

1 Claude F. Scott, Esq.
2 Pam Cole, Esq. (CA Bar No. 208286)
3 U.S. DEPARTMENT OF JUSTICE, ANTITRUST DIVISION
4 450 Golden Gate Avenue, Rm. 10-0101
5 San Francisco, CA 94102-3478
6 (415) 436-6660
7 (415) 436-6683 (Fax)
8 Attorneys for Plaintiff the United States of America

9 Also filed on behalf of 10 Plaintiff States (see signature block)

10 UNITED STATES DISTRICT COURT
11 NORTHERN DISTRICT OF CALIFORNIA
12 SAN FRANCISCO DIVISION

13 UNITED STATES OF AMERICA, et al.,

14 Plaintiffs,

15 v.

16 ORACLE CORPORATION

17 Defendant.

CASE NO. C 04-0807 VRW

Filed: June 8, 2004

Hearing Date: June 10, 2004 at 2:00 PM

**PLAINTIFFS' MEMORANDUM IN
OPPOSITION TO DEFENDANT'S MOTION
TO EXCLUDE TESTIMONY OF
PROFESSOR KENNETH ELZINGA**

PUBLIC VERSION

18 **INTRODUCTION**

19 Oracle has moved to exclude the testimony of Plaintiffs' economic expert, Professor
20 Kenneth Elzinga, under the authority of *Daubert v. Merrell Dow Pharms., Inc.*, 509 U.S. 579
21 (1993), and its progeny. At bottom, Oracle simply disagrees with Professor Elzinga's
22 conclusions, which is not the proper focus of a *Daubert* inquiry, *see* 509 U.S. at 595, and its
23 motion should consequently be denied.

24 Professor Elzinga is one of the nation's leading antitrust authorities. He has served on the
25 faculty of the University of Virginia since 1967, and most of his academic career has been
26 devoted to teaching and research in antitrust economics. He has served in the Antitrust Division
27 of the Department of Justice (DOJ) at the policy level, and has been (and currently is) a

1 consultant to the Federal Trade Commission. Professor Elzinga has lectured to federal judges on
2 antitrust economics, and has recently served as a special consultant to Judge Lewis A. Kaplan in
3 the Christie's- Sotheby's Auction Houses Antitrust Litigation. Professor Elzinga has testified in
4 many antitrust cases and has written numerous scholarly papers on antitrust economics. There is
5 no question here of Professor Elzinga's qualifications.

6 There is also no question that his opinions are relevant to the disputed issues in the case
7 and probative on those issues. Using the record available, he provides economic analysis and
8 opinions regarding market definition, entry conditions, and the effect the merger would have on
9 competitive conditions in the markets. There is nothing methodologically exotic about this: it is
10 what economists do in every antitrust case, and it is very similar (if not identical) to what
11 Oracle's own economists do here.

12 ARGUMENT

13 I. The *Daubert* Standard for Admissibility Focuses on Relevancy and Reliability, Not 14 Factual Issues in Dispute

15 Oracle's summary of the *Daubert* standard is correct as far as it goes, but omits some
16 important qualifications.

17 First, the Supreme Court decided *Daubert* in the context of toxic tort litigation, where
18 arguably the most pressing policy concern was that juries would be misled by experts offering
19 novel, untested theories, or even "junk science." See *Daubert v. Merrell Dow Pharmaceuticals,*
20 *Inc.*, 509 U.S. 579, 595-97 (1993) (new standard will prevent "befuddled juries"); *Elsayed*
21 *Mukhtar v. Cal. State Univ., Hayward*, 299 F.3d 1053, 1063-64 (9th Cir. 2002) (*Daubert* guards
22 against "junk science" and "is particularly important considering the aura of authority experts
23 often exude, which can lead juries to give more weight to their testimony"); *Daubert v. Merrell*
24 *Dow Pharmaceuticals, Inc.*, 43 F.3d 1311, 1321 n.17 (9th Cir. 1995) (scientific evidence must
25 "not mislead the jury"). In contrast, Dr. Elzinga's opinions in this case rest on economic
26 methodologies over which there is no serious dispute.

