The First Cut Is the Deepest: Use of Economics Before the Antitrust Agencies and the Courts

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IT IS NEWS TO FEW THAT SOPHISTICATED economic analysis has become an important component of antitrust practice, whether in advocacy before the federal and state antitrust agencies or in government or private antitrust litigation. Regardless of the forum, credible and persuasive economic analysis can represent the critical ingredient in evaluating the competitive consequences of a proposed merger or business conduct or in assessing the appropriate remedy for an antitrust violation. Indeed, economic analysis plays a central role in nearly every significant antitrust matter, even when the ultimate decision may emphasize other sources of evidence.[1]

As a practical matter, however, the role and significance of economic analysis can vary dramatically depending on the setting. An approach tailored to persuading the agencies may be unsuccessful, or even in some cases counterproductive, if applied in the courtroom, and vice versa. In our experience, including our time at the FTC, we have observed many matters where economic analysis was pivotal in securing a successful resolution, along with plenty of others (including, candidly, some our own cases while in private practice) where a different approach might have proven more effective.

In this article, we offer our perspective on how economic analysis is most effectively utilized in antitrust advocacy before the antitrust agencies and the courts, with the upshot being that a party's economic analyses are much more likely to be persuasive to the agencies than a federal court, especially in merger matters.

Economics at the Antitrust Agencies

In deciding how and when to present economic analysis to support antitrust advocacy, the single most important consideration is to understand the differences between the audience at the agencies compared with nearly all courts. Both federal antitrust agencies employ large staffs of experienced and dedicated economists, the Bureau of Economics at the Federal Trade Commission and the Economic Analysis Group at the Antitrust Division of the Department of Justice. These in-house economists, a subset of whom is assigned to every significant merger or non-merger investigation, serve a critical role in both agencies' decision-making.

In addition, the agencies often retain outside economic experts relatively early in the investigative process, particularly for cases that may well end up in litigation. This was certainly the case during our tenure. As with the legal staff at each agency, these economists typically specialize in particular industries, with their experience from prior cases informing their approach to new matters. As a result, agency economists often expect parties to engage in sophisticated quantitative analysis, and the legal staff and front-office management often rely heavily on economic analysis, including the conclusions and recommendations of economic staff.

The 2010 Horizontal Merger Guidelines reflect this heavy focus on economic analysis in agency merger reviews, with such increased emphasis on economics one of the driving forces for the 2010 revisions to the previous Guidelines.[2] The Merger Guidelines make clear that, while market structure and concentration certainly can play a role, 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."[3] The Guidelines outline the types of quantitative analyses that are frequently employed in merger investigations, including diversion ratios, measures of upward pricing pressure, merger simulation models, and critical loss analyses. At least when considering potential unilateral effects, and to the extent the necessary data are available, 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."[4]

Consistent with the 2010 Guidelines, in our experience the FTC and DOJ routinely rely on similarly sophisticated econometric models in merger reviews, including at the crit-

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ical early stages of determining whether to issue a Second Request or, in conduct cases and non-reportable deals, to open a full-phase investigation. In many cases, the agencies can be persuaded that a transaction is unlikely to harm competition even when market structure and concentration would exceed the thresholds for a presumption of harm under the Merger Guidelines and case law.[5]

Although the U.S. agencies do not publish their rationale for clearing a transaction very often, there are several prominent examples documented in public statements. In the FTC's review of Dollar Tree's acquisition of Family Dollar, for example, the Commission relied on a sophisticated econometric model as a primary means to identify the parties' overlapping stores presenting significant competitive concerns. As then-Chairwoman Edith Ramirez explained in a speech discussing the case, the Commission

> used an econometric model that allowed us to assess the likely impact of the transaction by taking into account, for any given local geographic area, the varying degrees of market power-constraining influence exerted by various retailers in that area. The model showed that in some geographic areas, the only retailers exerting a significant influence were Walmart and other dollar stores such as Dollar General. In other geographic areas, supermarkets or pharmacies, by virtue of their proximity and number, also exerted a significant influence. This approach produced a sophisticated understanding of likely competitive effects in part because it did not assume that a particular retailer fell inside or outside of any relevant market.[6]

In other words, the Commission was willing to look beyond any strict definition of the relevant market to evaluate the transaction's likely competitive effects.

