substituting Complaints or Hot Documents for Analysis

The Guidelines define a construct for predicting the competitive effect of a merger. However, it is possible that an analyst will substitute uncritical acceptance of customer complaints or “hot documents” for clear evidence of likely anti-competitive effects. While documentary evidence is useful in confirming the Guidelines’ conclusions of a likely anti-competitive effect, it does not represent an alternative to careful analysis.

2.9. Considering Guidelines Issues Sequentially

The Guidelines are designed to predict whether, considering the lost sales, a price increase is profitable to other goods outside the product market; manufacturers from outside the geographic market; fringe expansion within the market; independent pricing by direct competitors; and de novo entry or expansion that requires expenditures of sunk costs. However, a naive reading of the Guidelines could result in the sequential application of the questions, with the analyst only attempting to obtain sufficient information to pass a narrow screen of questions before moving on to the next issue. This type of analysis would be incorrect because the basic Guidelines’ question concerning the profitability of a price increase mandates a simultaneous analysis. In effect, a final analysis must be performed to determine if an anti-

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30 For a discussion of economic issues related to entry, see William J. Baumol et al., Contestable Markets and the Theory of Industry Structure (1982); Richard J. Gilbert, Mobility Barriers and the Value of Incumbency, in Handbook of Industrial Organization 476 (Richard Schmalensee & Robert D. Willig eds., 1989).

31 A “hot document” is a legal term of art applied to an incriminating internal document uncovered during an investigation. For example, a letter predicting a post-merger price increase would be considered a hot document.

competitive price increase would be profitable given all of the potential competitive responses.

2.10. Naively Balancing Efficiencies and Anti-competitive Effects

The Guidelines are vague regarding exactly how to integrate efficiencies into merger analysis. Some policy makers have suggested a price test, with evidence required to show that prices will fall before an otherwise anti-competitive merger should be allowed.\(^3\) This requires significant efficiencies to reduce costs such that the price falls, even though the merger increases the level of market power. Such an approach minimizes the consideration of efficiencies and is unlikely to be appropriate. Others suggest a social welfare standard in which deadweight losses are balanced against efficiency savings.\(^4\) This method would allow almost any merger. Numerous compromising positions are available that weigh both price and social welfare considerations.\(^5\) Moreover, it is likely the various efficiency and anti-competitive effects could also be integrated into a more balanced analysis through the use of expected values over the long run.

3. THREE CASE STUDIES

Throughout Eastern Europe, the former Soviet Republics, Latin America, and Asia, countries that have opened previously closed or state-dominated economies to competition, have simultaneously adopted legislative measures designed to advance and protect a market economy.\(^6\) Specifically, governments have revised or adopted competition legislation as a complement to the

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\(^3\) This approach adds another parameter, the pass-through, which must be estimated to complete the analysis. If the efficiencies are imitated by other firms, pass-through rates would approach 100 percent.


\(^5\) Roberts and Salop present a model that considers a weighted average of the consumer welfare and social welfare standards for different assumptions about the ease of imitation by other firms. Although the calculations are based on artificial equilibriums, the results highlight the sensitivity of the required efficiencies to the model's assumptions. See Gary L. Roberts & Steven C. Salop, *Efficiencies in Dynamic Merger Analysis*, 19 WORLD COMPETITION L. ECON. 5 (1996).

privatization and deregulation policies that typify pro-market reforms.\footnote{For an overview of these developments, see generally the collection of papers in \textit{John Fingleton, et al., Competition Policy and the Transformation of Central Europe} (1996) (examining the implementation of competition policy during the 1990s in Hungary, Poland, and the Czech and Slovak Republics and considering the effect of economic and political conditions on state involvement in regulating the competitive process); \textit{Private Sector Development Dept', World Bank, Regulatory Policies and Reform: A Comparative Perspective} (Claudio R. Frischtak ed., 1995); \textit{F.M. Scherer, Competition Policies for an Integrated World Economy} (1994) (analyzing the three-way integration among international trade policies, the competition policies nations and trading blocs implement to channel producers' behavior in pro-competitive directions, and the strategies nations and individual enterprises pursue to enhance their trading advantage in the international marketplace, and tracing the intellectual foundations and subsequent evolution of these three policy domains).}

3.1. Coke/Pepsi (Venezuela)

ProCompetencia,\footnote{ProCompetencia is an abbreviation of "Superintendencia para la Promocion y Proteccion de la Libre Competencia."} Venezuela's antitrust agency, recently investigated a merger complaint filed by Pepsi. The filing of the formal complaint was an indicator of Pepsi's objections to the proposed transaction whereby Pepsi's domestic bottler, Cisneros, switched allegiance to Coca-Cola after a 50 year business relationship with Pepsi.\footnote{See Ed McCullough, \textit{Pepsi Plans $100 Million Claim Against Bottler that Defected to Coke}, ASSOCIATED PRESS WIRE REP. (Aug. 22, 1996) (detailing reports of Cisneros' Pepsi franchise agreement). The franchise agreement was scheduled to remain in effect until 2003, yet Cisneros explained that the contract "included a clause that establishes if either of the two parties decides to withdraw early, he can do it under the condition of paying a penalty. I'm ready to assume that." \textit{Id.} It appears that Cisneros agreed to pay liquidated damages, although the newspaper report does not directly address this point. See \textit{id}.} ProCompetencia ultimately found the transaction to be an illegal horizontal acquisition of a competitor's assets and a violation of Article 11 of the Competition Law. Article 11 prohibits mergers that restrict competition or strengthen a dominant position.\footnote{For a more thorough discussion of the Coca-Cola case, see A.E. Rodriguez & Mark D. Williams, \textit{Recent Decisions by the Venezuelan and Peruvian Agencies: Lessons for the Export of Antitrust}, 43 \textit{Antitrust Bull.} 147 (1998).}