1 Although *Daubert* also applies in bench trials, the concern that the fact-finder will be
2 misled there carries little weight. See *Volk v. United States*, 57 F. Supp. 2d 888, 896 n.5 (N.D.
3 Cal. 1999) (“[I]t bears noting that the *Daubert* gatekeeping obligation is less pressing in
4 connection with a bench trial.”); *In re Bay Area Material Handling, Inc.*, 1995 WL 729300, *6
5 (N.D. Cal. Dec. 4, 1995) (Walker, J.) (“Given the flexible nature of FRE 702 . . . and given the
6 fact that the trier of fact in this case was a judge . . . there thus was little risk that the expert
7 testimony would be given undue weight”). Accordingly, in a bench trial, probing the nitty gritty
8 of experts’ methodologies under *Daubert* to avoid misleading the court may not be an efficient
9 use of judicial or party resources, because the court can simply hear the testimony and give it the
10 weight it deserves.

11 Second, to the extent that Oracle’s motion is based on objections to the *factual*
12 *foundation* of Professor Elzinga’s opinions, including Oracle’s argument that his data set is
13 flawed, nothing in *Daubert* or its progeny changed the fundamental rule that the factual basis of
14 an expert opinion “goes to the credibility of the testimony, not the admissibility, and it is up to
15 the opposing party to examine the factual basis for the opinion in cross-examination.” *Hose v.*
16 *Chicago Northwestern Transp. Co.*, 70 F.3d 968, 974 (8th Cir. 1995); accord *Southland Sod*
17 *Farms v. Stover Seed Co.*, 108 F.3d 1134, 1143 (9th Cir. 1997) (“Technical unreliability goes to
18 the weight accorded a survey, not its admissibility”) (citations omitted); *Kannankeril v. Terminix*
19 *Int’l, Inc.*, 128 F.3d 802, 807, 809 (3d Cir. 1997) (reversing exclusion of expert based on
20 “insufficient factual foundation” and cautioning that the “trial judge must be careful not to
21 mistake credibility questions for admissibility questions”).

22 Understood in light of all of the relevant law relating to exclusion of expert testimony
23 under *Daubert*, Oracle’s motion does not pass muster.

24 **II. Oracle’s Geographic Market Complaints Are Appropriate Subjects for Cross**
25 **Examination, Rather than a *Daubert* Motion**

26 *Daubert* is about the admissibility of an expert’s testimony, not the weight that testimony
27 should carry with the trier of fact. Oracle dresses up its upcoming cross examination of Professor
28

1 Elzinga as a *Daubert* motion in an attempt to have the court exclude testimony that would
2 otherwise be helpful to the Court in its analysis of the relevant markets in this case. The
3 economic principles and methodologies applied by Professor Elzinga are the ones cited by Oracle
4 in its court papers, and, under the law should be admitted.

5 Consistently with the *Merger Guidelines* and the case law, Professor Elzinga identified
6 the relevant geographic area in which a hypothetical monopolist could profitably raise prices. He
7 explains that foreign vendors that do not have a presence in the U.S. would not be able to
8 intervene if a hypothetical monopolist or cartel were operative in this country. “The geographic
9 market extends to the ‘area of effective competition’ . . . where buyers can turn for alternative
10 sources of supply,” *Oltz v. St. Peter’s Cmty. Hosp.*, 861 F.2d 1440, 1446 (9th Cir. 1988). In
11 addition, he chose the narrowest workable market that would fit this test, again consistent with
12 the law cited by Oracle (Oracle Mem., at 2-3).

13 Relevant markets are defined in order to aid a court in determining whether a merger may
14 lessen competition “in any line of commerce or in any activity affecting commerce in any section
15 of the country.” 15 U.S.C. §18. The key question in geographic market definition is whether a
16 hypothetical monopolist (or cartel) could increase price within the defined market, or whether
17 customers within the market would likely be protected by turning to additional sellers who are
18 not currently selling within the defined market. Thus, in this case, the relevance of the
19 geographic market question is to ask if customers in the United States would likely protect
20 themselves from a hypothetical monopolist consisting of Oracle, PeopleSoft, and SAP by turning
21 to other firms who currently do not sell within the United States. Professor Elzinga’s analysis of
22 the geographic market addresses this question in a mainstream manner, and he correctly observes
23 that no such other firms can be found (and, indeed, Oracle has not identified any).