Similar kinds of econometric analysis also played meaningful roles in the outcome of other agency investigations. In one consumer products transaction cleared with divestitures by the Commission during our tenure at the Commission, econometric price modeling presentations by the parties' economists were influential in a close-call decision to accept the parties' proposed remedy. In our view, those economic analyses showed that, when accounting for dynamic efficiencies resulting from the transaction, the transaction was unlikely to have price effects in any relevant market.

In a more recent transaction, before the Department of Justice, in which we represented the acquirer of a competitor's software business serving the real estate industry, the in-depth analyses that our economist team presented about switching to alternative products and the lack of head-to-head pricing between the merging parties undoubtedly helped our client clear the transaction at the front office despite significant concerns expressed by staff.

Nor is the agencies' reliance on sound economic analyses a recent phenomenon. Perhaps the poster child for the agencies' affording substantial weight to economic modeling is the Commission's 2002 decision to clear the merger between competing cruise line operators. There, in its closing statement, a majority of the Commission voted to clear the transaction even though it would "significantly increase concentration in a market already highly concentrated," because the evidence did not "support any theory of anticompetitive effects."[7] As the then-Director of the Bureau of Economics explained: "Basic data analysis can make a difference in decision making."[8]

The Commission's heavy reliance on econometrics in Dollar Tree/Family Dollar and the other examples mentioned above illustrate a broader and more fundamental point, which is that, when data is available, the agencies are generally quite receptive—and often eager—to receive sophisticated econometric studies and other quantitative analyses from the parties in a merger or conduct investigation. And this type of evidence can persuade the agency to clear a transaction or close a conduct investigation even when the structural evidence may suggest cause for concern.

Because, as detailed in the following section, courts continue to rely more heavily on qualitative evidence, such as internal party documents and testimony of industry participants, than on economic evidence, the best and sometimes only meaningful opportunity to use economic analysis to gain clearance for an otherwise problematic transaction is before the agencies. Thus, there can be little question that the first cut is the deepest (to borrow a phrase from the Cat Stevens song popularized by Sheryl Crow) when it comes to presenting sophisticated economic analysis.

Economics in the Courts

By contrast to the expert audience at the antitrust agencies, most judges and nearly all jurors have relatively little prior experience with economics or antitrust law. Even in courts that have a relatively large number of antitrust cases, antitrust generally comprises a tiny fraction of the overall docket. This relative lack of specialized experience does not necessarily mean that economic analysis is not relevant in litigation, or that judges and juries are incapable of understanding sophisticated economic concepts. In fact, our generalist court system is remarkably adept at learning and applying specialized areas of the law, including antitrust. Furthermore, in our experience, most judges assigned complex antitrust cases devote considerable effort to familiarize themselves with the economic analysis. But courts generally evaluate the economic evidence within the broader evidentiary record, typically relying more heavily on documents, testimony from fact witnesses, and other qualitative evidence.

In the FTC's challenge to the proposed Sysco/US Foods merger, for example, the court considered each side's economic expert testimony in considerable detail, but the court ultimately resolved the technical and methodological disagreements among the economists by turning to other sources of evidence. Faced with "competing expert testimonies" that came to opposite conclusions on market definition, the court considered each "in light of the evidentiary record as a whole" and concluded that the economic analysis of the FTC's expert was "more consistent with the business realities of the food distribution market" than that of the defendants' expert.[9] The court also focused its analysis of the relevant market on the "practical indicia" outlined in *United States v. Brown Shoe*, quipping that the "*Brown Shoe* practical indicia may indeed be 'old school' . . . [but] *Brown Shoe* remains the law, and this court cannot ignore its dictates."[10]