Under the terms of the agreement with Cisneros, Coca-Cola agreed to acquire 50% of the bottling business. The assets involved included eighteen bottling plants, distribution facilities,
and a number of soft drink brands, including the popular brand "Hit." In partnership with Cisneros, Pepsi had a premerger 82% share of the carbonated soft drink ("CSD") market, while Coca-Cola was a distant second with a 10.8% share. Anticipating an antitrust problem with ProCompetencia, Coca-Cola offered a divestiture. Coca Cola's solution entailed forming and subsequently spinning-off an independent firm comprised of 6 former Coca Cola-owned bottling plants, 21 warehouses and other distribution assets, 575 vehicles having Pepsi logos, and 8 million liters of finished Pepsi products. To ensure that Pepsi could weather the transition without any supply disruptions to its customers, the divested firm was required to offer Pepsi a short-term lease that would enable Pepsi to continue bottling and distribution operations. The divested assets offered sufficient capacity and distribution facilities to enable Pepsi to maintain the same level of production it had prior to the transaction. Coke gave Pepsi the right of first refusal to acquire the divested assets.

The Coke/Cisneros transaction, combined with the divestiture of the Coca Cola assets, would have actually lowered concentration from pre-merger HHI of 6870 to a postmerger HHI of 4410. Of course, concentration figures excluding the proposed divestiture (and based on bottling capacity) result in a significant increase in HHI to 8746 (with an increase of 2465 points). ProCompetencia argued that Coca-Cola controlled approximately 93.4% of the bottling facilities in the country. Based entirely on the latter concentration statistics, ProCompetencia could justifiably question the transaction. Such a case assumed, however, that the appropriate antitrust product market could be shown to be the production of CSDs at bottling plants and that the divested assets were not really independent, but rather, remained under the control of Coca-Cola. More specifically, ProCompetencia's case formally rested on the following assertions: (1) the merger could be evaluated with two relevant product markets, regular CSD and "light" (or "diet") CSD; (2) the analysis required six regional geographic markets; (3) the proposed merger would substantially increase the already high levels of concentration; (4) de novo entry and product expansion or repositioning by current producers was unlikely; (5) the voluntary divestiture of assets

41 Note, however, that ProCompetencia did not advance a CSD bottling facility market, but rather a regular and diet CSD market.
would fail to eliminate the anti-competitive effects of the consolidation; and (6) the merger was likely to result in a substantial reduction of competition.

We show in this paper that the ProCompetencia analysis failed to avoid a number of the Pitfalls. Perhaps the most critical one was focusing the analysis on the infra-marginal firms (Pitfall 4) rather than the marginal firms. However, ProCompetencia also appears to have required evidence on actual entry (Pitfall 7) and substituted documents for analysis (Pitfall 8).

Understanding the behavior of the consumer most likely to switch to a rival product as a result of an increase in the price of the good is a key element in the antitrust definition of markets. The consumer that is more sensitive to a price change is said to be a marginal consumer, whereas one that is traditionally unlikely to switch is referred to as an infra-marginal, or average consumer.42 To properly evaluate the likelihood that a price increase would be profitable for the producer, the analyst should understand not only how likely a marginal consumer is to switch in the face of a price increase but also the relative proportion of marginal consumers to total consumers. It is precisely the marginal consumer's ease of switching that makes firms wary of raising prices. Firms are well aware that with any price increase, they are likely to lose the most price sensitive customers. Because firms do not know the number of price sensitive consumers that determine the demand for their product, they effectively price their product to retain the more price sensitive consumers. Put differently, because of the inherent information asymmetry, marginal consumers set the price.

Operationally, in order to identify the proportion of marginal consumers in a market, the merger analyst must survey a large sample of customers and determine who is price sensitive. For example, in marketing surveys, someone who is a loyal consumer

42 In determining whether potential substitutes should be in a relevant product market, the agency needs to determine what percentage of sales would be lost to a hypothetical price increase as a result of the merger. If enough marginal consumers would switch to another product to make the hypothetical price increase would be unprofitable, that substitute should be included in the tentative product market. Only when the agency has determined that a hypothetical monopolist could profitably increase prices over a set of products because there are no additional substitutes to which consumers would turn, has the agency reached the correct product market. This requires that there are few marginal consumers in a correctly defined product market.
to one brand may not be so if faced with a heretofore unencountered change in relative prices. As such, a naive approach to these surveys may yield an underestimate of the number of marginal consumers. Similarly, marketing surveys tend to gather information on average consumers rather than marginal ones. Without the ability to properly design a survey, one can still fruitfully use existing data, but one should take into account the data's inherent biases and other limitations.

In its investigation, ProCompetencia appears to have mistakenly relied on the analysis of data from average consumers. The record shows that the agency placed substantial reliance on the market survey conducted by the Malaguti Company. This survey investigates the market preferences of different demographic groups, but it does not appear to identify any groups or individuals at the margin who might switch products in the face of a relative price change.  

