

ANTITRUST

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A N T I T R U S T

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These rules were the result of 2010 amendments to the Federal Court Rules.⁴ The same amendments allowed the court to order expert witnesses to confer with one another in advance of the proceedings in order to narrow the issues (para. 52.6). Kate further explained that similarly, the Competition Tribunal Rules also allow the court to appoint “one or more” independent expert, which is generally understood to contemplate hot tubbing.⁵

In his 2010 article, *The Changing Role of the Expert Witness*, the Honorable Ian Binnie of the Supreme Court of Canada, makes plain that expert advocacy and lack of independence from counsel and litigants is one of the primary reasons for recommending use of a hot tub.⁶ Justice Binnie recommended a number of changes to the way in which expert testimony is presented in Canada, including the requirement that “experts exchange reports and meet face to face for an unmediated discussion before trial” much like the joint conference used in Australia and the joint statement now prepared by experts in the UK. Justice Binnie also recommended that “a court should be able to require opposing experts to testify on the same panel and to be subject to questioning in the presence of each other, with the right to question each other in the presence of the trier of fact.” After noting that the procedure was used in administrative tribunals in Canada and in courts in Australia, Justice Binnie explained his understanding of the merits of the “hot pot” as he called it:

The theory is that experts testifying in the presence of one another are likely to be more measured and complete in their pronouncements, knowing that exaggeration or errors will be pounced upon instantly by a learned colleague, as opposed to being argued about days later, perhaps by unlearned opposing counsel.

Increased Use of Expert Hot Tubs in U.S. Courts

Since the “unprecedented” use of a hot tub in the 2003 census-challenge trial presided over by Judge Woodlock and two other federal judges, the use of hot tubs in federal litigation has increased significantly. Adam E. Butt, an Australian litigator who also practices in the U.S., in writing about the use of hot tubs in the U.S., reported that hot tubs have been utilized by several other U.S. judges (in addition to Judge Woodlock) in a range of proceedings, including in *Daubert* hearings, “a claims construction hearing, a class certification hearing and other civil matters.”⁷ Butt further reported that while “the method has not been seen as problematic in non-jury contexts,” its use in jury trials meets with different reactions by the judiciary, some “would avoid using hot tubbing in jury trials, believing it to be inappropriate for judges to inquire into or comment on expert evidence in front of jurors.” Butt reported that other judges

do not consider that the jury is off limits but they have their certain qualifications. For example, Judge Woodlock would need to be comfortable with who the experts were in order to use hot tubbing before a jury. Judge Zouhary would support using hot tubbing in jury cases where the expert evidence

was complicated (it helps to comprehend such evidence), but would avoid using it in simpler matters. Judge Weinstein has actually now used hot tubbing in one jury trial, in a birthing case. Nevertheless, he states that he would intervene less in such settings, because his intervention may be demeaning to attorneys, the jury may give greater reliance to questions/positions put forward by the judge, and the concurrent presentation of evidence (cf. sequential presentation) may create complications in relation to burdens of proof and allowing attorneys to present their case.

The Ohio Bar Association published a fascinating interview⁸ with Judge Zouhary⁹ about his first use of the hot tub method in the context of a class certification hearing. Judge Zouhary began the interview by extolling the virtues of the hot tub method: “Throwing everybody in the ‘hot tub’ at the same time allows the court, counsel and experts to confront or, ‘splash,’ each other directly, resulting in a better chance of reaching a correct conclusion.” He further explained that he had adopted the procedure on his own, without knowing of its use in Australia or elsewhere.

Judge Zouhary was prompted to adopt a hot tub to assist him in ruling on a class certification motion. He wanted to test the expert assertions made in the affidavits and deposition testimony, but wanted to do so short of a full-blown evidentiary hearing. Moreover, he wanted to provide an opportunity for the experts, who disagreed with one another, to have direct contact with him and with one another. This would not be a “traditional hearing for counsel to wax on.”

