

Strengthening the Micro Foundations for Coordinated Interaction in Merger Analysis



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Updated Approach to Coordinated Interaction

- ❑ DOJ and FTC initiatives to modernize CI analysis
- ❑ Moving from probabilistic statements to fact-specific inquiries
- ❑ Stylized facts / correlations to micro-economic foundations
- ❑ Theories focused on maverick firms, competitor asymmetries, and opportunities for mavericks to disrupt CI
- ❑ Recent examples: label stock (DOJ), cruise lines (FTC)

Two Areas Warranting Further Analysis

- I. Should history matter, and if so, how?

- II. How will a merger affect transparency?

Three Steps

Reality check

- Does the general phenomenon apply in the specific market?

Micro-economic foundations

- How does the merger affect the phenomenon?

Sensitivity check

- How big is the effect ?

I. Should History Matter, And If So, How?

- ❑ **In practice, courts have placed substantial weight on history**
 - ❑ History of price-fixing (*FTC v. Elders Grain*)
 - ❑ History of tacit coordination (*FTC v. Cardinal Health*)
 - ❑ History of price leadership (*FTC v. H.J. Heinz*)
 - ❑ History of cooperation in general (*Hospital Corp. of America v. FTC*)

- ❑ **History has shaped how agencies have heard evidence and influenced where they have set the bar**

- ❑ **These approaches appear to be guided by correlations, rather than micro-economic theory**

- ❑ **History used as a summary statistic for unobservables**

Reality Check

- ❑ Empirical evidence is very mixed
- ❑ Seemingly low recidivism rates in time series studies (Dick JLE 1996)
- ❑ Recidivists tend to be shorter-lived (Dick JLE 1996)
- ❑ But, some case studies do suggest learning by doing (Baker JLE 1989 and Alexander REStat 1994)

Micro-economic Foundations for History

- ❑ Agencies must ask: “Has history mattered in *this market?*” and “How will history affect CI after *this proposed merger?*”

- ❑ Empirical evidence that history has mattered
 - ❑ E.g., CI continued after the demise of suspect practices

- ❑ Incorporation of micro-economics of history into the specific competitive effects theory
 - ❑ History can help build current understandings
 - ❑ History can reveal firms’ “types”
 - ❑ History can “teach” firms how to coordinate
 - ❑ History can improve the accuracy of current and future monitoring

Sensitivity Check

- ❑ **Have “salient characteristics of the market changed appreciably” since the historical episode? (HMG §2.1)**
 - Has entry occurred ?
 - Has the geographic market broadened ?
 - Have power buyers emerged ?
 - Have capacity constraints been relaxed ?

II. How Will a Merger Affect Transparency?

- ❑ **Courts give substantial weight to transparency**
 - “Secrecy is the antithesis of successful collusion” (*US v. ADM*)

- ❑ **Agencies also highlight transparency**
 - Relevant factors include “the availability of key information concerning market conditions, transactions and individual competitors” (HMG § 2.1)

- ❑ **Intuition: transparency improves reaching terms of coordination, detecting deviations, and punishing deviations**

Reality Check

❑ How accurate is competitor intelligence?

- Compare merging parties' actual prices against pre-merger intelligence
- Compare prices against third-party industry intelligence

❑ Have changes in transparency led to changes in pricing?

- Danish antitrust agency published cement transaction prices, leading average prices to rise 15-20% (Albaek, Molgaard & Overgaard JIE, 1997)

❑ Have transaction prices closely tracked announced prices?

- In *US v. ADM*, court noted that while price changes were routinely pre-announced, transaction prices differed substantially.

Micro-economic Foundations for Transparency

❑ Explain how *this merger* will increase transparency

- E.g., *Premdor-Masonite* CIS (DOJ)

❑ Transparency of *what* ?

- Direct information: strategy choices (price, output) ?
- Indirect information: payoffs (profits, market shares) ?

❑ Discount appropriately for strategic customers and signal jamming incentives

Sensitivity Check

- ❑ How much better informed will merging parties (or other firms) be after the merger?
- ❑ Can we quantify the merger's impact on the signal-to-noise ratio?

Should History Matter, And If So, How?

- ❑ Courts have placed substantial weight on history
- ❑ History shapes how agencies hear evidence and where they set the bar
- ❑ History has been used as a summary statistic for unobservable factors
- ❑ Reality check: empirical evidence is very mixed
- ❑ Goal: incorporate *micro-foundations for history* into the competitive effects theory

How Will a Merger Affect Transparency?

- ❑ Courts and agencies give substantial weight to transparency
- ❑ Intuition: transparency improves reaching terms of coordination, detecting deviations, and punishing deviations
- ❑ Reality check: how good is the evidence in fact?
- ❑ Goal: explain how *this merger* will increase transparency