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# The Unintended Consequences of Narrower Product Markets and the Overly Leveraged Nature of *Philadelphia National Bank*

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## I. INTRODUCTION

Good morning! Many thanks to Bill and Ariel for inviting me to participate and to both Oxford University and the *Journal of Antitrust Enforcement* for having me here today. It is truly an honor to be here with all of you. Before I begin, I must give the standard disclaimer: The views I express today are my own, and do not necessarily reflect the views of the U.S. Federal Trade Commission or any other Commissioner.

As many of you may know, I have worn many hats in the course of my career thus far. I have been a practitioner, an in-house counsel, and an enforcer. Yet in any merger matter, or frankly pretty much any antitrust matter, my first question is typically the same: "What is the relevant market?" And with good reason! In the 1992 *Eastman Kodak* case, the Supreme Court explained that "[b]ecause market power is often inferred from market share, market definition generally determines the result of the case,"[1] as indeed it did there. Former FTC Chairman Robert Pitofsky likewise called it "the most important single issue in most enforcement actions."[2] And former FTC chief economist Jonathan Baker has said the issue has determined "the outcome of more cases … than any other substantive issue."[3]

Practitioners in the U.S. can trace the primacy of market definition back to at least 1950, when Congress last revised the operative portions of the Clayton Act,[4] our basic law for merger control in the U.S. As amended, the statute prohibits acquisitions "the effect of [which] may be substantially to lessen competition" or "restrain commerce in any section or community, or tend to create a monopoly in any line of commerce."[5] In the 1957 *DuPont* case, the Court determined

[1] Eastman Kodak Co. v. Image Tech. Servs., Inc., 504 U.S. 451, 469 n.15 (1992).
[2] Robert Pitofsky, *New Definitions of Relevant Market and the Assault on Antitrust*, 90 COLUM. L. REV. 1805, 1807 (1990).
[3] Jonathan B. Baker, *Market Definition: An Analytical Overview*, 74 ANTITRUST L.J. 129, 129 (2007).
[4] Celler-Kefauver Act, Pub. L. 81-899, 64 Stat. 1125 (1950).
[5] 15 U.S.C. § 18.

that "any line of commerce" meant a relevant product market, and that a plaintiff in a Clayton Act case needed to define such a market.[6]

In a series of roughly contemporaneous cases, the Court fleshed out some of the basic legal rules that rely upon a properly defined antitrust market. For today's purposes, I would like to focus upon two. First, in the late 1950s and early 1960s the Court explained how to define a relevant antitrust market, including familiar concepts such as demand substitution and cross-price elasticities.[7] Second, in a 1963 case called *Philadelphia National Bank*, the Court ruled that the statutory requirement to consider the effects "in any line of commerce" meant that a court must assess the economic effects in each relevant market separately.[8] This meant, among other things, that a court must consider each relevant antitrust market in isolation. If the net effect is negative in any one of them, then the court must enjoin the transaction. Or, to put it another way, economic efficiencies that occur outside the relevant market, no matter how large, can never offset harm within that market.[9]

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[6] *See* United States v. E.I. du Pont de Nemours & Co., 353 U.S. 586, 594 (1957) ("Determination of the relevant market is a necessary predicate to a finding of a violation of the Clayton Act because the threatened monopoly must be one which will substantially lessen competition 'within the area of effective competition.' Substantiality can be determined only in terms of the market affected.").

[7] *See* United States v. E.I. DuPont de Nemours & Co., 351 U.S. 377, 380-81 (1956) (Sherman Act case) ("Every manufacturer is the sole producer of the particular commodity it makes but its control in the above sense of the relevant market depends upon the availability of alternative commodities for buyers: i.e., whether there is a cross-elasticity of demand between cellophane and the other wrappings."); Brown Shoe Co. v. United States, 370 U.S. 294, 325 (1962) (Clayton Act case) ("The outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it.").

[8] United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 370 (1963) ("If anticompetitive effects in one market could be justified by procompetitive consequences in another, the logical upshot would be that every firm in an industry could, without violating § 7, embark on a series of mergers that would make it in the end as large as the industry leader.").