In the interview, Judge Zouhary quoted directly from the order he issued in advance of the hot tub, which is also available on Pacer:

At the beginning of each session, all experts for that session will be sworn. This Court, the experts, and counsel for each side will then engage in a discussion, structured around this Court’s questions. That conversation may include back-and-forth directly between the experts, in a point/counterpoint fashion, with this Court moderating. For instance, this Court may ask [plaintiff’s expert] to comment on [defendant’s expert’s] critiques with respect to an aspect of his impact model, then ask [defense experts] to respond, and so on. This Court may invite counsel to join in the legal aspects of that discussion, or comment on the legal consequences of the expert back-and-forth (e.g., what would follow, as a legal matter, from accepting or rejecting a particular expert’s criticisms). Counsel in each session may also make “opening statements” (not to exceed 10 minutes each, delivered before discussion with the experts) that show why plaintiffs have or have not met Rule 23’s requirements.

Judge Zouhary further explained that after setting aside a full day for this hot tub exercise, he sent “counsel ahead of time a set of questions that [he] wanted to be the focus of our discussion,” a technique he also uses in advance of oral argument and other pre-trial hearings. He explained why he liked the hot tub so much:

I found the experience rewarding and will not hesitate to use it again in the right case. What is “the right case?” One that involves multiple experts and a lengthy record, or perhaps a complex Markman hearing. The procedure requires the dueling experts to focus on the same point at the same time. And

the “point/counterpoint” dialogue—as opposed to the traditional appellate-type monologue—is a better way of evaluating the accuracy of an expert’s opinion. There is no hiding.

Judge Susan Illston, of the Northern District of California has utilized procedures very similar to hot tubs in antitrust cases. For example, Judge Illston has had the plaintiff’s and defendant’s experts testify “back to back on particular, difficult issues.”¹⁰ Judge Illston argues that this and other procedures create an order to the evidence which, in turn, allows the jury to “retain a better understanding of what those [disputed] issues are.”

Another context in which hot tubs have been used in U.S. courts is in the U.S. Tax Court. In several instances, Tax Court judges have, with the consent of the parties, received concurrent evidence from expert witnesses.¹¹

Conclusion

Why, you may ask, do I remain a hot tub enthusiast? In addition to the benefits now recognized by judges and advocates in Australia, the UK, Canada and the U.S., I believe strongly that the UK hot tub is a more effective way to present complex expert testimony. In two of the hot tubs for which I read a transcript, the hot tub took place over two or three days, with vigorous questioning by the tribunal and the opposing experts. While some advocates may feel as though the hot tub robs them of the opportunity for cross examination, my reaction upon reading the transcripts of these longer hot tubs was that it was more effective than cross examination at ferreting out the issues, and displaying the weaker or less credible opinions. This was both because of the interactive nature of the exercise and the fact that the opposing views on each issue were addressed concurrently.

Another benefit of the hot tub exercises I reviewed is that the court was obviously more engaged in the discussion because it was asking the questions. Watching someone else conduct a cross examination can be much less exciting and engaging than undertaking the exercise oneself. It reminded me of the benefits of an active bench when presenting an oral argument. I always view arguments before a “dead bench” as a wasted opportunity.

There are a few drawbacks to this method, but these largely can be addressed with careful planning by the advocate. Not all expert witnesses will be up to the challenge of engaging in two days of vigorous debate with the court and the opposing expert. Moreover, those experts who suffer from arrogance will be at a disadvantage. A willingness to concede weak points or to credit the opposing expert will be essential to obtaining the trust and respect of the court. Thus, as always, one must choose your expert witness wisely. The other potential drawback is that not all judges would have the resources to run an effective hot tub. However, there are many different ways to structure the hot tub—they need not all be a two-day grilling of an expert panel.

In my view, any opportunity for the court to engage directly with an expert should be encouraged, but the advocate must know her expert and judge when recommending a particular type of hot tub exercise.