24 Moreover, the purpose of calculating market shares is to help assess the competitive
25 conditions within a relevant market. Measuring market shares of sales within the United States is
26 much more likely to reflect customers’ preferences in the United States than would shares of
27
28

1 focused on developing applications for use by SAP's United States customers"⁴ and, "[w]ith a
2 local presence in Palo Alto, . . . is much better placed to work with U.S. customers and study
3 local legal publications."⁵ In short, SAP's substantial presence in the United States is important
4 to SAP's ability to compete for customers across the United States.

5 Unlike antitrust markets like supermarkets and hospitals, where the markets are highly
6 localized and the cases usually turn on the geographic market definition, here the key determinant
7 of pricing is the competitive bidding among close (but not perfect) functional substitutes. SAP
8 has a presence in this country in the economically meaningful sense of a U.S. sales and support
9 function and product development function, and its success in New Zealand or New Delhi
10 therefore has no bearing on the market definition question. Likewise, SAP's relatively strong
11 competitive presence in Europe will not protect consumers in the United States. As Professor
12 Elzinga has opined:

13 The preferences of customers within the U.S. influence demand substitution and
14 software pricing within the United States. The preferences of customers outside of
15 the U.S. have little relevance, if any, to preferences of customers within the country.
16 No arbitrage takes place between foreign and U.S. buyers or sellers. Consequently,
17 market share estimates for the U.S. serve as a proxy for customer preferences. Thus,
18 shares based on U.S. sales are appropriate for depicting SAP's appeal to U.S.
19 customers.

20 5/18/04 Rebuttal Report of Kenneth G. Elzinga, at 3 (Exhibit D). Professor Elzinga's geographic
21 market definition is standard practice, and his principles and methodologies are sound.

22 Oracle's reliance on *United States v. Eastman Kodak*, 63 F.3d 95 (2d Cir. 1995), is
23 misplaced. That case does not state "the correct analysis" (Oracle Mem., at 4), but merely
24 concluded that the district court did not abuse its discretion in finding a worldwide geographic
25 market on the particular facts presented. *See id.* at 109. The court even cautioned that "another
26

27 ⁴ SAP, *SAP North America: Setting Standards in E-Business Development*, at
28 <http://www.sap.com/company/saplabs/northamerica/> (last visited 7/8/04) (Exhibit B).

⁵SAP, *Understanding Market Requirements*, SAP Info, no. 98 (Sep. 2002), at
<http://www.sap.info/public/en/print.php4/article/Article-17613d79ba30bba7/en> (last modified
9/23/02) (Exhibit C).

1 fact-finder might have weighed the evidence differently.” In addition, it apparently was
2 undisputed in *Kodak* that all of the film brands were essentially indistinguishable in quality. *See*
3 *id.* at 99. Professor Elzinga found, supported by an extensive factual record, that the nature of
4 the market here is very different from the market the court examined in *Kodak*. *E.g.*, 4/26/04
5 Report of Kenneth G. Elzinga (“4/26 Elzinga Report”), at 44 (Exhibit E) (even “the output of
6 Oracle, PeopleSoft, and SAP is not homogeneous”).

7 Oracle seems to imply that, as a matter of law, the geographic market must be worldwide.
8 That position is erroneous: “the definition of the relevant market is a factual inquiry for the [fact-
9 finder],” not an issue of law. *Rebel Oil, Inc., v. Atlantic Richfield Co.*, 51 F.3d 1421, 1435 (9th
10 Cir. 1995). *Kodak* does not determine this case or restrict Professor Elzinga’s analysis of a
11 different factual record.