From the references made to the Malaguti survey, it is not clear if customers were asked whether their beverage consumption patterns would change in response to a price increase in a manner that would have revealed the proportion of price sensitive consumers. The proper phrasing of the standard antitrust hypothetical is as follows: Would you switch to another beverage if regular (or diet) CSD prices increased by a small and significant nontransitory amount? It is possible that ProCompetencia chose to dispense with the price test since, under the price controls regime, a carbonated soda price increase would have been unlikely.

ProCompetencia concluded that the prices of different beverages did not correlate, apparently based solely on a graphical presentation of beverage price data. The agency did not attempt to compensate for fluctuations in factors that affect either supply or demand, nor did it factor in the behavioral consequences of price controls and the generalized price control regime. Such cost and demand shifters are an integral part of any multivariate analysis of

Marginal consumers include consumers who will significantly decrease consumption, with out substituting to another product, if there is an increase in price.

While a price increase may not be likely under price controls, that fact does not rule out asking the hypothetical price increase question. If price controls do prohibit price increases and the industry is such that demand is fully satisfied at a given price level, it is unclear how a merger could result in anti-competitive effects.
price determination of multiple products.\textsuperscript{45} It would have been useful to review consumption data for various beverages throughout the 1990s. Evidence of the shifts linked to changes in relative price would have suggested broad markets.\textsuperscript{46}

One additional issue merits attention. Formally, market definition methodology recognizes the potential competitive influence of supply-side responses by competitors. The methodology restricts those responses to those that occur within one year. If, by shifting the use of its production plant or adding to its productive capacity without the expenditure of substantial sunk costs, a potential supplier can serve the market within a year, that firm should be included in the market. This type of supply side flexibility impugns potentially narrow markets such as diet CSD. Put differently, unless it is possible to demonstrate that regular CSD producers are unable to supply diet CSD within a year (without incurring substantial sunk costs), diet CSD can not be considered a separate market from regular CSD. Although it is self evident to some, a well conducted, if not necessarily exhaustive analysis should easily reveal that diet CSD and regular CSD do not require different manufacturing processes. Rather, the difference is entirely in the formulation of the CSD. This technical error did not seem to affect the decision.

Entry issues represented a significant problem. An important consideration in Coca-Cola’s fix-it-first divestiture is the perception that de novo or greenfield entry into CSD is difficult and unlikely to discipline anti-competitive effects in that market. After having been offered this admission by the parties, it is not surprising that ProCompetencia reached the same conclusion.

\textsuperscript{45} Under the price control regime, relative prices cannot change in response to market opportunities. The 32% average excess capacity in the industry suggests that supply is elastic. A more informative model of the competitive interaction between different beverages may show how the relative quantities of different beverages reacted to cost and demand shifters.

\textsuperscript{46} Furthermore, ProCompetencia did not attempt to correct its market definition to take into account distortions in consumer behavior caused by Venezuela’s inflationary environment. Inflation tends to obscure the information content of relative prices. For example, faced with the currency’s deteriorating buying power, consumers typically buy their supplies at the beginning of the pay period and hoard goods. On the supply side, since the prices of CSD are fixed by the government, any announced inflationary adjustment would give suppliers the incentive to minimize sales of CSD until prices are raised.
But ProCompetencia still appears to have confused the supply-side analysis. Although an arguable issue, the main "barrier-to-entry" that raises the costs of entry into CSD is the need to invest in brand-name advertising. However, this may be beside the point in this case. The relevant question is not what it would take for a de novo entrant to discipline a price increase in CSD. Rather, ProCompetencia should have determined the circumstances whereby the "closest" likely entrant or repositioner would have been able to discipline the price increase. The anticompetitive theory proposed by the agency is that Pepsi would be forced to become a marginal player or completely exit the CSD market as a result of the consolidation. Thus, ProCompetencia should have determined the likelihood that Pepsi could reposition itself or reenter the market to counter a price increase led by the Coke/Cisneros combination.\(^{47}\) Because Pepsi's brand reputation would not have diminished after the acquisition, the brand name barrier-to-entry did not affect Pepsi's ability to discipline a CSD price increase. An alliance with the Polar Group, a well-established beer manufacturer and distributor, appeared to offer the necessary bottling assets. Without a barrier to entry, even a sham Coke divestiture would not matter. The anticompetitive theory proposed by the agency was not applicable.

ProCompetencia also seems to have substituted documents for analysis. In December 1996, Superintendent Eduardo Garmendia found that the consolidation of bottling facilities and the acquisition of carbonated soda brands was a violation of Article 11 of the Competition Law. ProCompetencia argued that the voluntarily divested assets were insufficient to guarantee competition in the market. This conclusion was based on available documents that seemed to suggest that Coca-Cola's appointed trustees of the divested firm were insufficiently independent of Coca-Cola. In a