The increased use of hot tubs both here and abroad should encourage additional judges and litigants to experiment with this

interesting tool. I look forward to hearing of your hot tub experiences at lwood@foleyhoag.com. ■

- ¹ Lisa C. Wood, *Experts in the Tub*, ANTITRUST, Summer 2007, at 96.
- ² Lisa C. Wood, *Experts Only: Out of the Tub and into the Joint Conference*, ANTITRUST, Fall 2007, at 89.
- ³ Paragraph 11 of Practice Direction 35, entitled Experts and Assessors (adopted Dec. 21, 2017). Practice Directions apply to Civil Procedure Rules in effect in civil cases in the Queen’s Bench Division and the Chancery Division of the High Court, and to litigation in the county courts other than family proceedings. They are issued by the Lord Chief Justice.
- ⁴ The *Federal Courts Rules* can be found at <http://laws-lois.justice.gc.ca/eng/regulations/SOR-98-106/FullText.html>. (SOR/2008-141), para. 80(1).
- ⁵ The Competition Tribunal Rules can be found at <http://laws-lois.justice.gc.ca/eng/regulations/SOR-2008-141/FullText.html>.
- ⁶ 49 S.C.L.R. 2d 179 (2010).
- ⁷ Adam E. Butt, *Concurrent Expert Evidence in the United States—Is There a Role for Hot Tubbing?*, The Civil Jury Project at NYU School of Law (2018), <http://civiljuryproject.law.nyu.edu/concurrent-expertevidence-in-the-united-states-is-there-a-role-for-hottubbing/>.
- ⁸ Jack Zouhary, *Splash: Hot Tubbing in a Federal Courtroom*, 29 OHIO LAW. 10 (2015), <https://www.ohioabar.org/NewsAndPublications/OhioLawyer/Pages/Splash-Hot-tubbing-in-a-federalcourtroom.aspx>.
- ⁹ Judge Jack Zouhary is a federal district court judge sitting in Toledo, Ohio. He has served as a visiting district court judge in several states, sits by assignment on the Sixth and Ninth Circuit Courts of Appeals, and is an active Fellow of the American College of Trial Lawyers.
- ¹⁰ Melissa Lipman, *Judge Illston’s Tips for Economic Experts in Antitrust Cases*, LAW360 (Apr. 16, 2015).
- ¹¹ See *Rovakat v. Comm’r*, 255 TCM 29, XIV C (2010); *Crimi v. Comm’r*, 51 TCM (2013); *Green Gas Delaware Statutory Trust v. Comm’r*, 147 T.C. No. 1 (July 14, 2016).

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Battle of the Experts in Merger Litigation: Two Case Studies

BY DEBBIE FEINSTEIN AND WREDE SMITH

FOR MERGER PRACTITIONERS, ONE of the highlights of a merger trial or preliminary injunction hearing is the economists' testimony. It is a chance to hear the experts provide an overview of the entire case and is familiar ground for antitrust practitioners, who are well-versed in the economic terminology—HHIs (Herfindahl-Hirschman index), SSNIPs (small but significant and non-transitory increase in price), diversions and regressions, to name a few.

In contrast, judges in merger trials or preliminary injunction hearings have a short time period to get up to speed on the industry, antitrust law, and antitrust economics. They are immediately faced with conflicting testimony on complicated analyses that, in all likelihood, are unfamiliar to them. How they deal with the “battle of the experts” can often be dispositive to the outcome of a case. In this article, we examine the role expert testimony and analysis played in the courts' opinions in the Sysco and Advocate matters.

Sysco

In February 2015, the FTC, 10 states, and the District of Columbia filed a complaint to enjoin the Sysco/US Foods transaction.¹ The FTC alleged that post-merger, Sysco and US Foods would have a dominant market share for broadline foodservice distribution in the United States and in 32 local markets. The court agreed with the FTC, enjoining the merger. The economic analysis and testimony of the FTC's expert, Dr. Mark Israel, was key to the FTC's arguments in every facet of the case. Defendants' experts attempted to refute virtually every point Dr. Israel made, and the court often credited their arguments. Ultimately, however, the district court largely adopted Dr. Israel's analyses.

The FTC's Allegations. As is typical in merger litigations, the FTC in *Sysco* began with market definition, defining two relevant product markets: (1) broadline foodservice distribution services and (2) broadline foodservice distribu-

tion services sold to national customers. The FTC defined broadline foodservice distribution services as a distinct form of foodservice distribution not reasonably interchangeable with other forms of foodservice distribution.² Specifically, broadline distributors provide a breadth of products and services that other foodservice distributors do not provide, including broad geographic coverage through a network of distribution centers, large product portfolios in a variety of categories, private-label products at lower cost than branded items, frequent and flexible delivery schedules, and other value-added services such as nutritional information.