12 Next, Oracle argues that Professor Elzinga’s geographic market analysis is inconsistent
13 with the fact that global functionality is one of the features of high-function software. This is not
14 a proper *Daubert* argument. There is no allegation that his economic principles or methodologies
15 are flawed, but rather that global functionality requires a worldwide market. This argument fails
16 to recognize the competitive significance of software vendors’ presence in the United States and
17 ultimately distills to a factual issue to be weighed by the finder of fact.

18 Next, Oracle makes light of Professor Elzinga’s authorship of the “Elzinga-Hogarty” test
19 for geographic market definition. That test has been used by the courts when a firm’s ability to
20 respond competitively depends, in part, on the location of production assets and shipment (or
21 patient) flow data. It is not a useful test for the products at issue in this case, because the
22 software is not “shipped” in any economically meaningful sense of the word. Professor Elzinga
23 explained all of this in his deposition, but Oracle chooses to ignore it.⁶ Again, the “location” of
24 market participants is defined by their ability to undercut the hypothetical monopolist’s attempt
25 to increase prices in the United States.

26
27
28 ⁶ Elzinga Dep. at 273:6-19, 274:5-23 (Exhibit F).

1 **III. The Data Set and Proxy Used to Calculate Market Shares Are Reasonable, and if**
2 **Anything, Benefit Oracle**

3 Oracle complains that the market-share data calculated by Professor Elzinga do not match
4 perfectly the alleged relevant markets. Professor Elzinga calculates estimated market shares for
5 the high-function enterprise market by examining new license sales data from a large number of
6 software firms. He excluded from the calculations license revenues of less than \$500,000 per
7 customer per year in an attempt to screen out mid-market transactions. The data set available did
8 not indicate whether the license was for a mid-market product or a high-function product, so
9 some proxy was necessary. The \$500,000 filter was used as a proxy for high-function software.

10 It is unremarkable that Professor Elzinga used available data and necessary
11 approximations to calculate market shares. This is done in virtually every antitrust case because
12 data are not necessarily collected in any industry in the form that an experienced antitrust
13 economist would choose. Reasonable approximations are the rule, not the exception. Of course,
14 cross-examination on the reasonableness of the approximations is appropriate, as would be
15 competing market-share calculations from an opposing party's economist.

16 Indeed, Professor Elzinga's use of the \$500,000 filter provides market shares that are only
17 an approximation of the relevant economic parameters in the industry. That is unremarkable;
18 market shares are intended to be only a rough indicator of market power, *see, e.g., Ball Memorial*
19 *Hosp. v. Mutual Hosp. Ins., Inc.*, 784 F.2d 1325 (7th Cir. 1986), which is more than sufficient
20 for *Daubert* purposes. Again, the admissibility of the evidence is at issue here, not the weight
21 that the finder of fact should assign to the evidence.⁷

22
23 ⁷ Oracle's citation to *City of Tuscaloosa v. Harcros Chemicals, Inc.*, 158 F.3d 548 (11th
24 Cir. 1999) is misleading. The expert there was not an economist but a statistician, and his error
25 was to include sales data from Florida when the suit alleged collusive behavior only in Alabama.
26 *See id.* at 566-67. By contrast, the sales that Oracle criticizes Dr. Elzinga for including in his
27 analysis (Oracle Mem., at 9) are all within the United States, *see* 4/26 Elzinga Report, at 46, and
28 therefore are within Professor's Elzinga's geographic market and the geographic market alleged
by the United States. *City of Tuscaloosa* does not support Oracle's real objection to Professor
Elzinga's analysis, which is that Oracle believes that Lawson, Microsoft, and other sellers should

1 Moreover, the proxy used is, if anything, likely biased in favor of Oracle. For example,
2 Microsoft’s license sale to is included in the share data, but as other testimony will
3 confirm, that was not a high-function product sale. Likewise, certain sales data are
4 included, even though has only a narrow product niche and cannot undercut a hypothetical
5 monopolist’s exercise of market power. Thus, it is unsurprising that Oracle seeks to have the
6 market shares excluded in their entirety—even after making assumptions favorable to the
7 transaction, the shares still demonstrate that the transaction will substantially increase
8 concentration levels in already highly concentrated markets.⁸