Similarly, in both of the recent DOJ challenges to proposed health insurance mergers, the courts considered econometrics and other quantitative evidence but generally emphasized qualitative evidence and the *Brown Shoe* factors. In *Anthem/Cigna*, for example, the court resolved conflicting economic expert testimony by focusing on "real world evidence."[11] In evaluating competing methodologies for performing diversion analysis, the court emphasized the perceived tension between the "economic assumptions underlying the various methodologies" and the "internal communications that shaped and chronicles these events in real time," concluding that "Anthems' ordinary course documents tell a consistent story that contravenes the firm's litigation position."[12] Likewise, although the court in *Aetna/Humana* gave significant weight to customer switching data, it evaluated this evidence within the *Brown Shoe* framework.[13] And the *Aetna* court rejected what it perceived to be a "technical" and "purely econometric approach to market definition," concluding that econometric evidence must be considered in light of "the *Brown Shoe* factors and ordinary course of business documents."[14] Thus, in each of these recent litigated merger challenges, the court emphasized documents, testimony, and other forms of qualitative evidence, even when evaluating the quantitative evidence.

Perhaps most dismissive of the role of economics in a merger litigation was the Ohio federal court's decision not to hear *any* economic evidence at all in *FTC v. Steris/Synergy*.[15] In that case, which was during our tenure, the Commission sued to preliminarily enjoin a merger on the theory that the transaction would eliminate likely future competition between an incumbent provider of sterilization services for medical devices and a future rival poised to introduce a better competing technology. Prior to the hearing, the court strongly suggested that the parties focus their presentations exclusively on factual evidence of whether the alleged potential entrant was likely to enter the relevant market absent the transaction. The court, which denied the FTC's request for a preliminary injunction, saw no need to entertain economic evidence about market definition or industry conditions that made it attractive or unattractive for new entry.

To be sure, there are exceptions to this general pattern of courts' seeming reluctance to hinge their decisions in significant part on economics. In *Oracle/Peoplesoft*, for example, the court cautioned that "strong presumptions based on mere market concentration may be ill-advised in differentiated products unilateral effects cases," noting that "modern econometric methods" such as merger simulation models may be more appropriate in these circumstances.[16]

More recently, in the Third Circuit's decision reversing the denial of a preliminary injunction in a FTC hospital merger challenge, the court engaged in a detailed analysis of the appropriate methodology for applying the hypothetical monopolist test to define the relevant market for health care services.[17] These examples illustrates that federal courts can and do grapple with sophisticated economic models and concepts. But there is no question that the courtroom is a fundamentally different forum than the antitrust agencies, and economic analysis needs to be tailored appropriately to account for these inherent differences.

The Problem with Keeping Your Powder Dry

Most antitrust practitioners understand that the agencies are often more receptive to econometric studies, economic models, and other sophisticated forms of economic analysis. But in our experience, in practice advocates often fail to take full advantage of the opportunity to use these tools effectively. Most notably, we have observed numerous instances in which persuasive economic analyses were presented for the first time in litigation. Undoubtedly, this pattern may be attributed to practical realities—for example, many clients may be hesitant to invest in in-depth economic analysis early in an investigation, and often the data necessary to perform robust studies may not be available to the parties before the agencies are forced to produce third-party sources in litigation. Likewise, parties may be hesitant to present an economic approach that differs significantly from the standard models preferred by agency economic staff, or to appear to endorse the agency's preferred approach. Despite these limitations, however, in most cases we believe there is an opportunity to develop and present persuasive economic analyses earlier in the investigative process.

Effective Use of Economics Before the Agencies and the Courts

With these general observations in mind, how can antitrust practitioners more effectively utilize economic tools in advocacy before both the agencies and courts? Below, we outline some suggestions for both settings.

In seeking to persuade the agencies, in our view the most important consideration is the importance of earnestly engaging with agency economic staff. In many types of transactions, economic staff will approach their analysis with well-defined approaches and models. Although there may be compelling reasons why alternative models may accurately predict competitive effects in a particular transaction, realistically there is usually a much greater chance of persuading agency economic staff using their default framework. To the extent there may be a strong case for tweaking or refining this approach to better fit the circumstances of a particular transaction, in our experience it is generally most useful to focus on a small number of incremental refinements to the standard model. And, even if there is a strong case to apply a different framework, agency staff is most likely to be persuaded where the parties are able to demonstrate that anticompetitive effects are unlikely even using the agency's standard approach.