The FTC alleged that broadline distributors were distinct from other types of foodservice distributors, which include: (1) systems distributors, whose customers tend to be casual chain restaurants (e.g., Burger King, Wendy's, and Applebee's) that have limited or fixed menus and therefore demand fewer product items; (2) specialty distributors, which focus on distributing one or a small number of niche product categories, such as fresh produce or Italian food products, and serve customers such as independent restaurants; and (3) cash-and-carry stores like Restaurant Depot and club stores like Costco and Sam's Club, which do not offer delivery services or sales representatives dedicated to individual customers and therefore do not appeal to larger customers.³ The FTC pointed to *Brown Shoe's* “practical indicia,” or factors, used to define the boundaries of a product market.⁴ One of the *Brown Shoe* factors is “distinct customers,” which courts have applied to include the existence of special classes of customers.⁵

The second alleged relevant product market was broadline foodservice distribution services sold to National Customers. The FTC asserted that national customers, such as national hospitality chains and healthcare group purchasing organizations, are distinguished by the desire for a broadline distributor that can provide consistent products and services at all of their locations as well as centralized ordering and billing and volume discounts.⁶ Further, the FTC argued that both parties cater to national customers through “national account” teams dedicated to serving national customers and nationwide pricing and terms, among other benefits.

The FTC asserted that the relevant geographic market was “intertwined, and overlapping” with the relevant prod-

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uct market of broadline foodservice distribution to National Customers.⁷ The geographic market for National Customers was the United States, and the parties had a combined 75 percent share of sales to National Customers. Furthermore, the FTC argued that Sysco and US Foods were the only two truly national “broadliners,” with 72 and 61 distribution centers, respectively, compared to 24 distribution centers for the next largest broadliner.⁸ Additionally, the FTC asserted a separate relevant geographic market for local broadline customers. The FTC argued that the merging parties had a combined share of greater than 50 percent in 32 local markets.⁹

Evidence at Trial and in Proposed Findings of Fact.

At trial, the FTC relied heavily on Dr. Israel’s expert report and testimony to support its case. His testimony outlined a number of quantitative analyses, including the implementation of an aggregate diversion analysis to conduct the hypothetical monopolist test. An aggregate diversion analysis uses gross margin to determine the percentage of customers that would need to stay in the market in the face of a price increase to make the price increase profitable. The FTC’s expert used a gross margin of 10 percent, which resulted in a calculated aggregate diversion ratio of 50 percent. He compared that figure to the actual aggregate diversion percentage based on data from defendants’ national and regional requests for proposals (RFP), bidding summary information and documents, and US Foods’ Linc database used by local sales representatives to track sales opportunities. Those data showed that when one of the parties lost a bid or sale, the bid or sale went to another broadline distributor over 70 percent of the time.¹⁰ Thus, because the actual aggregate diversion percentage was greater than the calculated aggregate diversion ratio, Dr. Israel concluded that a hypothetical monopolist in broadline distribution would find it profitable to impose a SSNIP, and broadline distribution is a relevant product market.

In addition to using economic tools, the FTC’s expert provided testimony related to the relevant product market based on documents and testimony. For example, he walked through each of defendants’ alleged alternatives to broadline distribution (system distribution, specialty distribution, and cash-and-carry stores) and testified that each was not a reasonable substitute for broadline distribution due to differing characteristics. The testimony supported analyzing the merger differently for different classes of customers. In particular, the evidence showed that National Customers have different needs, such as negotiating and working under one contract to cover all of the customers’ locations, than other types of customers. Also, local broadline customers are different than National Customers, often making purchases without entering into a contract and relying on regular contact with a broadline distributor’s sales representatives to negotiate prices and place orders.

Regarding geographic market, economic testimony bolstered the FTC’s argument that the geographic market for broadline distribution sales to National Customers was the United States and the geographic market for local customers

was the customer’s local area. For National Customers, the assessment relied on qualitative evidence that National Customers negotiate contracts at the national level, broadline distributors have dedicated national sales teams, and regional broadline distributors band together to provide offerings to national accounts through groups like DMA (Distribution Market Advantage), a cooperative of nine independent regional distributors established to compete for customers with multi-regional distribution needs.

