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FTC and DOJ Propose Revisions to the Horizontal Merger Guidelines

On April 20, 2010, the Federal Trade Commission ("FTC") released for comment a proposed revision of the current Horizontal Merger Guidelines (the "1992 Merger Guidelines"). The 1992 Merger Guidelines provide a guide to how the U.S. Department of Justice ("DOJ") and FTC (collectively "the Agencies") review mergers among companies that compete for the same customers (so-called "horizontal" competitors). However, commentators have noted that the 1992 Merger Guidelines may no longer reflect the Agencies' enforcement policy. Now, the Agencies propose to revise the Guidelines.

The 2010 Merger Guidelines Revisions substantially change the text of the 1992 Merger Guidelines. In most respects, however, the revisions appear to embody existing agency practice rather than proposing major changes to merger review policy. Notably, the revisions:

- raise the concentration thresholds at which mergers are considered likely to create anticompetitive effects to more closely track actual agency practice;
- de-emphasize market definition, and provide more guidance on the fact-specific analyses and theoretical concepts the Agencies actually use in merger review;
- provide details on the types of evidence the Agencies consider in merger review;
- introduce concepts not previously covered or given much attention in the 1992 Merger Guidelines, but which have developed in enforcement practice over time, such as mergers' effects on innovation, and the analysis of mergers between buyers; and
- propose some new concepts, such as using merger review to enforce Section 2 of the Sherman Act's prohibition on the unlawful acquisition or maintenance of monopoly power.

The 2010 Merger Guidelines Revisions are substantially longer and, as a result, potentially more complex than the 1992 Merger Guidelines. They also adopt a tone that is slightly less favorable to mergers than the 1992 Merger Guidelines, notably with respect to firms with high margins (such as many technology companies). Whether this has any significance for enforcement remains to be seen.

A more detailed description follows, tracking the structure of the proposed revisions.

Section 1: Overview

The proposed revisions begin with an Overview outlining the philosophy behind the Guidelines. The revisions do not dramatically change the Guidelines' substance, but do adopt a somewhat more skeptical tone toward mergers. For example, the Overview notes that mergers should not be permitted to "entrench" market power (an addition to the prior "create or enhance" language); it adds "diminish[ing] innovation" and "reduced product variety" to the taxonomy of anticompetitive effects of mergers; and it asserts that "[e]nhanced market power may also make it more likely that the merged entity can profitably and effectively engage in exclusionary conduct."

A major theme of the proposed revisions, starting with the Overview, is that agency staff do not mechanically follow the five-step approach outlined in the 1992 Merger Guidelines, but instead engage in a more amorphous, fact-specific inquiry using a variety of analytical tools. It has long been the case that agency staff focus their analysis on the issues of most importance in each merger review, as opposed to proceeding rigorously through the 1992 Merger Guidelines' steps as if they were a checklist. Thus, this change in language largely reflects longstanding practice, though it also seems to be an attempt to grant even more discretion to the Agencies. It will be interesting, however, to see whether this change, combined with the de-emphasis on market definition described below, has any influence on the courts in litigated merger cases.

Section 2: Evidence of Adverse Competitive Effects

The 2010 Merger Guidelines Revisions include a new section entitled "Evidence of Adverse Competitive Effects," which outlines the type of evidence agency staff typically take into account, and the weight they accord that evidence.

The Agencies explain that they consider "any reasonably available and reliable evidence" in determining whether a merger under consideration is likely to cause anticompetitive effects, but this new section "discusses several categories and sources of evidence that the Agencies, in their experience, have found most informative…." The enumerated types of evidence include:

- For consummated mergers, evidence of actual competitive effects;
- Natural experiments or "direct comparisons based on experience";
- Market share and concentration in one or more relevant market(s);
- The closeness of competition among the parties (*e.g.* whether they are or are likely to become "head to head" competitors); and
- Whether the transaction would eliminate a "maverick" player in the market.

The Agencies also explain that the potential sources of these types of information include the merging parties themselves, customers, and other industry participants and observers. These types of evidence from this variety of sources are all widely used in practice by both the Agencies and counsel to merging parties, and many were discussed in the Commentary to the Merger Guidelines issued by the Agencies in 2006. Thus, the addition of this new section should not significantly change the Agencies' approach, and may be helpful to parties and counsel by enhancing transparency.

