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E-ALERT | Antitrust

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U.S. ANTITRUST AGENCIES ISSUE REVISED HORIZONTAL MERGER GUIDELINES

Last week, the U.S. Justice Department ("DOJ") and Federal Trade Commission ("FTC") (together, the "Agencies") issued revised Horizontal Merger Guidelines (the "Guidelines") describing how the Agencies seek to determine whether a merger of competing companies will substantially lessen competition. The final document is nearly identical in substance to the draft that was released for public comment in April.

WHAT YOU NEED TO KNOW ABOUT THE NEW MERGER GUIDELINES

The new Guidelines largely reflect what has been the enforcement practice and position of the Agencies for the past several years. In our view, they do not signal a radical shift in enforcement approach, notwithstanding the announced intention of Agency leadership to more aggressively challenge mergers. The Guidelines' apparent emphasis on margins, however, is a significant difference from prior policy statements and also the most untested and controversial aspect of the Guidelines.

Our main take-aways are as follows:

- Merger investigations will continue to focus in some cases on narrow potential markets and effects resulting from the elimination of competition between the merging firms specifically.
- Economic modeling of such "unilateral" competitive effects, such as "critical loss," "upward pricing pressure," and other analyses based on firm margins, will be a key part of many investigations.
- Given the Guidelines' focus on competitive effects demonstrated through economic modeling, companies with transactions before the Agencies must be prepared to engage Agency staff about these economic tools and the pro-competitive aspects of their deals at the earliest stages of an investigation.
- If accepted by the courts, the new Guidelines may result in a reduced burden for the government in challenging mergers, particularly with respect to the burden of establishing markets and market concentration, which was viewed as a difficulty for the government in cases like Oracle/PeopleSoft and Whole Foods/Wild Oats. The success of the Guidelines in steering development of the law, however, remains to be seen. It is not clear, for example, how receptive courts will be to decisions heavily dependent on economic modeling.
- While continuing to de-emphasize the importance of market concentration, the revised Guidelines also significantly raise the HHI screens to more accurately reflect when the Agency is likely to be concerned about a transaction.
- Although the revised Guidelines state that, in addition to price effects, the Agencies are concerned about the potential for non-price effects (such as effects on innovation, quality, and variety), the Guidelines do not provide specific guidance as to how the Agencies might separately assess the likelihood of such effects.

- The Guidelines offer greater insight into the analytical tools employed by the Agencies, many of which are not referenced in the 1992 guidelines (although they have been described in subsequent policy statements, such as the Agencies' 2006 Commentary on the Horizontal Merger Guidelines). At the same time, the Guidelines seek to increase the Agencies' flexibility in deciding when and how to employ particular tools in specific investigations. As a result, the Guidelines ultimately may reduce the predictability of merger enforcement.

SUMMARY OF MAJOR PROVISIONS

The following analysis does not describe every change in the Guidelines, but sets forth key changes we think will be of most interest to our clients.

Market Definition

The revised Guidelines make plain that market definition may not be the key determinant in an investigation. This change is likely a reaction to recent decisions by several federal courts rejecting the market definitions proposed by the Agencies, including those in the Whole Foods/Wild Oats and Oracle/PeopleSoft merger challenges.

- That having been said, the Guidelines acknowledge that the Agencies in each instance must assess all competitive alternatives available to customers of the merging firms. Further, in revisions to the April draft prompted by public comments, the Guidelines state that, "[i]n any merger enforcement action, the Agencies will normally identify one or more relevant markets" and a reference to market definition being only "one of the tools the Agencies use" has been removed.

- Accordingly, we expect courts to be receptive to arguments that, even under the new Guidelines, the Agencies must define a relevant market and explain how the merger is likely to reduce competition within that market.

Unilateral Effects Analysis of Differentiated Product Markets

The most substantial additions to the Guidelines relate to the potential for a merged firm to exercise market power unilaterally (or without regard to the reactions of other firms)—so-called unilateral effects analysis. While such analysis has been the basis of most merger challenges in recent years, it has also met with judicial skepticism in litigated cases lost by the government.