The FTC’s expert also used quantitative evidence to determine geographic markets for local customers. In each local market, the evidence showed a “draw distance,” measured as the radius from a distribution center that captured 75 percent of the sales of that distribution center.¹¹ The draw distance was used to identify “overlap areas” in which Sysco and US Foods both had distribution facilities. An analysis of each overlap area and the other broadline distributors that could compete in that overlap area showed that the merger would substantially lessen competition in 32 different local markets.

This testimony also was essential to the FTC’s arguments on competitive effects. Broadline distribution sales data from defendants and from third parties showed that the parties would have a 71 percent post-merger share of sales to National Customers.¹² Moreover, various iterations of market share calculations using sales data confirmed that (1) calculating the shares in different ways still resulted in high market shares and (2) even accounting for the defendants’ proposed divestiture of 11 US Foods distribution centers to Performance Food Group, another broadline distributor, the market shares remained problematic.

Additionally, economic testimony indicated the defendants were the two largest broadline distributors in the United States as measured by (1) broadline distribution revenue; (2) number of distribution centers; (3) size of delivery fleet; and (4) size of salesforce. The FTC’s expert testified that economics teaches that in a bid market like broadline distribution to National Customers, “the terms offered by the winning bidder are determined (or at least heavily influenced) by the capabilities of the second-best option for a given buyer. . . .”¹³ Where, as here, a merger occurs between the top two options for a given buyer, one must look at the price and terms offered by the third-best option for that buyer. In this instance, the third-best option was far less attractive, demonstrating that the merger would cause harm to National Customers.

Similarly, data from US Foods’s ordinary course sales representative reporting tool demonstrated that US Foods most often viewed Sysco as its largest competitor across local areas.¹⁴ Finally, an econometric event study based on Sysco’s entry into the market in Long Island critically showed that the entry resulted in a 1.4 percent decline in US Foods’ price for customers in that overlap area.¹⁵

Defendants’ experts, Dr. Jerry Hausman and Dr. Timothy Bresnahan, critiqued every aspect of the FTC expert’s work. Regarding product market, they argued that the aggregate

diversion analysis the FTC presented was conducted improperly and resulted in an overly narrow market definition. They contended that the formula used for the aggregate diversion analysis was incorrect, as was the use of a 10 percent gross margin. According to defendants' experts, use of the correct formula and gross margin resulted in an aggregate diversion ratio of over 100 percent, which showed that broadline distribution is an overly narrow market regardless of the actual aggregate diversion percentage.¹⁶ Further, the defendants' experts testified that the data used to calculate the FTC's actual aggregate diversion percentage was flawed. They testified that the parties do not retain comprehensive RFP data and that the RFP and bidding data providing the basis for the aggregate diversion percentage was created at the request of the FTC during the merger investigation. Finally, they argued that US Foods' ordinary course sales representative reporting tool tracked opportunities rather than actual wins and losses and that neither data source describes whether the defendants lost business for price reasons or due to another factor.¹⁷

Regarding the geographic market, they argued that the FTC expert's local geographic markets under-reported competitor sales. Regarding the unilateral effects, Dr. Bresnahan conducted a switching study showing that customers of one of the merging parties that switched distributors moved to the other merging party much less frequently than would be expected based on market shares.¹⁸

The Court's Opinion. The court relied heavily on the FTC's expert's testimony in its ruling for the FTC. In its determination that broadline foodservice distribution is a relevant product market, the court noted that "Dr. Israel's testimony served two primary functions. First, he acted as a de facto summary witness, synthesizing the mass of testimonial and documentary evidence gathered by the FTC. . . . Second, Dr. Israel conducted a SSNIP test, using what is known as an aggregate diversion analysis."¹⁹ Explaining that the summary testimony mirrored the court's discussion of testimonial and documentary evidence, the court focused on the FTC's aggregate diversion analysis. The court was persuaded by the arguments from defendants' experts that the data the FTC's expert relied upon was not comprehensive and showed prospective, rather than actual, sales. Therefore, the court did not rely on the precise percentages presented in the FTC's aggregate diversion analysis. The court noted, however, that the FTC expert's conclusions better reflected the business realities of the food distribution market than those of the defendants' expert, based on testimony from market participants that other types of distributors do not constrain the pricing of broadline distributors.²⁰