Section 3: Targeted Customers and Price Discrimination

The proposed revisions include an expanded discussion of price discrimination—the ability of merging firms to identify particular customers or types of customers who will tolerate higher prices. This reflects current agency practice, which has long considered price discrimination in both market definition and the assessment of competitive effects.

Section 4: Market Definition

The 2010 Merger Guidelines Revisions downplay market definition, noting that it is only "one of the tools the Agencies use to assess whether a merger is likely to lessen competition." The revisions explain that the market definition exercise is "useful to the extent it illuminates the merger's likely competitive effects [but t]he Agencies' analysis need not start with market definition" if other analytical tools illuminate the ultimate question of whether the merger is likely to lessen competition. The revisions emphasize that "competitive effects can inform market definitions," suggesting that in some instances the impact that a reduction in the number of rivals offering a product or group of products has on price may be more informative than market shares or other facts. The revisions also suggest

that this type of analysis is most likely to be used where there are multiple "alternative and reasonably plausible candidate markets [whose] market shares lead to very different inferences regarding competitive effects." In other words, the Agencies are most likely to apply this type of analysis in cases in which defining the relevant market(s) is difficult. The proposed revisions also contain a number of comments that appear designed to defend the Agencies' practice of defining narrow markets.

The reduced emphasis on market definition reflects current agency practice in which market definition clearly matters, but competitive effects theories are often viewed as more important. It may also be an attempt to address some of the recent difficulties the Agencies have faced in litigation, as—in some tension with Agency views—courts have generally considered market definition to be an indispensable requirement for a merger challenge, and resisted efforts to define narrow markets.

The proposed revisions also address the "hypothetical monopolist" test used to determine the appropriate relevant antitrust product market. The 1992 Merger Guidelines explained that a relevant product market is "a product or group of products such that a hypothetical profit-maximizing firm that was the only present and future seller of those products ('monopolist') likely would impose at least a 'small but significant and nontransitory' increase in price." The 2010 Merger Guidelines Revisions expand and update this definition, providing more specific examples of its application and of factual variations that might affect how it is applied.

Section 5: Market Participants, Market Shares, and Market Concentration

One of the most anticipated changes is the Agencies' proposed upward revision of the concentration thresholds used in assessing whether a proposed transaction would likely result in anticompetitive effects. The Agencies use the Herfindahl-Hirschman Index ("HHI") to calculate market concentration. The HHI is calculated by summing the squared market shares of all participants in a relevant market. Under the 1992 Merger Guidelines:

- An HHI of under 1,000 is considered unconcentrated. A merger that results in an unconcentrated market is considered unlikely to result in adverse competitive effects.
- An HHI of 1,000 to 1,800 is considered moderately concentrated. A merger that results in a change in the HHI of more than 100 points in such a market potentially raises antitrust concerns.
- An HHI above 1,800 is considered highly concentrated. A merger in a highly concentrated market producing an HHI increase of more than 50 points potentially raises anticompetitive concerns, and an increase of more than 100 points in a highly concentrated market would create a *presumption* that the merger will result in anticompetitive effects.

As a practical matter, however, these figures do not comport with the Agencies' actual enforcement actions, as the FTC and DOJ generally only challenge mergers that significantly exceed these thresholds. For example, a joint study by the FTC and Antitrust Division on the levels of concentration in challenged mergers between 1999 and 2003 revealed that over 87% of mergers challenged by the Agencies would have resulted in post-merger market concentration above 2,400 and almost all of the challenges at concentration levels below 2,400 were in three specific industries: petroleum, supermarkets, and banking.

The 2010 Merger Guidelines Revisions update these thresholds to more closely reflect the Agencies' actual enforcement practice. Under the 2010 Merger Guidelines Revisions:

- An HHI of under 1,500 is considered unconcentrated. A merger that results in an unconcentrated market is considered unlikely to result in adverse competitive effects.
- An HHI of 1,500 to 2,500 is considered moderately concentrated. A merger that results in a change in the HHI of more than 100 points in a moderately concentrated market "potentially raise[s] significant competitive concerns and often warrant[s] scrutiny."
- An HHI above 2,500 is considered highly concentrated. Mergers in a highly concentrated market producing an HHI increase of 100-200 points "potentially raise significant competitive concerns and often warrant scrutiny" and mergers in these markets producing an HHI increase of more than 200 points "will be *presumed* to be likely to enhance market power."

Also consistent with actual practice, the Agencies noted that in some cases the change in the number of competitors is more significant than changes in the HHI, changes in concentration are only one factor to be considered, and such changes in concentration may be more or less significant in particular contexts.