[9] U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES § 10, at 30 n.14 (Aug. 19, 2010), https://www.ftc.gov/sites/default/files/attachments/merger-review/100819hmg.pdf ("The Agencies normally assess competition in each relevant market affected by a merger independently and normally will challenge the merger if it is likely to be anticompetitive in any relevant market."). However, the agencies also claim very limited prosecutorial discretion to consider otherwise out-of-market efficiencies that are "so inextricably linked with [the market] that a partial divestiture or other remedy could not feasibly eliminate the anticompetitive effect in the relevant market without sacrificing the efficiencies in the other market(s)." *Id.*

Much has changed since the Court set down these basic legal rules, particularly in the field of economics. When the Court considered *Brown Shoe*, courts used qualitative measures to assess demand substitution. Over time that analysis has become increasingly quantitative, particularly with the rise of the hypothetical monopolist test in the 1980s. We have also honed the tools we use to measure competitive harm, introducing new concepts like diversion ratios, critical loss analysis, and UPP (Upward Pricing Pressure). Indeed, these tools have become so powerful that some scholars, such as Louis Kaplow, argue we no longer need to define markets.[10]

The relative breadth of a relevant product market has also changed. As I will explain in greater detail in a moment, agencies today typically allege – and courts routinely find – markets that are substantially narrower than their historical counterparts. Yet the governing legal rules, and particularly the prohibition on out-of-market efficiencies, have remained unchanged.

As a result, courts today apply a much more restrictive version of the rule against out-of-market efficiencies than the one the Supreme Court actually set in *Philadelphia National Bank*. Efficiencies that previously fell within relatively broad markets now fall outside relatively narrow ones. Nor is this dynamic theoretical – we have an event study to illustrate the issue. Although a proposed acquisition by the Philadelphia National Bank was blocked in the 1960s, its corporate successor was acquired by another bank in the 1990s. In that case two agencies took different approaches – one adhering to the market definition the Supreme Court used in the 1963 case, the other using a substantially narrower version – and reached radically different conclusions. The narrower market ultimately necessitated the divestiture of many assets that would not have been required pursuant to the broad product market definition.

[10] Louis Kaplow, *Why (Ever) Define Markets?*, 124 HARV. L. REV. 437 (2010).

I will also briefly touch on other potential implications of narrower relevant markets, including the risk that acquisitions of nascent competitors no longer appear to be horizontal overlaps. As Pitofsky noted before me,[11] broader markets are not necessarily synonymous with more permissive antitrust enforcement.

## II. EVOLUTION OF U.S. APPROACH TO DEFINING THE RELEVANT PRODUCT MARKET

So let us quickly trace the evolution of the U.S. approach to defining relevant product markets. As I mentioned a moment ago, in 1950 the operative statute was revised to prohibit any acquisition "the effect of [which] may be substantially to lessen competition, or tend to create a monopoly" "in any line of commerce … in any section of the country."[12]

This raises an obvious question: What is a "line of commerce?" The term is not defined in the statute, nor is it something you hear on the street. So in the 1950s and 1960s the Supreme Court set out to define the term. In a Sherman Act case in 1953 called *Times-Picayune*, the Court recognized that defining these types of markets is an inexact science. "The market, as most concepts in law or economics, cannot be measured by metes and bounds."[13] In the famous *Cellophane* case it similarly said that "[i]ndustrial activities cannot be confined to trim categories."[14]

Recognizing the inexact nature of the analysis, the Court attempted to define a range of discretion within which a fact-finder should operate. In *Times-Picayune* it explained that "a relevant market cannot meaningfully encompass [an] infinite range [of products]. The circle must be drawn narrowly to exclude any other product to which, within reasonable variations in

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[11] Pitofsky, *supra* note 2, at 1809 n.14 ("Market definition leading to broad markets is not necessarily antithetical to vigorous merger enforcement.").
[12] 15 U.S.C. § 18.
[13] Times-Picayune Publishing Co. v. United States, 345 U.S. 594, 611 (1953).
[14] United States v. E.I. DuPont de Nemours & Co., 351 U.S. 377, 395 (1956).

price, only a limited number of buyers will turn."[15] Today we sometimes call this the "narrowest market" principle, and it is routinely used by both courts and agencies.[16] Yet in *Cellophane* the Court also cautioned against drawing the circle too narrowly, explaining that it is also improper "to require that products be fungible to be considered in the relevant market."[17] Both of these concepts were imported wholesale into the Clayton Act precedents as they developed.

This tension – that markets should be "narrow" but "not too narrow" – has haunted market definition exercises ever since. Indeed, both commandments appear, almost side-by-side, in the current Horizontal Merger Guidelines.[18]

Although the basic legal rule for defining relevant product markets has not changed in almost 70 years, the product market in the average Clayton Act case has gradually narrowed over time. Today, agencies typically allege – and courts routinely find – markets that are substantially narrower than their historical counterparts.