- Consistent with the de-emphasis of market definition as a determining factor, the Guidelines suggest that it will often be better for the Agencies to use "direct evidence"—such as the merging firms' documents and economic modeling and diversion ratios—to show harm to competition from unilateral effects.

- However, the economic models described in the Guidelines always predict a price increase if there is any substitutability between products of the merging companies (i.e., the models always predict some "upward pricing pressure"). The Guidelines thereby effectively shift the burden to the parties to disprove the existence of an anticompetitive effect by, for example, demonstrating efficiencies or the likelihood of timely and sufficient entry.

Non-Price Unilateral Effects

The Guidelines introduce new academic theories of harm based on possible reductions in "innovation" or in "variety" or choice by the merged firm.

- For example, the draft states that the loss of product "variety" is a potential concern, "over and above any effects on price or quality of any given product," if it results from the merged firm withdrawing from the market "a product that a significant number of customers strongly prefer . . . ."
- There is no consensus support for these theories as bases for challenging mergers, in significant part because they do not provide a basis for predictable enforcement decisions. In this regard, although concerns about non-price effects may be increasingly important to the Agencies, the Guidelines do not provide specific guidance as to how the Agencies might assess the likelihood of such effects.

Coordinated Effects Analysis

The revised Guidelines retain the same basic factors identified in the 1992 guidelines for evaluating the risk of coordinated interaction due to a merger, but they provide some further explanation of how the Agencies view those factors. In this regard, the Guidelines identify three conditions which, if satisfied, are likely to lead to a merger challenge: "(1) the merger would significantly increase concentration and lead to a moderately or highly concentrated market; (2) that market shows signs of vulnerability to coordinated conduct . . . ; and (3) the Agencies have a credible basis on which to conclude that the merger may enhance that vulnerability."

Market Concentration & HHIs

The revised Guidelines preserve the HHI method of measuring market concentration. However, the HHI thresholds themselves have been raised to reflect better when the Agency is likely to be concerned about a particular merger. The new HHI levels are as follows:

- "Unconcentrated markets," or those in which mergers are unlikely to have adverse competitive effects or require further analysis, are defined as markets with HHIs below 1500. The previous threshold was 1000.
- "Moderately concentrated markets," or those in which mergers that involve an HHI increase of more than 100 points "potentially raise significant competitive concerns and often warrant scrutiny," are defined as markets with HHIs between 1500 and 2500. The previous range was 1000 to 1800.
- "Highly concentrated markets," or those in which mergers resulting in HHI increases of 100-200 points potentially raise significant concerns and those resulting in increases of more than 200 points "will be presumed to be likely to enhance market power," are defined as markets with HHIs in excess of 2500. The previous threshold was 1800 and the range of HHI increases that gave rise to concerns was 50-100 points.

Importantly, the Agencies retained the HHI presumption of harm that they assert should exist in "highly concentrated markets" when the change in the HHI exceeds 200 points. In practice, the Agencies have reduced their reliance on the HHI presumption over the years. By retaining the presumption language while increasing the HHI thresholds, the Agencies may be signaling that they will increase their reliance on presumed anticompetitive effects from mergers that exceed the new thresholds.

Sources of Evidence of Likely Anticompetitive Effects

The Guidelines contain a new section that explains the categories and sources of evidence that the Agencies find to be the most informative in predicting a merger's likely competitive effects.

- For example, the Guidelines underscore the importance of information and documents received from the merging parties. While the Agencies have always examined the parties' documents for relevant information, the Guidelines suggest greater reliance on such evidence in the future. Parties thus need to exercise great care to avoid creating misleading or inaccurate documents in this regard.
- The Guidelines also contain several broad statements about the significance of other information from the merging parties—such as their margins on sales of competing products or the terms of the transaction itself—that appear designed to bolster the Agencies' ability to litigate cases. For example:
  - "[I]f a firm sets price well above incremental cost, that normally indicates either that the firm believes its customers are not highly sensitive to price (not in itself of antitrust concern) or that the firm and its rivals are engaged in coordinated interaction . . . ."
  - "The financial terms of the transaction may also be informative regarding competitive effects. For example, a purchase price in excess of the acquired firm's stand-alone market value may indicate that the acquiring firm is paying a premium because it expects to be able to reduce competition or to achieve efficiencies."