Sections 6 and 7: Unilateral and Coordinated Effects

The 2010 Merger Guidelines Revisions also provide an expanded discussion of competitive effects (unilateral and coordinated) which reflects the considerable emphasis agency staff and merging firms typically place on this issue during merger review. Notably, the revisions switch the order of effects theories, moving unilateral effects ahead of coordinated interaction, which appears to reflect the more robust role unilateral effects have played in merger enforcement since the 1992 Merger Guidelines.

The 2010 Merger Guidelines Revisions reflect substantial changes to unilateral effects analysis, including an expanded discussion of bargaining and auction models and the elimination of market share screens. Additionally, the Agencies have proposed a new section that brings innovation analysis—previously found only in other guidance issued by the Agencies, such as the Antitrust Guidelines for the Licensing of Intellectual Property and the Antitrust Guidelines for Collaborations Among Competitors—into the Merger Guidelines themselves. The proposed revisions also include a discussion of the effects of mergers on "product variety"—a relatively untested area of merger analysis that has the potential to introduce uncertainty and confusion, as it is unclear whether adequate legal and economic guidance exists for assessing optimal levels of product variety.

While the discussion of coordinated interaction (joint action by competing firms) in the 2010 Merger Guidelines Revisions does not appear to be greatly different from that contained in the 1992 Merger Guidelines, the revisions downplay the "checklist" of conditions conducive to collusion that that was contained in the earlier Guidelines.

Section 8: Powerful Buyers

The proposed revisions include a new section discussing powerful buyers and their potential ability to check anticompetitive conduct. However, consistent with current practice, the revisions note that the "power buyer" defense is subject to a number of limitations.

Section 9: Entry

The 2010 Merger Guidelines Revisions provide a simplified discussion of "ease of entry," and its role in merger analysis. The Agencies explain that they will consider whether the prospect of entry into the relevant market will deter or counteract any competitive effects. In making this determination, the Agencies will consider the timeliness, likelihood, and sufficiency of entry. In considering whether entry is "likely," the 2010 Merger Guidelines Revisions also eliminate the requirement from the 1992 Merger Guidelines that entry must occur within two years in favor of a more amorphous approach, consistent with the tone and language of many of the other revisions. Importantly, the revisions note that the Agencies will give substantial weight to the actual history of entry into the relevant market. Lack of prior successful and effective entry may indicate that entry is slow or difficult.

Sections 10 and 11: Efficiencies and Failure and Exiting Assets

The proposed revisions do not substantially change the 1992 Merger Guidelines' discussion of efficiencies, or of the "failing firm" and exiting asset defenses.

Section 12: Mergers of Competing Buyers

The revisions elevate the discussion of mergers of competing buyers from a small note in the 1992 Merger Guidelines to an entire section. In the revisions, the Agencies note that just as mergers of sellers can enhance market power on the selling side of the market, buyer mergers can lead to increased market power, sometimes labeled "monopsony power." In analyzing whether a merger will likely enhance buyer market power, the Agencies will follow a similar framework to analyzing mergers of competing sellers. Therefore, for example, the Agencies will consider the presence of other buyers and efficiencies such as reduced transaction costs and volume-based discounts. Also, consistent with the DOJs recent interest in the agriculture industry, this new section includes an example of a merger involving agricultural buyers.

Section 13: Partial Acquisitions

Finally, the 2010 Merger Guidelines Revisions also reflect the Agencies'

increased interest in recent years in partial acquisitions of competing firms. Here, the revisions confirm that the Agencies will analyze partial acquisitions much as they do a traditional merger. Key factors will include whether the partial acquisition results in effective control of the target firm, the potential ability of the acquiring firm to influence the competitive conduct of the target firm, whether the acquisition will reduce the incentive of the acquiring firm to compete, and whether it will give the acquiring firm access to competitively sensitive information from the target firm. Through analysis of these factors, the Agencies weigh potential unilateral and coordinated effects against any likely efficiencies, though the revisions note that partial acquisitions usually do not enable many of the types of efficiencies associated with mergers.

Submission of Public Comments

The FTC is seeking comment by May 20, 2010, from all stakeholders to ensure that "the final Guidelines are clear and accurate in conveying the Agencies' merger enforcement intentions." After consideration of comments received, the FTC and DOJ presumably will release a final version of the revised Merger Guidelines. We would be pleased to discuss how these changes would affect your business and whether you would like to submit comments.

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