Between approximately 1950 and 1980, the Supreme Court typically defined relevant product markets broadly. In the 1962 case *Brown Shoe Co. v. United States*, for example, the Supreme Court defined separate relevant product markets for (i) all men's shoes, (ii) all women's shoes, and (iii) all children's shoes.[19] In doing so, the Court explicitly rejected the defendant's attempt to narrow the markets by alleging separate markets for different price tiers, concluding that "the boundaries of the relevant market must be drawn with sufficient breadth to include the

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[15] *Times-Picayune*, 345 U.S. at 612 n.31.
[16] *See, e.g.*, FTC v. Sysco Corp., 113 F. Supp. 3d 1, 26 (2015) (quoting and applying the *Times-Picayune* rule).
[17] *DuPont*, 351 U.S. at 394.
[18] HORIZONTAL MERGER GUIDELINES, *supra* note 9, § 4.1.1, at 10 ("Because the relative competitive significance of more distant substitutes is apt to be overstated by their share of sales, when the Agencies rely on market shares and concentration, they usually do so in the smallest relevant market satisfying the hypothetical monopolist test."); *id.* § 4, at 8 ("However, a group of products is too narrow to constitute a relevant market if competition from products outside that group is so ample that even the complete elimination of competition within the group would not significantly harm either direct customers or downstream consumers. The hypothetical monopolist test (see Section 4.1.1) is designed to ensure that candidate markets are not overly narrow in this respect.").
[19] 370 U.S. 294, 326 (1962) ("Applying these considerations to the present case, we conclude that the record supports the District Court's finding that the relevant lines of commerce are men's, women's, and children's shoes.").

competing products of each of the merging companies and to recognize competition where, in fact, competition exists" and that "further division of product lines based on 'price/quality' differences would be 'unrealistic.'"[20] The Court also rejected attempts to distinguish among different kinds of children's shoes as "impractical and unwarranted."[21]

The Supreme Court endorsed a similarly broad product market the following year in *United States v. Philadelphia National Bank.*[22] There, the Court held that the relevant product market was "the cluster of products (various kinds of credit) and services (such as checking accounts and trust administration) denoted by the term 'commercial banking.'"[23] Although the Court acknowledged that the competitive dynamics varied among the products and services included in this broad market, it nonetheless concluded that "it is clear that commercial banking is a market sufficiently inclusive to be meaningful in terms of trade realities."[24] The Supreme Court applied the same "commercial banking" product market in the following twelve years to six other bank mergers,[25] sometimes in the face of attempts to define broader markets[26] (*e.g.,*

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[20] *Id.*
[21] *Id.* at 327-28.
[22] 374 U.S. 321 (1963).
[23] *Id.* at 356.
[24] *Id.* at 357 (internal quotations and citations omitted).
[25] United States v. First Nat'l Bank & Trust Co. of Lexington, 376 U.S. 665, 667 (1964); United States v. Third Nat'l Bank in Nashville, 390 U.S. 171, 181-82 n.15 (1968) (affirming "commercial banking" product market); United States v. Phillipsburg Nat'l Bank & Trust Co., 399 U.S. 350, 360-61 (1970) (holding the district court erred when it defined narrower product markets with a broader range of participants because "the cluster of products and services termed commercial banking has economic significance well beyond the various products and services involved"); United States v. Marine Bancorporation, Inc., 418 U.S. 602, 618-619 (1974) (noting that the district court's definition of a "commercial banking" product market was not appealed but "in any event it is in full accord with our precedents"); United States v. Connecticut Nat'l Bank, 418 U.S. 656, 666 (1974) (reversing a district court finding that the relevant market included both savings banks and commercial banks, although acknowledging that the market may eventually broaden to include both types of banks, and remanding the case with instructions that "the District Court should treat commercial banking as the relevant product market"); United States v. Citizens & So. Nat'l Bank, 422 U.S. 86, 120-21 (1975) (affirming "commercial banking" product market).

