CUSTOMER TESTIMONY OF ANTICOMPETITIVE EFFECTS IN MERGER LITIGATION

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I. INTRODUCTION

Let me at the outset thank Dale Collins and Lisl Dunlop, and the Association of the Bar of the City of New York, for organizing this event. It is a privilege to be a participant on such a distinguished panel of speakers. I would note that present here today are representatives of both sides in a recent case that I had the pleasure to hear and that I will be discussing to a limited extent today. That case, *Federal Trade Commission v. Arch Coal, Inc.*,[1] is notable for the fine advocacy on both sides by the Federal Trade Commission and the private bar.

The topic for discussion today is how to prove anticompetitive effects in merger litigation. Professor Milton Handler, who provides the name and the inspiration for this lecture series, wrote an article that touched on precisely this topic two decades ago in the *Columbia Law Review*.[2] Indeed, the article was as prolific as Professor Handler himself, touching on a variety of different areas of antitrust law—from vertical restraints all the way down to the *in pari*

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[1] 329 F. Supp. 2d 109 (D.D.C. 2004).

[2] Milton Handler, *Reforming the Antitrust Laws*, 82 COLUM. L. REV. 1287 (1982).

delicto defense—and many different actors on the antitrust stage, including the Antitrust Division of the Department of Justice, the Federal Trade Commission, and the Supreme Court.[3]

One of the topics to which Professor Handler paid special attention was the approach of antitrust law to merger litigation and merger review, and most of all, the government's enforcement policies in this context. Professor Handler took the view that merger analysis at the time relied too heavily, as he put it, "on statistics, presumptions, and abstract theory."[4] He explained that this approach had led to the wholesale invalidation of a wide range of mergers in which a more searching analysis would have produced a very different result.[5] He argued that the law should throw a wider analytical net, and conduct an inquiry into "other economic factors, including the stability of the market, the structure of the buying side of the market, the durability of the product, and the ease of entry."[6]

Professor Handler pointed to some indications that this view was gaining currency at the time. One piece of evidence was the Supreme Court's 1974 decision in *United States v. General Dynamics Corp.*,[7] in which the Court affirmed a lower court judgment permitting the merger of two coal companies, even though the government offered statistics showing that the coal industry was highly concentrated in

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[3] For example, Professor Handler devoted an entire section of the article to the issue of dual antitrust enforcement by the FTC and the Department of Justice. *See id.* at 1318-25. This aspect of federal antitrust enforcement was "much debated" then and, of course, continues to be today. *See id.* at 1318-25; *see also* William Kovacic, *Downsizing Antitrust: Is it Time to End Dual Federal Enforcement?*, 41 ANTITRUST BULL. 505 (1996); Ernest Gellhorn et al., *Has Antitrust Outgrown Dual Enforcement? A Proposal for Rationalization*, 35 ANTITRUST BULL. 694 (1990); RICHARD A. POSNER, ANTITRUST LAW 280 (2d ed. 2001). The two cases discussed principally in this article were litigated by different arms of the government but confronted a similar problem.

[4] Handler, *supra* note 2, at 1307.

[5] *Id.* at 1311.

[6] *Id.* at 1315.

[7] 415 U.S. 486 (1974).

many areas of the country at the time, and the level of concentration would increase post-merger. The Court concluded—based on a careful examination of the "structure, history and probable future" of the industry—that one of the merging companies was unlikely to be a meaningful competitor for future coal sales in the industry in the absence of a merger.[8] That decision, Professor Handler noted, marked a change from the Supreme Court's earlier, more doctrinaire and rigid approach.[9]

Professor Handler also highlighted comments by then-Assistant Attorney General for the Antitrust Division William Baxter, who—in a discussion much like this one before the City Bar in November 1981—indicated that the government's merger enforcement efforts moving forward would be guided less by a cold application of concentration and market share formulae and increasingly by a more free-ranging inquiry into whether the merger was likely to facilitate collusion on the basis of an examination of a variety of different factors and kinds of evidence.[10] Professor Handler applauded that approach. He described it as a "new, enlightened enforcement policy," one that appropriately recognized that statistics and formulae were not the end of the inquiry and that a more functional approach to merger enforcement was needed to remain true to the purpose of Section 7 of the Clayton Act.[11]

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[8] *Id.* at 498-99. The Supreme Court consequently affirmed the district court, which—as the Supreme Court described it—had relied on "more than three weeks of testimony and a voluminous record," from which it discerned "a number of clear and significant developments in the industry" that overcame the government's "statistical showing." *Id.* at 497.