\(^{47}\) Immediately following ProCompetencia's decision, Pepsi announced it was reentering the CSD market as a partner in a joint venture with the Polar Group, a large domestic beer manufacturer. Pepsi's departure from CSD marketing appears to have been very temporary. Thus, it seems that one cannot support a foreclosure theory whereby Pepsi could be excluded from the CSD market in the long run as a result of the Coca-Cola/Cisneros agreement. This also suggests that an appropriate analysis of entry would imply that any anticompetitive CSD price increase could be disciplined (and perhaps that brewers could be considered uncommitted entrants in a CSD bottling market). Unfortunately, although it was aware of the possible Polar/Pepsi collaboration, ProCompetencia appears to have been unable or unwilling to address these issues.
market economy, economic actors are presumed independent unless business relationships exist to bind them together. Thus, to claim the divestiture was a sham, it would be necessary to show how the financial interests of the trustees aligned with those of Coke. Moreover, the evidence would need to show that Pepsi could not quickly remove the trustees by purchasing the divested firm.48 Similarly, as discussed above, ProCompetencia relied on available marketing and management documents to conclude that the product market was CSD without discounting the fact that these documents were widely understood to contain puffery and other analytically empty statements. Such statements are typically meant to enhance the value of the company for the benefit of stockholders and rarely reflect market conditions.

In conclusion, the ProCompetencia decision to block Coke's arrangement with Pepsi's long-time bottler fell victim to a number of the Pitfalls. The difficulties may be linked to data problems and the unqualified application of a technique designed for a well-functioning market economy to an economy in transition. Historical evidence of marginal customers and episodes of entry may not be readily available to serve as a model for a competitive analysis. However, as a general rule, transactions that appear to reduce concentration tend to be pro-competitive. Without clear evidence that the spin-off was a fraud, enforcement action would have been difficult to justify.

3.2. Anheuser-Busch/Antarctica (Brazil)

The second example involves actions taken by the Brazilian Administrative Council for Economic Defense ("CADE"), the Brazilian antitrust enforcement agency, against one of two recent joint ventures affecting Brazil's beer industry. In one deal, Miller Brewing Company and Cervejaria Brahma planned a joint venture to produce Miller Genuine Draft in Brazil.49 The other joint venture, involving Anheuser-Busch and Antarctica, would have

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48 Of course, ProCompetencia could have taken a different course of action by claiming that the spun-off assets were not viable.

49 Brahma is the largest Brazilian brewer with a market share approximating 50 percent, while Miller is the third-largest brewer in the world. See The Report, Vote, and Supplement of the Reporting Member of CADE Regarding the Proposed Joint Venture between Anheuser-Busch and Antarctica, ATÓ De Concentracao, NO. 83/96 25 tbl.6 (visited Nov. 3, 1999) <http://www.mj.gov.br/cade/ing_juri.htm> [hereinafter Anheuser-Busch Decision].
increased the presence of Budweiser and other Anheuser-Busch brands in Brazil.\textsuperscript{50} Antarctica is Brazil’s second-largest brewer with 32\% of the market\textsuperscript{51} and Anheuser-Busch is the world’s largest brewer. The venture contemplated Anheuser-Busch’s purchase of 5\% of Antarctica, with an option to acquire 30\%. Both American beers had been sold in Brazil before the joint ventures, but had failed to obtain even 1\% of the Brazilian market.\textsuperscript{52} CADE moved to block both deals.

In its initial decision in 1997, CADE determined that the Anheuser-Busch-Antarctica joint venture would reduce potential competition.\textsuperscript{53} The articulated theory, based on the American antitrust concept of potential competition, implies that a firm not participating in a market may affect competition in an oligopolistic or monopolistic industry. Two variants of the theory exist.\textsuperscript{54} First, the acquisition of a leading firm might reduce competition by eliminating the acquiring firm’s impact on competition. This variant is known as perceived potential competition, and evidence is generally required to show that incumbents respond to the threat of entry posed by the acquiring firm.\textsuperscript{55} Second, the acquisition of a leading firm might reduce the prospect of future entry into the market. This variant is known as actual potential competition, and evidence of actual entry intentions is required for the concern to be viable.\textsuperscript{56} CADE noted that the Miller and An-

\textsuperscript{50} Budweiser only had a negligible share of the Brazilian beer market. See id.

\textsuperscript{51} See id. at 25 tbl.6.


\textsuperscript{53} See Anheuser-Busch Decision, supra note 49.

\textsuperscript{54} See generally Guidelines, supra note 1, at S-8 (explaining the two variants of the American theory of potential competition upon which CADE’s decision was based).

\textsuperscript{55} The perceived potential competition theory has limited applicability because it is very difficult to prove that market incumbents respond to the threat of one specific entrant. Hot documents, supplemented with effects evidence, appears to be the only valid approach.

\textsuperscript{56} See Guidelines, supra note 1, at S-9. The actual potential competition doctrine, like standard horizontal merger enforcement, is inherently proscriptive in nature. To make a case, the plaintiff must prove: (1) the market under review is not performing competitively; (2) the potential entrant is likely to enter; (3) few if any other potential entrants are likely to enter; and (4) the actual entry will have a pro-competitive effect on the market. See id. All of these
heuser-Busch joint ventures, "far from rendering the market more competitive, consolidate[d] [their] structures and even crystallized the shared dominant position between Brahma and Antarctica."\(^{57}\)

The Anheuser-Busch transaction raised particular concerns for CADE for a number of reasons. Given its economic size, greater efficiency, position in the world market and, principally, business expansion strategy of targeting the main emerging economies for entry, Anheuser-Busch appeared to be a potential entrant. Choosing to enter via an association with an established Brazilian leader rather than by solo entry raised the anti-competitive concern. The association between the former potential competitor and one of the leaders of the Brazilian market represented the effective elimination of competition between the companies. In effect, "[t]he association between two companies translates into a 'non-aggression pact' upon including clauses of discrimination of prices and market segments in which the two companies will be active."\(^{58}\)