The Court did not reach the question in a seventh case. *See* United States v. First City Nat'l Bank of Houston, 386 U.S. 361, 369 n.1 (1967).
[26] *Connecticut Nat'l Bank*, 418 U.S. at 666.

those that encompassed both large commercial banks and smaller consumer-oriented "savings" banks) and sometimes in the face of narrower proposed markets.[27]

Whereas the Supreme Court tended to define broad markets, in lower courts the story was more mixed. Indeed, Pitofsky cites "many instances" in which he believed that lower courts defined "excessively, and sometimes ludicrously, narrow market definitions."[28] In the late 1950s and early 1960s, for example, government enforcers successfully alleged relevant product markets for "florist foil" (a particular light-weight grade of aluminum foil), "high-priced iron golf clubs," "low-priced baseballs," and "industrial-grade rental garments."[29]

Product markets became somewhat more standardized when, in the early 1980s, the Antitrust Division of the U.S. Department of Justice (DOJ) introduced the hypothetical monopolist test. During the 1980s and 1990s, courts often, though of course not always, defined markets around a single industrial or consumer good.[30] For example, Judge Bork wrote a decision in 1986 affirming the definition of a relevant product market for "aircraft transparencies requiring, for want of a better term, 'high technology' to produce, without regard to the materials of which they are fabricated."[31] The same year the Sixth Circuit affirmed a district court decision involving the "dishwasher" market.[32]

Although a systematic comparison is difficult, there is strong anecdotal evidence that both enforcers and courts define markets much more narrowly today than they did when the basic Clayton Act jurisprudence was developed. Let me give you two examples.

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[27] *Phillipsburg Nat'l Bank & Trust Co.*, 399 U.S. at 360-61.
[28] Pitofsky, *supra* note 2, at 1808.
[29] *Id.* at 1808 n.9 (citing Reynolds Metals Co. v. FTC, 309 F.2d 223, 227 (D.C. Cir. 1962) (foil); A.G. Spaulding & Bros. v. FTC, 301 F.2d 585, 588, 597 (3d Cir. 1962) (golf clubs and baseballs); United States v. Blue Bell, Inc., 395 F. Supp. 538, 543 (M.D. Tenn. 1975) (garments)).
[30] *See* Gregory J. Werden, *The History of Antitrust Market Delineation*, 76 MARQ. L. REV. 123 (1992) (tracing the ebb and flow of market definition over time).
[31] FTC v. PPG Indus., 798 F.2d 1500, 1504-06 (D.C. Cir. 1986) (Bork, J.).
[32] White Consol. Indus. v. Whirlpool, 781 F.2d 1224, 1227-29 (6th Cir. 1986).

The first example comes from the retail grocery industry. In the 1966 *Von's Grocery* case, the Supreme Court found the relevant product market for a merger of two Los Angeles-area grocery stores was the market for "retail grocery sales."[33] In the 1990 case *California v. American Stores Co.*,[34] the Supreme Court implicitly accepted a slightly narrower market for "supermarkets," grocery stores of at least 10,000 square feet.[35] By 2008, in the *Whole Foods* case,[36] the Commission alleged, and the D.C. Circuit found over a sharp dissent by then-Judge Kavanaugh,[37] an even narrower market for the "operation of premium natural and organic supermarkets."[38]

The second example comes from coal mining. In the early 1970s case *General Dynamics*, the district court concluded that the relevant market for assessing the competitive effects of a merger of two coal miners was "interfuel" competition among different energy sources – including coal, natural gas, and uranium – used to generate electricity.[39] The Supreme Court affirmed without commenting on the relevant product market,[40] but the dissenters argued that the relevant market was too broad; they felt the relevant product market should have been "all coal."[41] Yet in another merger of coal miners in the early 2000s, *Arch Coal*, the FTC alleged a market for "8800 BTU coal from the Southern Powder River Basin"[42] in Wyoming and the district court found a market for all Southern Powder River Basin coal.[43]

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[33] United States v. Von's Grocery Co., 384 U.S. 270, 272 (1966).
[34] 495 U.S. 271 (1990).
[35] *See id., affirming* 697 F. Supp. 1125, 1129 (C.D. Cal. 1988) (defining the relevant product market as such).
[36] FTC. v. Whole Foods Market, Inc., 548 F.3d 1028 (D.C. Cir. 2008).
[37] *See id.* at 1051-52 (Kavanaugh, J., dissenting).
[38] *Id.* at 1037-1041 (Brown, J.).
[39] United States v. General Dynamics Corp., 341 F. Supp. 534, 545-46 (N.D. Ill. 1972).
[40] United States v. General Dynamics Corp., 415 U.S. 486, 510-11 (1974).
[41] *Id.* at 517-22 (Douglas, J., dissenting).
[42] FTC v. Arch Coal, Inc., 328 F. Supp. 2d 109, 121 (D.D.C. 2004) (recounting plaintiff's argument before the court).
[43] *Id.* at 119-123.

At least two dynamics seem to be driving this trend. First, enforcers have increasingly alleged, and courts have increasingly endorsed, finer market distinctions based on price tiers or product characteristics. For example, in the early 2000s the FTC alleged that "the sale of superpremium ice cream to the retail channel" was a relevant product market in the *Nestle-Dreyers* consent agreement.[44] Second, enforcers have increasingly alleged, and courts have increasingly endorsed, narrower price-discrimination markets.