We do note one important factor to consider in adopting the agency's preferred framework during the investigative stage. If the matter ends up in litigation, litigation staff may attempt to use the parties' good-faith efforts to engage with staff offensively, as evidence that even defendants' own expert(s) admit the transaction may harm competition.

For example, a GUPPI analysis or merger simulation model presented during the investigation may show some potential for upward pricing pressure or price effects. Indeed, these tools can generate superficially adverse results in nearly every merger among competitors, and courts may not appreciate that this inherent feature of this type of analysis should not be interpreted as evidence the merger is likely to substantially lessen competition.

In our view, however, this risk is manageable, and it should not deter engagement with agency economic staff on their terms. But it is important to keep this possibility in mind when presenting such economic analysis, including appropriate caveats explaining that this analysis is presented for illustrative purposes and does not represent an endorsement of the analytical approach. In some cases, there may also be value in using a different economic expert in litigation, particularly if the parties intend to advance a fundamentally different approach in that setting.

Recognizing the importance of engaging with agency economic staff, it is equally important to understand the limits of economic analysis within the broader range of evidence that the agencies will evaluate in reviewing a proposed transaction. Despite the growing role of quantitative analysis, the agencies of course continue to rely heavily on the parties' ordinary-course-of-business documents and the perspective of customers and other market participants. In presenting economic analysis, it is critical to remain mindful of these other sources of evidence, which—if they appear to contradict the inferences of the economic work—may cast serious doubt on the reliability or relevance of the quantitative analysis.

In one recent transaction we defended, for example, we presented what we believe to be compelling economic evidence that the parties were not especially close competitors. Though staff could not dispute the results of this analysis, internal documents appearing to show intense competition between the parties made staff skeptical of the conclusions we were attempting to draw from the quantitative analysis. Although we were ultimately successful in persuading the agency to clear the transaction, we were not able to do so until we compiled a robust record of ordinary-course documents and third-party evidence corroborating our position.

This factor—presenting economic analysis that is consistent with the other sources of evidence—is important in any setting, but of paramount importance once the advocacy transitions to the courtroom. Whereas agency staff are generally willing to look past a few bad documents or vocal customer opposition if the balance of evidence indicates the transaction is unlikely to harm competition, the same type of evidence can be fatal in litigation if not handled appropriately. In our experience, most judges use economic analysis at most as a supplement to, or interpretive guide for, the other, more familiar sources of evidence. If an economic expert's testimony does not fit closely with the qualitative evidence, the court is unlikely to afford it much, if any weight. As discussed above, courts frequently evaluate the reliability of an economic expert's testimony based on the degree to which the expert's analysis is consistent with other sources of evidence, particularly the defendants' ordinary course business documents.[18]

For this reason, the economic expert's role in antitrust litigation should be to help tell the overall story and to provide the court with a roadmap for applying the evidence to the analytical framework of the governing case law. The most effective experts, guided by experienced trial counsel, will present economic analysis—even when it involves complicated econometrics or economic models—using an intuitive, common-sense approach that fits comfortably within legal precedent. Thus, economic testimony remains important, but its function differs from the agency setting.

Conclusion

The recent wave of merger litigations stresses that economics, while certainly relevant to courts, rarely if ever can carry the day when faced with substantial qualitative evidence to the contrary. So, if a party is prepared to expend the resources to litigate, it is probably a wise investment to front load the economic analyses at the agency level. ■

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1 Our own experience is confirmed by public statements from agency leadership spanning Republican and Democratic administrations. *See, e.g.*, Andrew Finch, Acting Assistant Att'y Gen., Remarks at Global Antitrust Enforcement Symposium 5 (Sept. 12, 2017), https://www.justice.gov/opa/speech/acting-assistant-attorney-general-andrew-finch-delivers-remarks-global-antitrust ("Economics has played, and will continue to play, a fundamental role in antitrust enforcement."); Bill Baer, Assistant Att'y Gen., U.S. Dep't of Justice, Connecting the Antitrust Dots: In Praise of Herb Hovenkamp 4 (Oct. 23, 2014), https://www.justice.gov/atr/file/517731/download ("Today, an investigation of—or lawsuit challenging—a potential violation of the antitrust laws inevitably involves economists (and often econometricians) on both sides.").