[9] Handler, *supra* note 2, at 1312-13. Professor Handler had in mind decisions such as *United States v. Von's Grocery Co.*, 384 U.S. 270 (1966), *United States v. Pabst Brewing Co.*, 384 U.S. 546 (1966), and *United States v. Philadelphia National Bank*, 374 U.S. 321 (1963), all of which he viewed as examples of the Court invalidating mergers almost exclusively on the basis of market share and concentration data. Handler, *supra* note 2, at 1310-12.

[10] Handler, *supra* note 2, at 1313-14 & n.170.

[11] *Id.* at 1313. Handler described the new policy as follows:

Here we are, more than two decades later. The functional approach advocated by Professor Handler is well-entrenched in both enforcement policy and modern antitrust jurisprudence. However, a countervailing problem may have emerged in the government's merger enforcement approach, illustrated by recent federal court cases. Within a few weeks of each other, two district court decisions last year denied requests by the government to enjoin mergers. I refer to Chief Judge Vaughn Walker's notable decision in *United States v. Oracle Corporation*,[12] which rejected the attempt by the Department of Justice to block the merger of two software companies, and my decision a month earlier in the *Federal Trade Commission v. Arch Coal* case, in which I denied the Federal Trade Commission's attempt to enjoin the merger of two coal companies.

There are many differences between the two decisions, but I would like to focus today on one striking similarity: both decisions underscored what, in the view of the two judges, was an over-reliance by the government on certain subjective evidence of anti-competitive effects, and emphasized the weakness of that evidence in determining the likely effects of a proposed merger in the respective relevant markets. The subjective evidence in both cases, interestingly enough, took largely the same form: the government introduced testimony from numerous customers of the merger partners expressing their view that the proposed merger would result in anticompetitive effects in the industry.

> [T]he Division now recognizes . . . that statistics are not the end of the inquiry. Thus, however a proposed merger fares on the [Herfindahl] index, in making an enforcement decision the Division plans to look also at other economic factors, including the stability of the market, the structure of the buying side of the market, the durability of the product, and the ease of entry. These considerations seem to suggest the same functional view that *Brown Shoe* required.

Id. at 1315.

[12] 331 F. Supp. 2d 1098 (N.D. Cal. 2004).

We may be seeing evidence, then, that the pendulum has swung too far in the other direction. Twenty years ago, many were concerned about the overemphasis on statistical evidence of market conditions in the merger context, and they pushed for and achieved a shift in the law towards a more functional approach to merger review. Today, there is reason to consider whether merger enforcement has become too functional and too dependent on rhetorical evidence of anticompetitive effects that is unmoored from statistical or economic support. This morning, I will provide an adjudicator's perspective on one specific aspect of this question: the uses and limitations of customer testimony of anticompetitive effects, using the *Oracle* and *Arch Coal* cases as illustrations.

II. *ARCH COAL* AND *ORACLE*

In *Arch Coal*, the FTC and the defendants both had offered testimony from numerous customers, which in that case were the utilities that converted coal into electricity. The FTC, for its part, had relied on this evidence to show that customers believed that the challenged merger would lead to higher prices.[13] The essence of the testimony was that the proposed merger reduced the number of coal companies, and that the resulting increased concentration would mean higher prices. As I explained in my opinion, my view was that this evidence was not particularly useful in an antitrust case:[14]

> [W]hile the Court does not doubt the sincerity of the anxiety expressed by SPRB [Southern Powder River Basin] customers, the substance of the concern articulated by the customers is little more than a truism of economics: a decrease in the number of suppliers may lead to a decrease in the level of competition in the market. Customers do not, of course, have the expertise to state what will happen

[13] *Arch Coal*, 329 F. Supp. 2d at 145.