Whatever the cause, I do not necessarily mean to suggest that the narrower markets are too narrow. Indeed, it is entirely possible that these products have become more differentiated over time, reducing the extent of customer substitution. Rather, I am observing only that, *in practice and on average*, relevant product markets have shrunk significantly since the Supreme Court set out the basic Clayton Act rules.

## III. IMPLICATIONS

An economist might tell you that it is immaterial today whether a market is broad or narrow. Given advances in economic techniques, we often measure competitive effects directly by looking at diversion ratios, critical loss metrics, and estimates of Upward Pricing Pressure (UPP).

It is interesting to note that while our economic tools have improved, they have done so largely on only one "side" of the equation, the measurement of anticompetitive effects. In contrast, our tools for assessing efficiencies remain largely the same. This asymmetry means the shift towards narrower product markets in theory can – and in practice has – affected our competitive assessments and legal conclusions. In the interests of time I will focus upon one, the treatment of efficiencies, and briefly sketch two others.

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[44] *See* Complaint ¶ 11, *Nestle Holdings, Inc.*, Dkt. No. C-4082, *available at* https://www.ftc.gov/sites/default/files/documents/cases/2003/06/dreyercomplaint.htm

### A. Efficiencies

The move toward narrower relevant product markets has reduced the legal importance of procompetitive efficiencies in two ways.

#### 1. Out-of-Market Efficiencies

First, as former FTC Commissioner Josh Wright recognized a few years ago,[45] narrow markets push more and more otherwise cognizable efficiencies outside the relevant market. As I explained earlier, in the 1963 case *Philadelphia National Bank*, the Supreme Court held that "anticompetitive effects in one market [cannot] be justified by procompetitive consequences in another,"[46] which today we call the rule against out-of-market efficiencies. Yet in 1963 the relevant product market for banking mergers was "the cluster of products (various kinds of credit) and services (such as checking accounts and trust administration) denoted by the term 'commercial banking.'"[47] The rule against out-of-market efficiencies should be understood within the facts of the case. To restate the *PNB* rule, one might say "anticompetitive effects outside the cluster of products and services denoted by the term 'commercial banking' cannot be justified by procompetitive consequences in a different market, such as grocery retailing or electricity generation."

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[45] *See* Joshua Wright, Do the New HMGs Move From Cheap Talk to Commitment on Out-of-Market Efficiencies?, TRUTHONTHEMARKET.COM, Aug. 20, 2010, https://truthonthemarket.com/2010/08/20/do-the-new-hmgs-move-from-cheap-talk-to-commitment-on-out-of-market-efficiencies/; Joshua Wright, Judge Sullivan and the UPP: Much Ado About Nothing or Articulating the Real Problem with the New HMGs?, TRUTHONTHEMARKET.COM, May 14, 2010, https://truthonthemarket.com/2010/05/14/judge-sullivan-and-the-upp-much-ado-about-nothing-or-articulating-the-real-problem-with-the-new-hmgs/ (criticizing the 2010 Guidelines as "tend[ing] to lead to narrower markets," which "will inevitably lead to circumstances in which the consumers in the narrowly defined markets are harmed, but others are benefitted" because "*Philadelphia National Bank* precludes counting efficiencies outside the relevant market").

[46] United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 370 (1963)

[47] *Id.* at 356 ("We have no difficulty in determining the 'line of commerce' (relevant product or services market) and 'section of the country' (relevant geographical market) in which to appraise the probable competitive effects of appellees' proposed merger. We agree with the District Court that the cluster of products (various kinds of credit) and services (such as checking accounts and trust administration) denoted by the term 'commercial banking,' composes a distinct line of commerce.").

Yet that is not how enforcers apply the rule today. In 1998, Philadelphia National Bank's successor was acquired by another large bank called FirstUnion. Under U.S. law, banking mergers are reviewed concurrently by both the sector-specific regulator, the Federal Reserve Board (FRB), and the DOJ. Both must give their approval.

In that case the two agencies defined radically different markets. The FRB cited and adhered to the product market fixed by the Supreme Court in *Philadelphia National Bank*.[48] Reflecting industry developments, it defined an even broader geographic market encompassing nine counties near Philadelphia, as compared with the four-county area the Supreme Court had used in 1963. The DOJ, in contrast, broke the "cluster" and defined separate markets for each product – savings accounts, checking accounts, and the like.[49] It also narrowed the relevant geographic market, rejecting the FRB's nine-county market and the Supreme Court's four-county market in favor of a narrower two-county area.