Efficiencies

The Guidelines appear to increase the burden on merging firms in demonstrating efficiencies.

- For example, the Guidelines signal that the Agencies will be even more reluctant than they have been in the past to credit efficiencies unless they are passed through to consumers.
- However, the Guidelines go further than the Agencies have previously been willing to go in acknowledging that transactions that may result in anticompetitive effects in one relevant market may nevertheless not be challenged if they also yield significant efficiencies in a different market, such that "the merger is likely to benefit customers overall."

Entry

While the Guidelines maintain the general requirement that entry must be timely, likely, and sufficient to prevent anticompetitive harm, they change the specific criteria in ways that may make it somewhat more difficult to defend a merger on this ground.

- For example, instead of requiring entry within two years, the Guidelines require entry to be "rapid," which could be a period shorter than two years.
- Further, the Guidelines state that "[e]ntry by a single firm that will replicate at least the scale and strength of one of the merging firms is sufficient" and that "[e]ntry by one or more firms operating at a smaller scale may be sufficient if such firms are not at a significant competitive disadvantage." This appears to be in contrast to the previous version of the guidelines, which required entry at a scale sufficient to defeat an anticompetitive price increase, which does not necessarily require the entrant(s) to make the same number of sales as either of the existing parties.

Other Additions

The Guidelines include several new sections that address (i) powerful buyers; (ii) mergers of competing buyers; and (iii) partial acquisitions.

- The Guidelines observe that powerful buyers may be able to constrain the ability of the merging parties to raise prices, but also state that the Agencies will not presume that the presence in the market of powerful buyers alone forestalls a merger's potential competitive effects.
- The Guidelines explain that monopsony issues, or those raised by mergers on the buying side of the market, are examined under essentially the same framework that is used to evaluate whether a merger is likely to enhance market power on the selling side of the market. The Guidelines state that the Agencies distinguish between effects on sellers arising from a lessening of competition and those arising from other causes, such as the ability of the combined firm to lower its transaction costs or take advantage of greater volume discounts, both of which are potential efficiencies under the Guidelines.
- The Guidelines address partial acquisitions, or transactions in which a buyer acquires a minority interest in a competing firm. Although such transactions may not eliminate competition between the parties, the Agencies will examine them much as they would a full merger if, for example, the transaction results in the buyer acquiring effective control or all or substantially all of the competing firm's assets. The Agencies also may investigate such deals to determine, for example, whether the buyer (i) will have a reduced incentive to compete; (ii) will be able to influence the competitive conduct of the target firm; or (iii) will have access to non-public, competitively sensitive information from the competing firm.

Statement of FTC Commissioner Tom Rosch

On the same day that the Agencies issued their revised Guidelines, FTC Commissioner Tom Rosch issued a statement in which he supported their issuance but pronounced them "flawed as both a description of how the staff (at the Commission at least) conducts ex ante merger review and what the Agencies should tell courts about merger analysis."

- Commissioner Rosch's statement, for example, suggests that concerns about non-price effects may be a more significant driver of the Agencies' enforcement decisions than even the revised Guidelines indicate, and he is critical of the Agencies' "fail[ure] to offer a clear framework for analyzing non-price considerations."
- Rosch also criticizes the Guidelines for an "overemphasis on economic formulae and models based on price theory" and the emphasis such theories place on margins. He calls out for specific criticism the Guidelines' view that a "sinister inference" can be drawn from high margins and their incorporation of the "upward pricing pressure" theory.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our antitrust group:

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