CADE's initial decision elicited pointed commentary in the international press. Business Week asked if Brazil was antitrust or anti-foreign.\(^{59}\) The Wall Street Journal reported that CADE was becoming the newest four-letter word in the international business community.\(^{60}\) In December 1997, CADE stated that it would permit the Anheuser-Busch joint venture to go forward, subject to the condition that Anheuser-Busch increase its ownership interest in Antarctica from 5% to 30%, and commit to further investments in Brazil.\(^{61}\) As restructured, CADE believed the arrangement would show a greater commitment by Anheuser-Busch to the Brazilian market. At last report, the joint venture still appears to be on hold while negotiations between Anheuser-Busch and CADE continue.

issues can be addressed with standard Guidelines' considerations, and the theory is explicitly recognized in the 1984 version of the Merger Guidelines.

\(^{57}\) Anheuser-Busch Decision, supra note 49, at 26; see also Page, supra note 52 (discussing the Anheuser-Busch decision).

\(^{58}\) Anheuser-Busch Decision, supra note 49, at 26.


\(^{60}\) See Matt Moffett, Brazilian Panel is Foreign Firms' Nemesis, WALL ST. J., July 9, 1997, at A10.

\(^{61}\) See Jonathan Wheatley, Brazil Watchdog Sets Conditions for Brewing Link-up, FIN. TIMES (London), Dec. 12, 1997, at 27.
This potential competition decision also can be used to highlight some of the Pitfalls. CADE's adoption of the potential competition doctrine implicitly acknowledges that high concentration causes competitive problems (Pitfall 1), but also seems to focus on the lack of actual entry (Pitfall 7). Moreover, the lack of consideration given to efficiencies implies problems both with dismissing efficiencies (Pitfall 3) and with balancing efficiencies with anti-competitive effects (Pitfall 10).

The potential competition doctrine, by its very nature, assumes that concentrated markets are linked to competitive problems. While concentration tends to be a necessary condition for competitive concern, it is not a sufficient condition. The Brazilian beer market presents an interesting example of the misuse of concentration statistics. While Brahma had 46.6% of the market and Antarctica 31.9% in 1995, those shares had declined from 50.3% and 40.8%, respectively, in 1989. During that time, the third leading brewer increased its share from 7.9% to 14.6%, while the fourth leading brewer increased its share from .2% to 5.4%. These changes suggest that there is a substantial competitive threat to the leading firms from existing competitors. While the share observations could be compatible with dominant firm pricing, evidence should be presented to preclude the competitive explanation. Moreover, a competitive analysis would need to present a clear collusive theory (Pitfall 2) or a comprehensive unilateral effects story (Pitfall 6) to support the inference of a competitive problem.

Second, a potential competition decision must prove that the acquiring firm is one of only a few likely entrants. This requires a complex analysis showing how the acquiring firm could enter the market without establishing the ease of entry for all of the other potential entrants. As with a horizontal investigation, it would be inappropriate to focus only on the internal decision-making process of the potential entrants. Although some review of the acquiring firm's actual interest in entry is probably neces-

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63 See id.
64 Moreover, CADE itself noted that the third largest local brewer was controlled by Coca-Cola and aggressively increasing market share by its distribution and advertising advantages. See Anheuser-Busch Decision, supra note 49, at 16.
65 See Guidelines, supra note 1, at S-9.
sary to meet the burden of proving a violation, the analysis should go well beyond intentions to show why the acquiring firm would enter while other firms would not. A standard Guidelines entry analysis should be able to highlight the special advantages held by the acquiring firm to support the potential competition case.

In the Brazilian beer market, there was little reason to think that Anheuser-Busch had a special advantage over other firms as a potential entrant. CADE noted that the second, third, and seventh leading world brewers had formed alliances with domestic brewers. It seemed, the fourth, fifth, and sixth leading brewers in the world would also be capable of entry. Evidence that Anheuser-Busch had made a commitment to the large reforming economies would only be useful in inferring its entry intentions, but without evidence that it was precluding other entrants, no violation occurs.

The potential competition doctrine generally ignores efficiencies. Thus, it is not surprising that efficiency considerations were also lost on CADE. However, efficiencies remain an important consideration in any antitrust case, and a complete evaluation of the likely cost savings and their implications for competition should be required in any competition policy. It is important to note that the proposed transactions were not simply foreign acquisitions, but were joint ventures to introduce new or relatively unknown brands to the Brazilian market. By enjoining the mergers because of the possibility that effective de novo or toehold entry would occur in the future trades a very certain immediate efficiency benefit to Brazil's consumers for a chance of a somewhat greater future benefit. There seems to be a very small likelihood, and certainly no proof, that the long-term prices of beer would be harmed by the acquisition, and it is clear that the loss of Budweiser as a significant player in the market would be a loss to Brazilian consumers. Further analysis could explore the possibility that the joint venture would improve the efficiency of the

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67 It would also be necessary to show the entry affected competition in the market. Following Guidelines' principles, this would require the entry to affect the structure of the competitive problem identified in the initial analysis.