9 Oracle also complains that Professor Elzinga used a poor-quality data set in calculating
10 market shares, and cites *SMS Sys. Maint. Servs., Inc. v. DEC*, 188 F.3d 11 (1st Cir. 1999), as
11 support for the proposition that the testimony should therefore be excluded. Once again, Oracle
12 confuses admissibility of the evidence with the weight the evidence might be given by the fact
13 finder. The expert opinion in the *SMS* case was not “excluded” because of data flaws, but rather
14 was admitted but given no weight because the expert offered “only a bare conclusion” and did
15 not *explain* why the data was proper to use for the conclusions he drew. *See id.* at 25. Professor
16 Elzinga, by contrast, explained why he used the data he had, 4/26 Elzinga Report at 46
17 (Exhibit G) (because “[p]recise data on sales in the relevant markets are not publicly available”);
18 explained what was included in the data (*see id.*); provided in an exhibit (Ex. 7) (Exhibit G)
19 giving more detailed information on the data and how it was used; and then confirmed the
20 statistical evidence with declaration testimony (*see id.* at 49-50) (Exhibit H).

21 Finally, Oracle complains that Elzinga used assumptions in reconciling the sales data
22 from different firms into one useable data set. On cross examination, Oracle is free to try and
23 show how any of the flaws it alleges would bias the results in favor of the Plaintiffs. *See, e.g.,*

24 _____
25 be included in the *product* market.

26 ⁸ Indeed, it is telling that Oracle’s motion does not contend that the estimated shares are
27 biased in any manner against Oracle. Rather, it simply contends that the estimates do not
28 measure share perfectly, but perfection is not required.

1 *Southland Sod Farms v. Stover Seed Co.*, 108 F.3d 1134, 1143 (9th Cir. 1997) (in response to
2 criticisms about questionable assumptions regarding an economist’s damages model, the Ninth
3 Circuit said “These asserted defects, however, go to the weight, and not the admissibility, of
4 Wagner’s testimony.”). These concerns, however, do not justify Oracle’s efforts to avoid that
5 cross examination by twisting its arguments into a *Daubert* motion in an attempt to deny the
6 Court the benefit of Dr. Elzinga’s expert testimony.

7 **IV. HHIs Are Relevant to Unilateral and Coordinated Effects Theories**

8 Oracle’s claim that the Herfindahl-Hirschman Index (“HHI”) of concentration is solely
9 “designed to indicate the propensity of a market to *coordinated effects*” (Oracle Mem. at 12;
10 emphasis in the original) is wrong as a matter of economic theory. Oracle quotes from
11 deposition testimony in which Professor Elzinga correctly opines that there is no mechanically
12 precise or “pristine” relationship between the HHI and predicted merger effects in models of
13 differentiated products (5/28/04 Elzinga Dep. 254:10-19, as quoted in Oracle Mem. at 12).
14 Oracle grossly mischaracterizes Professor Elzinga’s testimony as being that the HHI is
15 uninformative for unilateral effects analysis. This erroneous claim is Oracle’s, not Professor
16 Elzinga’s.

17 Oracle’s claim that the HHI is uninformative for unilateral effects analysis is contrary
18 both to the published views of its own expert, Professor Hausman, and to the use of HHIs made
19 by the courts. In support of his conclusion that “AT&T has market power in the interLATA long-
20 distance market,” Professor Hausman cites the high HHI in residential long distance. Professor
21 Hausman describes the HHI as a “standard” concentration measure, as indeed it is. (Jerry A.
22 Hausman, “Competition in Long-distance and Telecommunications Equipment Markets: Effects
23 of the MFJ,” *Managerial and Decision Economics*, 1995, vol.16, pp.365-383.) Courts routinely
24 cite HHIs as a basis for liability in merger cases, without any detailed explanation of the
25 particular theory of oligopoly that motivates the judgment. *See, e.g., FTC v. Staples, Inc.*, 970
26 F.Supp. 1066 (D.D.C. 1997) (HHIs cited in support of a unilateral effects “head to head
27 competition” theory).