2 Carl Shapiro, *The 2010 Horizontal Merger Guidelines: From Hedgehog to Fox in Forty Years*, 77 Antitrust L.J. 49, 65 (2010).

3 U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines § 4 (2010) [hereinafter Merger Guidelines], http://ftc.gov/os/2010/08/100819hmg.pdf.

4 *Id.* § 6.1; *see also* Shapiro, *supra* note 2, at 68 ("DOJ puts far more weight on diversion ratios and margins than on the HHI level when diagnosing unilateral price effects. This has been the case for many years.").

5 *See, e.g.*, Malcolm B. Coate & Shawn W. Ulrick, Bureau of Economics, Fed. Trade. Comm'n *Transparency at the Federal Trade Commission: The Horizontal Merger Review Process 1996–2003*, at 58 (Feb. 2005), https://www.ftc.gov/sites/default/files/documents/reports/request-mailed-copy-

transparency-federal-trade-commission-horizontal-merger-review-process-1996-2003/0502economicissues-1.pdf.

[6] Edith Ramirez, Fed. Trade Comm'n, The Horizontal Merger Guidelines Five Years Later 5 (Sept. 29, 2015), https://www.ftc.gov/system/files/documents/public_statements/805441/ramirez_-_georgetown_antitrust_enforcement_symposium_9-29-15.pdf; *see also* Statement of the Commission, Fed. Trade Comm'n, In re Dollar Tree, Inc., FTC File No. 141-0207 (July 13, 2015), https://www.ftc.gov/public-statements/2015/07/statement-federal-trade-commission-matter-dollar-tree-inc-family-dollar.

[7] Statement of the Federal Trade Commission, In re Royal Caribbean Cruises, Ltd., FTC File No. 021-0041 (Oct. 4, 2002), https://www.ftc.gov/sites/default/files/documents/cases/2002/10/cruisestatement.htm; *see also* Joseph J. Simons, Merger Enforcement at the FTC n.44 (Oct. 24, 2002), https://www.ftc.gov/public-statements/2002/10/merger-enforcement-ftc.

[8] David Scheffman, *The FTC Cruise Line Merger Investigation, ABA Section of Antitrust Law "Brown Bag Program,"* Antitrust Source 6 (Jan. 2003), https://www.americanbar.org/content/dam/aba/publishing/antitrust_source/lerner.authcheckdam.pdf.

[9] FTC v. Sysco Corp., 113 F. Supp. 3d 1, 36–37 (D.D.C. 2015); *see also id.* at 55, 64 (agreeing with the FTC's analysis of the relevant market because its position was "consistent with market realities" and "corroborated by other evidence in the record," such as ordinary course documents and businessperson testimony).

[10] *Id.* at 27 n.2; *see also* United States v. Aetna, Inc., 240 F. Supp. 3d 1, 21, 23–29 (D.D.C. 2017) (relying on *Brown Shoe* factors to evaluate the relevant product market); FTC v. Staples, Inc., 190 F. Supp. 3d 100, 118–21 (D.D.C. 2016) (same).

[11] United States v. Anthem, Inc., 236 F. Supp. 3d 171, 198 (D.D.C. 2017); *see also id.* at 210.

[12] *Id.* at 219.

[13] *Aetna*, 240 F. Supp. 3d at 21, 26–28.

[14] *Id.* at 39.

[15] FTC v. Steris Corp., 133 F. Supp. 3d 962 (N.D. Ohio 2015).

[16] United States v. Oracle Corp., 331 F. Supp. 2d 1098, 1121–22 (N.D. Cal. 2004).

[17] FTC v. Penn State Hershey Med. Ctr., 838 F.3d 327, 339–41 (3d Cir. 2016).

[18] *See, e.g.*, *Anthem*, 236 F. Supp. 3d at 210 (noting that "the refutation of the defense expert's criticisms can be found in Anthem's own files"); *Sysco*, 113 F. Supp. 3d at 55, 64 (agreeing with the FTC's analysis of the relevant market because its position was "consistent with market realities" and "corroborated by other evidence in the record," such as ordinary course documents and businessperson testimony).