68 This is likely to be a historical artifact of the general disdain for efficiencies found in U.S. antitrust policy around the evolution of the potential competition doctrine.
Brazilian brewing industry, an efficiency that would be passed on, at least in part, to consumers.

Although the potential competition doctrine can be used to attack potentially anti-competitive mergers, a sound analysis must closely address the issues of competition and entry. A detailed model of competition should be advanced to illustrate just how the market fails to perform in a competitive manner. Next, a careful entry analysis must be undertaken to ensure that the acquiring firm is one of only a few, or better yet the only, likely entrant into the market. Finally, an analysis would need to be performed to show how the entry actually resolves the competitive problem. While CADE has focused on a concentrated relevant market and therefore the theory could apply, the evidence gathered falls short of that which is necessary to meet the high burden of a potential competition case. Even once this burden is met, it remains necessary to balance the anti-competitive effects with the relevant efficiencies.

3.3. **Staples/Office Depot (United States)**

A third example comes from the court record of the Federal Trade Commission's ("FTC") 1997 challenge of Staples' proposed acquisition of Office Depot.⁶⁹ Both Staples and Office Depot sell a broad range of office supplies in numerous cities and towns across the United States. Before the merger, both Staples and Office Depot operated over 500 stores.⁷⁰ The key feature of these stores is their mega-store, minimal service format. A third competitor, OfficeMax, followed the same basic retail strategy. Office supplies were also available through the traditional high service retailers, large broad-based general retailers (i.e. Wal-Mart, Best Buy, and Club stores), and numerous mail order houses. The FTC's basic concern with the Staples merger was that the transaction would create an office superstore monopoly in fifteen local markets and a duopoly in twenty-seven other local markets. The court upheld the government's position, issuing an injunction to prevent the merger.

Although the Staples transaction threatened to create fifteen monopolies, Staples offered the FTC a settlement that required divestiture of the offending stores. Thus, the court decision in-

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⁷⁰ See id. at 1069.
volved an acquisition which reduced the number of office supply superstores from three to two in various local markets.\textsuperscript{71}

The parties presented elaborate price/concentration studies purporting to show the likely effect of the acquisition. Relying on thorough empirical work aided by a peculiar rhetorical twist, the FTC successfully reversed the product market methodology by first establishing an econometric result and then concluding that the superstore product market was the only one likely to support such an econometric finding. Showing a price effect in Staples stores because of the entry of nearby Office Depots, the FTC argued that the office supply superstores constituted a relevant product market.\textsuperscript{72}

The court found that the merger would eliminate Staples' most significant competitor, Office Depot, leading to what could be best described as a unilateral price increase.\textsuperscript{73} However, the court decision did not really address the ability of OfficeMax to reposition itself as a close competitor. Moreover, if OfficeMax could reposition itself to compete, some type of collusion theory would be required.\textsuperscript{74} Evidence suggesting that Staples and OfficeMax could coordinate their pricing was missing from the decision. Overall, the decision could have contained more structural evidence to support the hypothesis that anti-competitive behavior was likely.

\textsuperscript{71} The market definition of the "sale of consumable office supplies through office supply superstores" is certainly suspect, and the various criticisms are incorporated in the Pitfall discussion below. It is important to note that a correct competitive analysis will highlight problems with narrow market definitions and will not find a competitive problem when one does not exist, regardless of the initial market definition. However, if the appropriate market were the sale of office supplies, the Guidelines would save the analyst time by noting the post-merger Herfindahl was under 1000, and no further investigation was required. For the finding on market definition, see id. at 1074.

\textsuperscript{72} See id. at 1073. The FTC argued that the fall of Staples' prices as a result of Office Depot entering the market would be consistent with prices rising if Office Depot were to exit. From this effect, the government argued, it would be necessary for superstores to be a relevant market because the effect could only occur if consumers did not defeat a price increase by choosing to purchase other products.

\textsuperscript{73} See id. at 1082.

\textsuperscript{74} A collusion theory would be difficult to craft in a broad market. Evidence would be needed to suggest that the independent retailers could not quickly expand their marketing of office supplies. It would be difficult to assert that Wal-Mart, Target, or the various "Box" retailers could not obtain competitive prices on inputs or handle the distribution efficiently. Unlike a grocery retailing market, the so-called fringe firms are all large players in other retailing businesses.
The court decision appeared to fall victim to a number of the Pitfalls. Of particular interest are: focusing the analysis on the infra-marginal firms (Pitfall 4), requiring evidence on actual entry (Pitfall 7), considering Guidelines' issues sequentially (Pitfall 9), and naively balancing efficiencies and anti-competitive effects (Pitfall 10).75

The court’s overall discussion concerning customers who would not switch to other office supply retailers appears to implicitly address a general desire of Staples’ customers for “direct-one-stop-shopping” for office supplies. However, these infra-marginal customers will have no effect on competition if a sufficient number of other customers are willing to switch on the margin. Although the court’s decision was filled with evidence suggesting that Staples and Office Depot maintained higher prices in the absence of superstore competition, little study was given to the overall level of prices in the marketplace.76 Without evidence showing that Staples and Office Depot offered the lowest prices in each market, it is difficult to infer that marginal customers could not switch to alternative vendors in response to a price increase. Likewise, the underlying concept of “direct-one-stop-shopping” was underdeveloped. Evidence suggesting that almost all consumers needed to purchase some items at Staples or Office Depot (at prices significantly lower than mail-order) and facts about transaction costs that implied that the consumer could only efficiently undertake one shopping trip per-period would also serve to limit the magnitude of the marginal consumer effect. Without such evidence, the court’s conclusions are not convincing.