Continuing with its product market analysis, the court accepted that a product market could be defined by groups of customers, noting that Section 4.1.4 of the Horizontal Merger Guidelines provides that "[i]f a hypothetical monopolist could profitably target a subset of customers for price increases, the Agencies may identify relevant markets defined around those targeted customers, to whom a hypothetical

monopolist would profitably and separately impose at least a SSNIP."²¹ The court explained that markets in which only a subset of customers could be targeted for price increases are termed "price discrimination markets."²² The court again found the FTC expert's hypothetical monopolist test to be supported by the weight of the evidence and found in favor of a product market of broadline distribution sales to National Customers.

The court found that the relevant geographic market for broadline distribution sales to National Customers was the United States, pointing to the same evidence used to define the relevant product market: that broadline distributors enter into nationwide contracts with National Customers and have teams devoted to such customers.

Regarding broadline distribution in local markets, the court called Dr. Israel's use of draw distances to determine areas of competitive overlap a "practical approach and solution to an otherwise thorny problem" in the absence of an industry standard for defining markets at a local level.²³ The court noted that the approach generally takes into account that driving long distances to provide services has negative implications for distributors. It therefore concluded that relevant local geographic markets were areas of overlap resulting from Dr. Israel's 75 percent draw method.

Turning to competitive effects, the court relied on the FTC's market share calculations due to the lack of industry-recognized standards for market shares for broadline sales to National Customers. Noting that the FTC expert ran many variations on his market share calculations, the court found that the FTC did not need to present market share figures "with the precision of a NASA scientist."²⁴ The court was most convinced by the use of data collected from third parties to estimate the split of broadline distributors' sales to National Customers and to local customers. The court adopted the assumption that the 16 largest broadline distributors had the same national/local sales split, which resulted in a market share of 59 percent for the defendants and an HHI increase of 1,500 points. This led the court to conclude that the merger would result in a significant increase in market concentration for broadline sales to National Customers.

For local markets, the court again relied upon the FTC expert's draw method to determine market shares. The court agreed with the defendants that the 75 percent draw method excluded some competitor sales and did not reflect the nuances of each particular local market, but noted that the FTC expert again conducted a variety of market share calculations. Ultimately, the court found the FTC's market share calculations to be informative but not conclusive evidence of competitive harm in local markets. Furthermore, the court found these figures to be corroborated by ordinary course documents and testimony and, as a result, found that the merger would lessen competition in local markets.

After finding competitive harm based on high market shares, the court analyzed the FTC's evidence on unilateral effects, one source of which was an empirical analysis of bid-

ding opportunities to evaluate closeness of competition. The court compared the FTC expert's analysis to the defendants' expert's switching study. The court explained that the FTC expert's analysis better captured actual competition between the parties, used a more representative data set, and was corroborated by qualitative evidence that the defendants were close competitors, particularly for national customers.

Finally, the court cited the FTC expert's merger simulation model, which used an auction model, based on the theory that the winning bidder will offer price and service terms just good enough to beat the second place bidder. Using the auction model and factoring in the defendants' proposed divestiture to Performance Food Group, the model demonstrated that the merger would harm national customers by more than \$900 million annually.²⁵ The court again acknowledged the defendants' concerns about the RFP/bidding data used in the merger simulation model, but found that the merger simulation model supported a finding that the merger would substantially lessen competition in broadline distribution sales to National Customers.

FTC v. Advocate and NorthShore

The FTC (joined by the State of Illinois) challenged the combination of Advocate Health Care and NorthShore University HealthSystem in late December 2015.²⁶ The FTC alleged that Advocate and NorthShore were the two leading providers of general acute care inpatient hospital services in the northern suburbs of Chicago, Illinois. The FTC alleged that the combined firm would have 60 percent of the market, with the third largest competitor, Northwest Community, having only 14 percent.²⁷ Initially, the district court denied the FTC's motion for a preliminary injunction on the basis that "destination hospitals" should be included in the geographic market. The FTC appealed to the Seventh Circuit, which reversed and remanded. On remand, the district court conducted a full analysis of the FTC expert's arguments and granted the FTC's motion for a preliminary injunction.