[14] *Id.*

> in the SPRB market, and none have attempted to do so.[15]

Therefore, I concluded "that the concern of some customers in the SPRB market that the transactions will lessen competition is not a persuasive indication that coordination among SPRB producers is more likely to occur."[16] I noted that the FTC had "relied heavily" on such evidence.[17]

These statements echoed similar concerns identified only a few weeks later by Chief Judge Walker in the *Oracle* decision. It appears from the opinion that the Department of Justice had placed customer witnesses on the stand in that case to testify that they would be unable to avoid a price increase by the merged company in the wake of the merger. The Department, in fact, had described these customers as their "strongest witnesses."[18] Chief Judge Walker, however, found that the views were "not backed up by serious analysis that they had themselves performed or evidence they presented."[19] Therefore, the testimony amounted to little more than "speculation" about the likely effects of the merger:[20]

> If backed by credible and convincing testimony of this kind or testimony presented by economic experts, customer testimony of the kind plaintiffs offered can put a human perspective or face on the injury to competition that plaintiffs allege. But unsubstantiated customer apprehensions do not substitute for hard evidence.[21]

Both the *Arch Coal* and *Oracle* decisions emphasized that the customer witnesses in the case were credible and

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[15] *Id.* at 146.

[16] *Id.*

[17] *Id.* at 145.

[18] *Oracle*, 331 F. Supp. 2d at 1125.

[19] *Id.* at 1131.

[20] *Id.*

[21] *Id.*

sincere.[22] Nevertheless, both opinions—decided in similar contexts within the span of a month—noted the government's heavy reliance on the customer evidence, and concluded that it was largely unhelpful in determining the likely anti-competitive effects of the challenged mergers. Professors Areeda, Hovenkamp, and Solow have described "'subjective' testimony by customers" in the merger enforcement context as the "[l]east reliable" form of evidence of anticompetitive effects in the merger enforcement context.[23] But if *Oracle* and *Arch Coal* are any indication, the government may be relying on evidence of this nature to a considerable and increasing degree. Certainly the FTC in *Arch Coal*, in my experience, placed a great deal of emphasis on this type of customer testimony, and, to be fair, the defendants did, as well. The remainder of this piece will provide a judge's perspective on the uses and misuses of this kind of subjective evidence.

III. RELIANCE ON CUSTOMER TESTIMONY OF ANTICOMPETITIVE EFFECTS

This discussion, it must be emphasized, is not designed to persuade anyone that customer testimony is useless in all its forms. It is essential to understand, and this is something that is reflected in both Chief Judge Walker's decision and mine, that testimony from customers can be relevant to a number of topics in a merger case, including as an explanation for certain pricing or market behavior, as context for determining how the market truly operates, and as evidence relating to market definition and substitutability. It is unlikely that the government, in *Arch*

[22] *See, e.g.*, *Arch Coal*, 329 F. Supp. 2d at 145 ("[T]he Court does not doubt the sincerity of the anxiety expressed by SPRB customers."); *Oracle*, 331 F. Supp. 2d at 1130 ("And the court does not doubt the sincerity of these witnesses' beliefs in the testimony that they gave. What the court questions is the grounds upon which these witnesses offered their opinions on the definition of the product market and competition within that market.").

[23] PHILLIP E. AREEDA ET AL., ANTITRUST LAW ¶ 538b, at 239 (rev. ed. 1998).

Coal or any other merger enforcement case, could proceed without some reliance on customer witnesses. Indeed, in *Arch Coal*, I expressly relied on testimony by customers to assess the cause of a previous price increase in the market,[24] to explain the nature and confidentiality of the sealed bids that were used in the market,[25] and to determine how customers viewed one of the merger companies that the FTC had presented as a valuable maverick in the relevant market.[26]

One common feature of all of these evidentiary uses is that they pertained to facts about which the customers had actual knowledge—that is, about which they were competent to testify. The testimony was not forward-looking, and did not require any predictions or projections about the future. The merger review analysis under Section 7, however, is fundamentally a forward-looking inquiry.[27] It should not be surprising, then, that in certain respects the testimony of customers will come up short. As I see it, the issue is not whether the evidence is subjective, or used to prove anti-competitive effects—instead, it is the competency of the evidence itself that is at issue. In *Arch Coal*, I explained my understanding that customers do not have any particular expertise that allows them to speculate on the likely effect of a merger.[28] But that is, after all, the essential question in any action by the FTC or the Department of Justice seeking to enjoin a merger.