The entry analysis concentrated on a finding that the office superstore niche was characterized by an exit in the mid-1990s. The court chronicled a tale of failure and exit after the explosion of entry in the 1980s.77 Market saturation was also advanced as a barrier to entry. A more detailed analysis of the economics of en-

75 See id. at 1082 n.13. The court found that the Commission had showed a reasonable probability of an anti-competitive effect, even if a broader office supply retailing by big store market was considered (in which post-merger Herfindahls ranged from 1,793 to 5047). This conclusion falls victim to the Pitfall of assuming that concentration causes competitive problems (Pitfall 1). The agencies rarely challenge mergers in markets with Herfindahls around 1,800; thus, at least some of these broader markets would not raise competitive concerns.

76 See id. at 1076-77.

77 See id. at 1086-88.
try could have overcome the focus on history. For example, evidence suggesting that a large network of stores was necessary for entry would have augmented the saturation evidence. On the other hand, in retailing, economies of scope could overcome scale disadvantages. For example, the court's decision did not highlight why U.S. Office Products would fail at entry with a limited range of office supplies. If U.S. Office Products could exploit some synergy with other services that they offer small businesses, their limited selection might not be a fatal handicap. Moreover, the historical failure of Best Buy is not as important as the reason why Best Buy failed to profit from a niche entry into office supplies. Overall, entrants fail in markets with no entry barriers all the time (restaurants are an obvious example), so entry analysis based on failure is not very insightful. Instead, the court should have explored the reasons why entry would not be profitable and hence unlikely to preserve competitive pricing.

The simultaneous evaluation of the Guidelines' considerations appeared missing from the overall Staples decision. This was particularly troubling because a number of the competitive issues required careful analysis. First, given a finding that consumable office supplies are available through the superstore market, the competitive ramifications of the merger depend, in part, on the elasticity of demand that a post-merger Staples/Office Depot would face. If the demand were relatively elastic, little market power would exist. Second, the ability to exploit the market power depends on the underlying structure of the market. No analysis was really presented for how much competition could be expected from OfficeMax and if collusion could be expected. These issues would have some effect on the profitability of a price increase. Third, even if an anti-competitive effect would occur, it could be undermined by entry and fringe expansion. If the adverse effect is small, even a fringe entrant could restore competition. Overall, without some type of adding-up analysis, which considers all of the possible sources of competition in response to an anti-competitive price increase, it appears inappropriate to conclude that Staples could exercise market power.

78 *See id.* at 1086 (noting U.S. Office Products' acquisition of Mailboxes, Etc., a nationwide franchise of 3,300 units).

79 *See id.* at 1088.
At this point, one could argue that the factual evidence and statistical analysis of a likely anti-competitive effect presented in *Staples* really substituted for the adding-up analysis, along with resolving all the Pitfalls in the Guidelines' analysis. In other words, good effects evidence negates the need for competition analysis, because the effects evidence addresses the key concern of likely competitive effects. Since the market definition, concentration, unilateral effects or collusive theory, and entry discussions are all constructs designed to indirectly address competitive concerns, they are mooted by a strong competitive effects conclusion. While this represents an interesting argument, it seems to turn on the quality of the effects and the Guidelines' evidence. Unless the actual proof of effects is overwhelming, the standard Guidelines' approach is still useful. When the implications of the two approaches to merger analysis differ, it is necessary to check both techniques for flaws and reach a balanced judgment.

The final efficiency balancing appeared to apply the naive price test of consumer welfare. The court declined to accept the parties' five year efficiency claims of between $4.9 and $6.5 billion, although the decision suggests that some efficiencies would be realized. Moreover, the court also rejected the parties' assertion that the pass-through rate would be approximately two-thirds, it instead accepted the FTC's econometric estimate of 15% to 17%. While no exact numbers were given in the court's deci-

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80 See Jonathan B. Baker, Remarks before the American Bar Association's Antitrust Section, Economics Committee (July 18, 1997) (transcript available at http://www.ftc.gov/speeches/other/stspch.htm); see also Jerry A. Hausman, Documents Versus Econometrics in Staples (1997) (unpublished manuscript) (on file with author). Baker postulates that the FTC's empirical studies played an important role in the court's decision, while Hausman suggests that the Staples' econometrics "cancelled out" the FTC work, leaving the judge with the problematic price increase documents to support an anti-competitive effect. Dr. Baker was the director of the FTC's Bureau of Economics at the time of the trial; Professor Hausman served as an expert witness for the defense.

81 The court's attempt to address the structural issues and its careful analysis given the effects evidence suggest that the court's decision avoided Pitfall 8 (substituting complaints or hot documents for analysis).

82 The court clearly avoided Pitfall 3 (dismissing efficiencies as speculative) by rejecting the "clear and convincing" standard. See Staples, 970 F. Supp. at 1089.

83 See id. at 1090 (noting that Staples and Office Depot have a proven track record of achieving cost savings through efficiencies).