1 Although the HHI does not offer a mechanically precise measure of unilateral effects with
2 differentiated products, or of coordinated effects, the HHI is informative in assessing the
3 likelihood of both kinds of effect. This is reflected in the Merger Guidelines as well as in the
4 way courts have used HHIs in merger analysis. Professor Elzinga’s use of HHIs is entirely
5 consistent with this history. Indeed, Professor Elzinga states clearly that he adopted the analytic
6 paradigm of the Horizontal Merger Guidelines (“Guidelines”) “to consider the issue of how
7 closely positioned SAP, PeopleSoft and Oracle are relative to other choices in the marketplace,”
8 and that, among other things, the data most useful for doing that was “the output of the big three
9 and others purportedly in the market by Oracle.” Elzinga Dep. at 254:24 – 255:17 (Exhibit I).

10 Oracle mischaracterizes Professor Elzinga’s expert report on the likelihood of
11 coordinated effects resulting from the acquisition. In his expert report, Professor Elzinga clearly
12 states, “Market concentration is one of the key variables that bears on the likelihood a group of
13 rivals could coordinate their behavior successfully.” 4/26 Elzinga Expert Report at 57
14 (Exhibit J). This is a completely standard economic opinion as Oracle acknowledges. (See
15 Motion, p. 11 at 24-25, “Professor Elzinga’s only mention of these standard oligopoly and
16 collusion theories...”). Professor Elzinga goes on to say, “As I showed earlier, the relevant
17 markets are highly concentrated. Further, for many customers, this merger is a 3 to 2 merger (or
18 4 to 3).” 4/26 Elzinga Expert Report at 57 (Exhibit J). It is hard to understand why Oracle
19 characterizes these opinions as “... very carefully qualified.” (Motion, p. 11 at 25). In
20 deposition, Professor Elzinga conceded he would not be able to say that anticompetitive
21 coordinated effects are likely here.

22 As Oracle notes, the Plaintiffs’ Trial Brief does not discuss conventional coordinated
23 effects theory. It is quite another thing, however, for Oracle to suggest that the *Daubert* line of
24 cases precludes Professor Elzinga from expressing his general concern on this point in his report,
25 or that this expressed concern there somehow discredits his other opinions.

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

Kristen M. Olsen, Esq.
Assistant Attorney General
Office of the Attorney General of Minnesota
445 Minnesota Street, Suite 1200
St. Paul, Minnesota 55101-2130
(651) 296-2921
(651) 282-5437 (Fax)

Jay L. Himes, Esq.
Chief, Antitrust Bureau
Office of the Attorney General of New York
120 Broadway, 26th Floor
New York, NY 10271
(212) 416-8282
(212) 416-6015 (Fax)

Todd A. Sattler, Esq.
Assistant Attorney General
Consumer Protection and Antitrust Division
600 E. Boulevard Ave., Dept. 125
Bismark, ND 58505-0040
(701) 328-2811
(701) 328-3535 (Fax)

Steven M. Rutstein, Esq.
Assistant Attorney General
55 Elm Street
Hartford, CT 06106
(860) 808-5169
(860) 808-5033 (Fax)

Paul F. Novak, Esq.
Assistant Attorney General In Charge
Special Litigation Division
Michigan Department of Attorney General
P.O. Box 30212
Lansing, MI 48909
(517) 335-4809
(517) 373-9860 (Fax)

Mitchell L. Gentile, Esq.
Assistant Attorney General
Antitrust Section
Office of the Attorney General
150 E. Gay St., 20th Floor
Columbus, OH 43215
(614) 466-4328
(614) 995-0266 (Fax)

Ellen S. Cooper, Esq.
Assistant Attorney General

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

Chief, Antitrust Division
State of Maryland
200 St. Paul Place, 19th Floor
Baltimore, MD 21202
(410) 576-6470
(410) 576-7830 (Fax)

Counsel for Plaintiff States