Absent such expertise or meaningful in-house empirical studies or experiences with similar mergers in the past, any speculation by customers on the likely anti-competitive effects of a proposed merger is likely to be no more than that—speculation. Witnesses can do no more than repeat

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[24] *See Arch Coal*, 329 F. Supp. 2d at 133-34.

[25] *See id.* at 144.

[26] *See, e.g., id.* at 146-48.

[27] *See, e.g.*, Brunswick Corp. v. Pueblo Bowl-o-Mat, Inc., 429 U.S. 477, 484 (1977).

[28] *See, e.g., Arch Coal*, 329 F. Supp. 2d at 146 ("Customers do not, of course, have the expertise to state what will happen in the SPRB market, and none have attempted to do so.").

broad economic principles that they think will result in certain effects in the market. I described this in my opinion, and it appears that Judge Walker had the same reaction in *Oracle*, emphasizing that the customer testimony was "not backed up by serious analysis that they had themselves performed or evidence they presented."[29] Judge Walker noted that the customer witnesses presented by *Oracle*, although they, too, inevitably reflected some speculation, carried more weight because they "testified about concrete and specific actions that they had taken and been able to complete in order to meet their information processing needs."[30] Ultimately customer testimony was unhelpful in either case because those witnesses, unlike experts who have studied the market and have a basis for offering opinions, are not competent to provide what amounts to largely ungrounded opinions as to likely future collusion among their suppliers. Their testimony is simply not rationally based in their experience or expertise.

Part of the problem lies in the essential nature of an action to block a proposed merger. Unlike in most antitrust cases, the question of anticompetitive effects in the merger context involves predictions about the future, and the game of predicting the future poses a unique set of dilemmas for counsel and the fact-finder alike. The predictive power of economics far outreaches the similar power of any individual in the industry, no matter how intelligent or experienced that individual may be. Working at Oracle does not make one an oracle, and unless the executive moonlights as a professor or can travel through time, she will not be able to testify directly as to the future events that are at the center of the court's inquiry. Of course, the executive will be able to provide essential information on the nature of the industry, the likelihood of entry, the history of pricing activity, and the predatory activities of firms with market power in a pre-merger world. All of these variables are certainly critical inputs in the economic analysis and will therefore shine light indirectly on the likely results of the merger. However,

[29] *Oracle*, 331 F. Supp. 2d at 1133.

[30] *Id.* at 1133.

emotional appeals or predictions of dire consequences by customers will rarely carry the day in the antitrust context.

This is not a problem of failing to present a fair or representative sample of customer viewpoints. In litigation, advocates (including the government in antitrust cases) may choose the best witnesses to present their side of the story. The adversarial system will address any selectivity issue through the opponent presenting contrary evidence, perhaps resulting in a "battle of customer witnesses" for the fact-finder to resolve. It may be different, however, for the government in making its initial enforcement decision, where a full and accurate assessment of customer viewpoints is desirable.

IV. THE EMERGENCE OF A SUBJECTIVE APPROACH TO MERGER REVIEW

In some respects, this issue of the utility of customer testimony is just another variation on the long-running debate over the use of subjective versus objective evidence in antitrust law. That debate certainly pre-dates the acquisition challenged in *Oracle* and the coal industry merger in *Arch Coal*. It even pre-dates the coal industry merger thirty years earlier in *General Dynamics* that—as discussed earlier—marked, in Professor Handler's view, the beginning of the modern era of functionalism in antitrust analysis. In *United States v. Falstaff Brewing Corp.*,[31] for example, Justice Marshall and Justice Rehnquist tussled in concurring and dissenting opinions over the reliability of the subjective prediction by a company entering a geographic market through acquisition regarding whether it would have entered the market in the absence of the acquisition. Justice Marshall urged that subjective evidence "is inherently unreliable and must be used with great care,"[32] while Justice Rehnquist took the view that, at least in that context, "the

[31] 410 U.S. 526 (1973).