84 Pass-through is defined as the percentage of the efficiency "passed-through" to consumers in the form of lower prices. For a discussion of the analysis behind the pass-through estimate, see ORLEY ASHENFELTER ET AL., IDENTIFYING THE
sion, it is possible to consider a few scenarios. For example, if $1 billion in efficiencies were accepted, the savings to consumers would be around $150 million, while $2 billion in efficiencies would generate about $300 million in consumer savings. The court did not find the (unstated) efficiency savings to be sufficient to overcome the anti-competitive effect.

A more detailed analysis would have shown how sensitive the balancing conclusion was to the acceptance of the naive price rule. First, take the combined sales of the company as $10 billion dollars and assume 50% of the sales were in affected markets; another 50% of the sales could be eliminated because many products did not fall into the disposable office supply markets (e.g., furniture and computer equipment). A 5% price increase on the remaining $2.5 billion would generate a rough estimate of the revenue from the price increase of $125 million. However, most of this profit is transferred to the Staples’ stockholders instead of being lost to society. Assuming constant costs and a disposable office supplies demand elasticity of one, the merger would impose a deadweight loss of only a few million dollars. Thus, under the social welfare

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85 The FTC estimated efficiencies of 1.4% of sales, which appears to amount to $140 million per year or $700 million over a five year period. See Serdar Dalkir & Frederick R. Warren-Boulton, Prices, Market Definition, and the Effects of Merger: Staples-Office Depot (1997), in THE ANTITRUST REVOLUTION 143 (John E. Kwoka, Jr. & Lawrence J. White eds., 3d ed. 1999). This could be considered a lower bound on the relevant efficiencies. It is important to note that the pass-through will be 50% for a firm facing a linear demand curve and constant marginal costs, regardless of the elasticity of demand. If a merger changes the structure of a market from effectively competitive (with a low pass-through) to one in which the firm has unilateral market power, it is probably better to accept the 50% pass-through, defined by linear unilateral demand curve (with constant costs), than to try and estimate the pass-through with pre-merger data.

86 The share of the combined Staples/Office Depot business subject to an anti-competitive price increase is an assumption, while the 5% price increase basically matches the 4.9% from Dalkir & Warren-Boulton. See Dalkir & Warren-Boulton, supra note 85, at 12.

87 The loss is one-half the revenue gain generated from the marginal 5% of customers who choose not to purchase from Staples at the higher prices. The correction of one-half is used to adjust for the fact that only a single marginal discouraged customer suffers the full loss. All other customers suffer lower losses as they switch to alternatives for less than the full 5% price increase. This concept is easily illustrated by drawing a downward sloping demand curve and two flat parallel cost curves (separated by the 5% price increase). The deadweight loss is the triangle defined by the intersection of the demand curve and the two cost curves and the relevant price increase.
standard, the annual potential efficiencies of $200 to $400 million would clearly outweigh the deadweight loss.

The court took a different approach comparing the $30-$60 million in savings passed on to consumers to the total transfer of $125 million. This application of the price test (a consumer welfare standard) would clearly support the court’s injunction. However, if a weighted standard were used, a weight exceeding 32.5% for social welfare would suggest that the merger was efficient for the smaller efficiency estimate. Since this weight approximates the corporate tax rate, even the court’s finding on efficiencies could have justified an efficiency defense.

In summary, the Staples decision appeared to be trapped by several of the Pitfalls. One possible explanation for the mistakes is that the court decided the decision did not need a strong Guidelines’ foundation and focused the bulk of the decision on evaluating the actual effects evidence. Although this explanation seems sufficient for most of the Pitfalls, a better balance of efficiencies and anti-competitive effects could have been undertaken. In general, efficiencies tend to dominate anti-competitive effects for most balancing rules.

4. CONCLUSION

We have argued that the decisions in three recent high profile merger cases suffered from various merger-analysis Pitfalls as explained in the text and our previous work. The cases that were discussed were deliberately chosen to highlight the analytical advantages of a succinct approach to merger analysis based on case law and economic analysis. The Pitfalls approach minimizes the cost and use of resources devoted to merger analysis, by focusing on the most controversial and problematic areas likely to arise in an investigation. Thus, an initial examination of a prospective case based on the Pitfalls approach may shorten the time and

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88 The pass-through is critical here, since the annual postulated efficiencies of $200 to $400 million exceed the estimated price effect of $125 million.
89 See Roberts & Salop, supra note 34, at 5.
90 Another efficiency analysis could be undertaken to evaluate the long-run competitive dynamics of the market. In general, pass-through rates increase and anti-competitive effects decrease over time. Of course, the conclusion of any analysis depends on the data, and the limitations implicit in the actual Staples decision precludes any strong conclusions. Even a social welfare analysis would predict a competitive problem if the actual efficiencies were small enough.
scope of investigations, minimize the likelihood of enjoining potentially efficiency-enhancing acquisitions, and reduce the cost of antitrust reviews.

The approach is also simple to present in court and regulatory proceedings and to understand. Many of the problems noted here may have been caused by the way the cases were argued rather than by methodological pecadillos. Obviously, if counsel failed to present evidence on a key point, the trier-of-fact would have difficulty with a relevant finding. Alternatively, problems may have been caused by the presentation of unnecessarily complex and confusing evidence. If the relevant facts were not made clear, the regulator or court may have been unable to make the appropriate finding. Thus, an obvious point perhaps worth belaboring is that it is crucial for any party to an antitrust dispute to present its arguments in a straightforward, clear, and understandable fashion. The Pitfalls analysis is a readily available conceptual approach well-suited for such a task.