The FTC's Allegations. It was clear from the outset that the key battleground would be geographic market definition, an issue on which the FTC had floundered in the past.²⁸ More recent challenges in which the government had been successful involved rural areas where there was little dispute about the geographic market.²⁹

The complaint did not define a precise geographic market. Instead, the FTC claimed the market "is no broader than the North Shore Area."³⁰ It pointed to case law holding that the relevant geographic market "need not be identified with 'scientific precision,'" but rather need only identify "in which part of the country competition is threatened."³¹ In its opening brief, the Commission pointed to a number of factors supporting its alleged geographic market:³²

- The North Shore Area was largely co-extensive with NorthShore's primary service area used in its ordinary course strategic analyses;

- Evidence that patients strongly prefer to receive general acute care services locally, including data on where patients go and testimony from the executives of the merging parties; and

- Documents and testimony that the hospitals in the area competed with each other and not with other hospitals.

Finally, the FTC argued that a hypothetical monopolist of North Shore Area hospitals could profitably impose a SSNIP. It pointed to analysis by its expert, Dr. Steven Tenn, who found a high level of intra-market diversion between North Shore Area hospitals. With respect to competitive effects, along with documents and testimony, the FTC again pointed to Dr. Tenn's work. The FTC explained that he had conducted an analysis that showed that a significant number of patients view the merging parties as their first and second choices. Based on that analysis, Dr. Tenn estimated that post-merger prices at the defendants' North Shore Area hospitals would rise by an average of 8 percent.³³

Defendants' Daubert Motion. The defendants took issue with Dr. Tenn's work from their opening briefs. The defendants argued that Dr. Tenn used a novel approach for geographic market definition that had no support in academic literature or case law, arbitrarily excluded major competitors based on an unsupported view that Northwestern Memorial, a hospital south of the North Shore Area, was a "destination" hospital, and also excluded hospitals simply because they competed with only one of the merging hospitals but not both or had less than 2 percent share in the market.³⁴

The defendants' economists critiqued Dr. Tenn's model showing a price increase as failing to measure actual substitution between the merging firms. The defendants' economists claimed they had faithfully applied the FTC's normal method for assessing price increases—which Dr. Tenn failed to use—and found the merger would have no statistically significant effect on price. In addition, one of the defendants' economists, Dr. Thomas McCarthy, contended that Dr. Tenn failed to account for repositioning that would further make his finding of a price increase implausible.³⁵

In a move somewhat unusual for merger litigation, the defendants moved to exclude Dr. Tenn's testimony altogether, by making a *Daubert* motion and reiterating the criticisms of Dr. Tenn's work they had made in their opening brief. The court refused to exclude Dr. Tenn's testimony, finding that Dr. Tenn properly constructed his geographic market using the hypothetical monopolist test. The court noted that he analyzed admissions to all of the hospitals in the Chicago area and calculated diversion ratios for all of those hospitals. The court thus concluded that "his hypothetical monopolist analysis accounts for competition from all area hospitals, not just those that are included in his proposed geographic market."³⁶

On the question of whether Dr. Tenn improperly excluded "destination hospitals," the court found that to be a topic for cross-examination, not a basis to exclude. Finally, the

court rejected the defendants' argument that Dr. Tenn's model had never been used before, holding that neither the Merger Guidelines nor the academic literature suggest there is only one way to conduct a merger simulation.³⁷

Evidence at Trial. Based on the pre-trial proceedings, it appeared that the stage was set for a close look at the economic evidence at trial. Indeed, there was substantial testimony at trial from Dr. Tenn (as well as that of the defendants' experts). Much of that testimony was highlighted in the FTC's post-trial brief. The FTC pointed to Dr. Tenn's testimony on both geographic market definition and competitive effects, noting:

- Dr. Tenn's empirical analysis that patients at NorthShore Area hospitals traveled only short distances for hospital services;
- Dr. Tenn's conclusion that a hypothetical monopolist owning only the six merging hospitals could impose a SSNIP and that the North Shore Area market (which included five non-party hospitals) was therefore conservative;
- Dr. Tenn's analysis showing that there is a significant level of substitution between Advocate and NorthShore hospitals based on the hospital choice model (also Defendants' expert's preferred method to calculate diversions); and
- Dr. Tenn's willingness to pay analysis quantifying that the merger would result in increased prices.³⁸

The defendants' brief highlighted a few of their many criticisms:

- Dr. Tenn's model made no sense—showing that 52 percent of patients who choose hospitals in the Tenn North Shore Area would divert to a competing hospital outside the area in the absence of their first choice;
- Dr. Tenn arbitrarily excluded certain hospitals, as noted above;
- Dr. Tenn's price increase model had never been used before, always predicted a price increase, and failed to account for insurers' bargaining leverage; and
- The defendants' expert's accepted model showed the merger is not likely to lead to a material price increase.³⁹

The District Court's Opinion. The district court's opinion denying the FTC's preliminary injunction motion focused almost entirely on Dr. Tenn's geographic market analysis. The court rejected the method by which Dr. Tenn had constructed the geographic market. As foreshadowed by the court's *Daubert* opinion, the question of whether destination hospitals could be excluded from the geographic market turned out to be critical. The court's main holding was that there was no economic basis for excluding "destination hospitals."⁴⁰ The court found that Dr. Tenn's rationale for exclusion—that they are not substitutes for Advocate and NorthShore—assumed the answer to the very question the geographic market exercise is designed to elicit. The court found that Dr. Tenn's assumption that patients like to receive care close to home was not supported by the evidence, point-

ing to various testimony that suggested that patients traveled longer distances for outpatient care.

The court similarly criticized Dr. Tenn's requirement that only hospitals competing with both hospitals should be included in the geographic market, noting Dr. McCarthy's testimony that "you can constrain the postmerger system by constraining any [one] of its hospitals."⁴¹ This was one of the rare times the court pointed to specific evidence from the defendants' expert in the opinion.

The court also found that Dr. Tenn's exclusion of destination hospitals "ignores 'the commercial realities of th[is] industry,'" specifically that: (1) payers negotiate a single contract for both inpatient and outpatient services; (2) outpatient services are on the rise and inpatient services are on the decline; and (3) outpatient services are a key driver of hospital admissions.⁴²

The Seventh Circuit Opinion. The Commission appealed to the Seventh Circuit which reversed and remanded. Once again, the focus was on Dr. Tenn's analysis. The Seventh Circuit found that the district court mistook Dr. Tenn's iterative approach to defining the market for circularity and that the court offered no explanation for why a narrow candidate market would ultimately produce narrow results.⁴³ With respect to Dr. Tenn's exclusion of destination hospitals, the Seventh Circuit noted that demand for those hospitals differs from demand for general acute care hospitals like the parties' hospitals. Next, the Seventh Circuit assessed Dr. Tenn's determination that patients choose hospitals close to home. The Seventh Circuit found that the evidence on which the district court relied related to outpatient care, not inpatient acute care.⁴⁴ Finally, it turned to Dr. Tenn's diversion ratios. It noted that as to that evidence, the district court had incorrectly focused on patients and not what insurers would do. It concluded by asking "how many hospitals can insurers convince most customers to drive past to save a few percent on their health insurance premiums. We should not be surprised if that number is very small. Plaintiffs have made a strong case that it is."⁴⁵

The District Court's Opinion on Remand. In a remand opinion almost three times the length of the original district court opinion, the court found for the FTC. After reciting some of the procedural history with respect to geographic market, the court began by finding that "even taking their testimony with a grain of salt, the record as a whole supports the view that insurers genuinely believe that a plan that excludes Advocate and NorthShore is not viable in the North Shore Area."⁴⁶ The court noted that even if "some—or even many—patients are willing to travel outside the market," the defendants must show that enough would do so that insurers are unlikely to agree to pay supracompetitive prices to be able to offer a plan to patients unwilling to travel.⁴⁷

The court next turned to Dr. Tenn's reliance on diversion ratios. The parties argued that if the district court erred by relying on diversion ratios because they focused on patients, not insurers, then Dr. Tenn's analysis based on diversion