[32] *Id.* at 548 (Marshall, J., concurring); *see also, e.g., id.* at 548 ("[S]ubjective evidence should be preferred only when the objective evidence is weak or contradictory."); *see generally id.* at 566-72 (discussing the issue at length).

distinction between 'objective' and 'subjective' evidence is largely illusory."[33]

I will not presume to contribute meaningfully to that long-running debate in my brief remaining time. We can also bracket for later discussion, and I imagine we may hear something on it today, why subjective customer evidence regarding anticompetitive effects is—if *Arch Coal* and *Oracle* are any indication—playing a more prominent role in merger litigation. For now, I will confine my remaining remarks to a particular point, which is that you—the assembled antitrust counsel and economists—should not shy away from introducing difficult concepts, economic or otherwise, to a federal trial judge merely because those concepts are outside the judge's area of expertise.

One of the great delights and considerable challenges of being a judge is encountering a range of issues that, in all candor, one often does not know much about at the outset. To be a judge, one hopes, is to have one's mind constantly stretched and tested, often in several different directions at once. The federal courts are presented every day with many demanding matters that are beyond the ken of a particular judge. We hear patent disputes, securities claims, and complicated contractual cases involving industries that one might not even know existed, much less understand at the outset, and cases requiring the interpretation of statutory and regulatory schemes stretching into hundreds of pages. Antitrust cases present their own unique challenges, and merger cases all the more so: they involve devilish factual and analytical issues, an enormous record, perhaps not the clearest body of law, and often require a judicial decision in a short period of time, particularly if the government seeks to prevent an imminent merger or acquisition.

The challenge of a judge is to engage and immerse him- or herself in the unfamiliar issues head-on, while the challenge of the advocate is to take the complicated issues and explain or present them in a clear fashion to someone who, in all probability, is not an expert in the field. In a truly complex

[33] *Id.* at 575 (Rehnquist, J., dissenting); *see also id.* at 575-76 (responding to Justice Marshall's arguments on the subject).

case, the judge will start at some point near incomprehension, the advocate will start at some point near incomprehensible, and ideally they will advance towards each other and meet somewhere in the middle.

The advocates in *Arch Coal* completed this exercise in an exemplary fashion. It was an excellently presented case. As in many endeavors, there is a risk in a challenging case that an advocate will drift from presenting sophisticated evidence in a simple fashion to presenting only evidence that is simple, and avoiding the complicated evidence altogether. Customer testimony of anticompetitive effects in a merger case is likely to be just that. Such evidence, even if simple, usually will not be competent, given its fundamentally speculative nature, and is also highly unreliable given its subjective and frequently biased source. So if there is a lesson here, it is to trust the judges. The fact that we are not, as a rule, nearly as experienced in antitrust matters as most of you does not mean that we are not determined to learn the relevant law and economics, as well as the facts, in the course of the case, and should not be viewed as a reason to dilute the evidence. The fact that merger analysis is an open-ended inquiry should not be regarded as an invitation to proceed on the basis of rhetoric or emotional appeals. A frank reading of the decision in *Oracle* is that Chief Judge Walker was calling for more concrete information and more economic analysis, not less. Judges assess difficult facts in unfamiliar terrain for a living, it is what we are paid to do (not all that well, I would add), and we generally are able to discern who is competent to testify as to an inherently theoretical subject, such as the likely future competitive effects of a proposed merger, and who is not. As a rule, it seems to me, customers may not be.

That certainly does not mean, as I have already indicated, that there is no role for customer testimony in Section 7 merger cases. Such testimony may prove valuable, or even essential, on several subjects. It means only that the utility of customer testimony on the particular subject of likely future anticompetitive effects is limited so long as the testimony remains speculative, because it is not based in

demonstrable factual knowledge or economic expertise. In both *Arch Coal* and *Oracle*, therefore, such customer testimony presented by the government was rejected by the courts.

Now, our host Dale Collins mentioned to me last night that he liked to ask government representatives what likely anti-competitive effects are, and I can see by the glint in his eye that he would love to ask me that question as well. That would be a waste of time, Dale, although I will not steal the line of Justice Stewart by saying that "I know it when I see it."[34] Instead, I will wait in a particular case for antitrust practitioners and economists to guide me to enlightened judicial understanding on that perplexing question. For now, I close with the observation that customer evidence, often highly subjective and not buttressed by rational experience or demonstrable expertise, is unlikely to prove persuasive to federal judges in establishing likely anticompetitive effects.

[34] Jacobellis v. Ohio, 378 U.S. 184, 197 (1964) (Stewart J., concurring).