Perhaps unsurprisingly, the different market definitions imposed by the FRB and DOJ produced different competitive effects analyses and different legal conclusions. The DOJ found significant harm and required the parties to divest 32 branches and $1.1 billion in assets.[50] And, more to my point, it did not publicly mention efficiencies at all.[51] In contrast, the FRB found

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[48] *See* Fed. Res. Sys., *In re* First Union Corp., Order Approving the Merger of Bank Holding Companies at 8 (Apr. 13, 1998) [hereinafter FRB Order] ("The Board and the courts traditionally have recognized that the appropriate product market for evaluating bank mergers and acquisitions is the cluster of products (various kinds of credit) and services (such as checking accounts and trust administration) offered by banking institutions." (citing, *inter alia*, *Philadelphia National Bank*)); *see also* Robert Kramer, Chief, Lit. II Section, Address before the Am. Bar Ass'n: "Mega-Mergers" in the Banking Industry, at 3, Apr. 14, 1999 (describing the FRB's approach to product and geographic market definition in CoreStates/First Union as "the broad market" approach).

[49] *See* Robert Kramer, Chief, Lit. II Section, Address before the Am. Bar Ass'n: "Mega-Mergers" in the Banking Industry, at 3-4, Apr. 14, 1999 (explaining that, in CoreStates-First Union, the DOJ rejects the cluster product market approach used in *Philadelphia National Bank* because "[w]e view banks as multi-product firms with different products that consumers do not find to be good substitutes for one another" and that these narrower product markets have "ramifications for geographic market definition," which is also narrower than in *PNB*).

[50] *See* Press Release, U.S. Dep't of Justice, Justice Department Approves First Union/Corestates Merger After Parties Agree to $1.1 Billion Divestiture in Pennsylvania, Apr. 10, 1998 (describing the relevant market defined by the DOJ).

[51] *See id.*

that the transaction would produce "public benefits" in the form of "increased consumer convenience and gains in efficiency" that likely "outweigh" the "*de minimis*" competitive harms.[52] It therefore cleared the transaction without imposing any additional conditions.

I am not the only one who thought the choice of market definition affected the legal conclusion. In a speech at the ABA Spring Meeting the year after the merger closed, Robert Kramer, who oversaw the DOJ review, explained that "the FRB and [DOJ] in their analysis use[d] different product markets and this [difference] played a significant role in this matter."[53] He also characterized the FRB's analysis as the "broad market" approach.[54] A student Note published in the *Duke Law Journal* came to the same conclusion.[55]

So where does that leave us? To summarize, *Philadelphia National Bank* interprets the "any line of commerce" provision in § 7 to bar consideration of any efficiencies that fall outside the relevant market. As a theoretical matter, narrower markets mean more and more of the previously relevant efficiencies fall outside the relevant market (as do some harms, though the relationship will rarely if ever be symmetric). And as a practical matter that is exactly what happened when the DOJ imposed significant conditions upon the acquisition of Philadelphia National Bank's successor by FirstUnion. The end result is that courts and agencies now apply the *Philadelphia National Bank* rule to bar efficiencies that the Supreme Court would have credited when the case was decided in 1963. In the FirstUnion case, this change caused DOJ to require more than a billion dollars in divestitures that a sister agency deemed unnecessary under the 1963 definition of the relevant product market.

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[52] FRB Order, *supra* note 48, at 50.
[53] Kramer, *supra* note 49, at 3.
[54] *Id.*
[55] *See* Note, Tim McCarthy, *Refining Product Market Definition in the Antitrust Analysis of Bank Mergers*, 46 DUKE L.J. 865, 868 (1997) (noting the divergence and observing that "[b]ecause the Division's method is intended to determine whether any of these several submarkets may be susceptible to anticompetitive effects, its scrutiny is now widely regarded as more stringent than that of the Fed").

### 2. Magnitude of Offsetting Efficiencies

Since a 2001 D.C. Circuit case called *Heinz*, narrower markets have also changed the magnitude of offsetting efficiencies a defendant must prove. That case changed the playing field in two ways relevant here.

First, the court adopted a sliding scale for assessing efficiency claims that becomes more exacting as markets narrow and market shares increase. In general, defendants must show only that the likely cognizable efficiencies exceed the likely anticompetitive effects, and therefore are unlikely "to substantially lessen competition … in any line of commerce."[56] But when the market is highly concentrated, defendants must prove not just efficiencies, but "extraordinary efficiencies,"[57] which I interpret to mean the magnitude of those efficiencies that remain in the relevant market must substantially exceed the magnitude of harms. Although this rule started in the D.C. Circuit,[58] it is now also binding circuit precedent in the Third and Ninth Circuits,[59] and has been followed by trial courts in the Sixth and Seventh Circuits.[60]

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[56] 15 U.S.C. § 18; *see* U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES § 4 (Apr. 2, 1992, rev. Apr. 8, 1997), *available at* https://www.ftc.gov/sites/default/files/attachments/merger-review/hmg.pdf.

[57] FTC v. H.J. Heinz Co., 246 F.3d 708, 720 (D.C. Cir. 2001).

[58] *See id.*; United States v. Anthem, Inc., 855 F.3d 345, 349 (D.C. Cir. 2017) ("[W]e hold that the district court did not abuse its discretion in enjoining the merger based on Anthem's failure to show the kind of extraordinary efficiencies necessary to offset the conceded anticompetitive effect of the merger in the fourteen Anthem states: the loss of Cigna, an innovative competitor in a highly concentrated market.");

[59] *See* FTC v. Penn State Hershey Med. Ctr., 838 F.3d 327, 347 (3d Cir. 2016) ("In order to rebut the prima facie case, the Hospitals must show either that the combination would not have anticompetitive effects or that the anticompetitive effects of the merger will be offset by extraordinary efficiencies resulting from the merger." (citing *Heinz*, 246 F.3d at 718-25)); Saint Alphonsus Med. Ctr.-Nampa Inc. v. St. Luke's Health Sys., Ltd., 778 F.3d 775, 790 (9th Cir. 2015) ("Because § 7 seeks to avert monopolies, proof of "extraordinary efficiencies" is required to offset the anticompetitive concerns in highly concentrated markets." (citing, *inter alia*, *Heinz*, 246 F.3d at 720-22)).

[60] *See* FTC v. Advocate Health Care, No. 15-cv-11473, 2017 WL 1022015, at *12 (N.D. Ill. Mar. 16, 2017) ("Where the merger would result in high market concentration levels, as in this case, the defendants must provide proof of 'extraordinary efficiencies' based on a 'rigorous analysis' that ensures that the proffered efficiencies represent more than 'mere speculation and promises about post-merger behavior.'" (quoting *Heinz*, 246 F.3d at 720-21)); FTC v. OSF Healthcare Sys., 852 F. Supp. 2d 1069, 1089 (N.D. Ill. 2012) ("Moreover, '[h]igh market concentration levels require proof of extraordinary efficiencies ... and courts generally have found inadequate proof of efficiencies to sustain a rebuttal of the government's case.'" (quoting United States v. H&R Block, Inc., 833 F. Supp. 2d 36, 89 (D.D.C. 2011)); FTC v. ProMedica Health Sys., Inc., No. 3:11-cv-00047, 2011 WL 1219281, at *57 (N.D. Ohio Mar. 29, 2011) ("Efficiencies must be 'extraordinary' to overcome high concentration levels." (quoting *Heinz*, 246 F.3d at 721-22)).

Second, merging parties in highly concentrated markets face a heightened evidentiary burden when seeking to prove efficiencies. As the court explained in *Heinz*, "given the high concentration levels, the court must undertake a rigorous analysis of the kinds of efficiencies being urged by the parties in order to ensure that those 'efficiencies' represent more than mere speculation and promises about post-merger behavior."[61] Although one hopes that the court conducts a rigorous analysis in every case, it appears to believe even greater rigor is necessary when markets are narrow and market shares high.

Now let us combine these two effects. Because markets have narrowed, a defendant that previously could have carried its burden by showing efficiencies must now prove "extraordinary efficiencies" under a particularly "rigorous analysis." In other words, the defendant must prove efficiencies of a much greater magnitude than before. The test, if actually applied this way, likely forecloses an efficiencies defense in many narrow market cases.

## B. Other Effects

Although I have focused upon efficiencies thus far, the extent to which relevant product markets have narrowed also has implications for other aspects of merger analysis. Let me briefly mention two that cut in opposite directions.

First, narrower markets can make it more likely that two firms that compete in the same broad market – such as "retail supermarkets" or "coal" – are not viewed as horizontal competitors. For example, one firm may fall out of the market entirely. This may be particularly likely in dynamic markets with nascent competitors. In these markets, competitors often seek to "leapfrog" each other by introducing products with new and different features. In the short run, an entrant's product may be differentiated from existing products sold by others. Yet incumbents may – and in such markets often do – quickly "catch up" by introducing similar

[61] *H.J. Heinz*, 246 F.3d at 721.

features to their own products. In these instances, narrower markets may miss the forest for the trees, resulting in relatively *less* aggressive antitrust enforcement.

Second, whereas in some cases narrowing the product market will exclude one of the merging firms, in other cases it will just exclude some of their competitors, thereby pushing up the merging parties' combined market share. Because market shares are an input in many economic models we use to measure anticompetitive effects, our economic models may be more likely to find harm in narrow markets.

Narrow markets that exclude some competitors may also be more likely to trigger legal presumptions. In recent years courts siding with the government plaintiff have repeated an emerging modern maxim: "There can be little doubt that the acquisition of the second largest firm in the market by the largest firm in the market will tend to harm competition in that market."[62] If narrowing markets means that there are fewer other firms in the market, it becomes more likely, all else equal, that a given merger will combine the first- and second-largest firms in the relevant market.

## CONCLUSION

In conclusion, the basic legal rules we use in merger cases were developed during the "broad market" era of the 1950s, 60s, and 70s. With the development of new analytic techniques, particularly the hypothetical monopolist test, markets began to narrow. They are now quite narrow indeed, often combining three or four adjectives.

[62] FTC v. Whole Foods, Inc., 548 F.3d 1028, 1043 (D.C. Cir. 2008) (Tatel, J.) (quoting FTC v. Whole Foods, Inc., 502 F. Supp. 2d 1, 8 (D.D.C. 2007)); FTC v. Sysco, Inc., 113 F. Supp. 3d 1, 88 (D.D.C. 2015) (Mehta, J.) (quoting *Whole Foods*, 548 F.3d at 1043); FTC v. Staples, Inc., 190 F. Supp. 3d 100, 138 (D.D.C. 2016) (Sullivan, J.) (quoting *Sysco*, 113 F. Supp. 3d at 138 (quoting *Whole Foods*, 548 F.3d at 1043)); *see also* FTC v. Wilhelm Wilhelmsen Holding ASA, 341 F. Supp. 3d 27, 59 (D.D.C. 2018) (quoting *Whole Foods*, 548 F.3d at 1043, in a parenthetical).

I fear that we have changed the way we define markets without fully understanding the legal ramifications. Although we facially apply the same legal rule in a consistent manner across time, the substantive effect has changed. This impact is particularly noticeable for efficiencies. Although how one defines the relevant product market has some effect on our assessment of anticompetitive effects, it completely dictates our assessment of procompetitive efficiencies. As the FirstUnion banking case makes clear, efficiencies that fell within the relevant market, and therefore were cognizable under *Philadelphia National Bank*, are now excluded under that same case. Because narrower markets often result in greater market shares, as was the case in *Whole Foods*, narrower markets also raise the legal and evidentiary bar a defendant must clear when seeking to prove offsetting procompetitive efficiencies.

In other cases, narrower markets may cut in the other direction by making antitrust enforcement less aggressive. This result may be particularly likely in dynamic markets where competition often involves the introduction of new features that, at least temporarily, differentiate products. And there are probably many other effects cutting in both directions.

At this point, it is impossible to say that narrower markets are necessarily "better" or "worse" than broad ones in any normative sense. Further study surely is warranted.

In terms of a research program, I believe we should start with two lines of inquiry. First, we should conduct additional retrospectives aimed at helping us understand whether we have been drawing product markets correctly. For example, we should explore whether overestimated the extent to which products were differentiated, particularly in dynamic markets with nascent competitors. Second, we should further develop the tools we use to assess potential merger efficiencies. Looking at past acquisitions that were consummated, how did the efficiencies the merging parties actually achieved compare to (a) the efficiencies that they predicted in their advocacy to us and (b) the efficiencies that staff internally credited? For example, we may want to directly measure how a firm's cost structure changed after a merger closed. We should also seek to identify any types of efficiencies, static or dynamic, that mergers often produce but that firms or agencies rarely expect beforehand.

Many today, both within government and without, are calling on us to scrutinize the way we assess mergers. I agree that merger retrospectives are warranted. Whereas most scholars focus on anticompetitive harm, however, I believe any defensible assessment of our current approach must look at both sides of the competitive ledger. And, given the trend toward narrower markets, I worry that we now may be unintentionally excluding efficiencies that we should credit both as an economic matter and a legal one. So I look forward to seeing some merger retrospectives examining whether we are defining product markets correctly and accurately accounting for procompetitive efficiencies.