



Everything You Wanted To Know About The Antitrust Agencies But Were Too Afraid To Ask: A Review Of The DOJ And FTC's Proposed Revisions To The Horizontal Merger Guidelines

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On April 20, after much discussion and five days of joint workshops, the Antitrust Division of the Department of Justice and the Federal Trade Commission issued draft revisions to the Agencies' Horizontal Merger Guidelines. These proposed revisions represent the first revisions to the Guidelines since 1997 and the first comprehensive overhaul since 1992. The draft revised Guidelines are currently in a period of public comment that expires on June 4, after which the Agencies will consider the comments and likely finally approve the proposed Guidelines.

Rather than bringing about a sea change in enforcement policy at the Antitrust Agencies, the proposed Guidelines largely codify what most practitioners understood to be the realities of the Agencies' merger-enforcement analysis. Indeed, FTC Chairman Jon Leibowitz stated in a press release that the revised Guidelines reflect the "evolution" of the Agencies' assessment of mergers over the past 18 years.¹ The proposed revisions attempt to align the Guidelines with Agency practice by placing a greater emphasis on analysis of competitive effects than the 1992 Guidelines, which focused largely on the structural aspects of market definition and concentration. This article summarizes some of the highlights of the revised Guidelines, including the aspects of the Guidelines that changed and those that stayed the same.

New Section on Evidence Considered by the Agencies

The first thing one notices when reading the proposed Guidelines is that the structure of the Guidelines changed

significantly from the 1992 version. The first of these structural changes is the insertion of Section 2 of the revised Guidelines entitled "Evidence of Adverse Competitive Effects," which was not present in previous versions of the Guidelines. Section 2 sets forth a hierarchy of types and sources of evidence that the Agencies' staffs consider, which previously was known only to the staffs themselves and the attorneys who regularly represented parties before them.

Although several sections of the proposed Guidelines are either revised or entirely new, some aspects remained the same despite calls for change.

The proposed Guidelines note that the most persuasive evidence of anticompetitive effects is the presence of price increases or other changes – such as a reduction in output – in a consummated merger.² If direct evidence is not available – as it would not

be in a premerger investigation – the proposed Guidelines cite "natural experiments" as preferable methods of analysis.³ This change reflects current practice of the Agencies' staff, whereby they often examine effects of previous mergers in the relevant market or, in mergers involving localized markets, compare competitive conditions in various markets based upon the number of competitors in those markets. This technique was used in *FTC v. Whole Foods*, in which the FTC cited evidence of aggressive price competition between the merging parties in local markets where they competed head-to-head, and in *FTC v. Staples*, in which the FTC compared prices in markets with three office superstore chains to markets that had only two chains.⁴ After the discussion of natural experiments, Section 2 contains brief descriptions of the importance of market concentration, head-to-head competition, and the presence of "maverick" firms in the relevant market, which largely track the discussion of these types of evidence in the 1992 Guidelines.⁵

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Finally, Section 2 contains a discussion of the reliability of various sources of evidence. Consistent with the experience of practitioners, the proposed Guidelines state that much of the evidence that is persuasive to the Agencies' staff originates with the merging parties themselves, and that the Agencies tend to place greatest weight on documents that were generated in the ordinary course of business rather than specifically for the merger.⁶ The Guidelines also explain that evidence from customers of the merging parties is helpful to anticipate how the market would react to a "small but significant and nontransitory increase in price."⁷ Finally, the Guidelines set forth the long-understood reality that, while information from competitors is helpful to assessing market conditions, the Agencies place little weight on their overall views of a merger.⁸ After all, if a merger were going to lead to increased prices, one would hardly expect competitors to complain!

Enhanced Discussion of Unilateral Effects

Many practitioners believed that the 1992 Guidelines did not adequately capture the analytical robustness that is required to appropriately assess unilateral effects—*i.e.*, effects on competition that the merged firm can cause by itself. Thus, the proposed Guidelines' enhanced discussion of unilateral effects was among the most anticipated revisions to the Guidelines.

Just as in the 1992 Guidelines, the proposed Guidelines state that unilateral effects "are greater, the more the buyers of products sold by one merging firm consider products sold by the other merging firm to be their next choice."⁹ But unlike the previous Guidelines, the proposed revisions provide a substantial amount of detail on how the Agencies go about making this judgment. For example, the proposed Guidelines clarify the types of evidence that are persuasive to Agency staff in assessing unilateral effects, such as customer-switching reports, customer surveys, and win/loss reports.¹⁰ In addition, the proposed Guidelines now explicitly acknowledge the role of merger simulations in assessing competitive effects. Once again, this does not represent a change in policy but rather an acknowledgment of the value of these predictive models that were often used by practitioners before the Agencies to quantify the likely price effects (or lack thereof) of potential mergers. In keeping with the proposed Guidelines' focus on effects rather than structure, the proposed Guidelines state that merger simulations need not be dependent on relevant market definition.¹¹

The proposed Guidelines' discussion of unilateral effects contains two entirely new sections relating to innovation competition and markets characterized by bargaining or auctions. Regarding innovation competition, the proposed Guidelines state that the Agencies will be most concerned with mergers that either eliminate a competitor that was an aggressive innovator or that combine two firms that previously had demonstrated the

strongest capabilities to innovate.¹² At the same time, proposed revisions recognize that a merger may enhance the parties' ability to innovate and that this enhanced potential may be considered along with other potential efficiencies arising from the merger.¹³ Regarding bargaining and auction markets, the proposed Guidelines state that anticompetitive effects are expected to be greatest when the merging parties frequently represented the winner and runner-up in auctions or requests for proposals, and that these effects are magnified when the merging parties have a distinct advantage over rivals in their ability to serve customers.¹⁴ Once again, these revisions do not set forth a new direction in policy but rather echo the Agencies' current view of bargaining and auction markets.

Minor Revisions to Market Definition

Compared with the proposed Guidelines' overhauls in some areas, the changes that were made to the Guidelines' discussion of market definition are relatively minor. The proposed Guidelines leave intact the hallmark of market definition—the "SSNIP test"—which defines markets by attempting to predict whether customers would switch their purposes away from a hypothetical monopolist in response to a "small but significant and nontransitory increase in price."¹⁵ The proposed revisions make a minor adjustment to the SSNIP test, defining a SSNIP as a hypothetical price increase of 10% as opposed to 5-10% under the 1992 Guidelines.¹⁶ This signals a possible willingness of the Agencies to recognize slightly larger markets than the 1992 Guidelines tolerated.

Aside from the tweak to the SSNIP test, the revised Guidelines reflect only clarifications of existing Agency practices. For example, the proposed Guidelines state that the Agencies may draw a relevant market around a particular type of customers if the firms in the relevant market are able to target that type of customer for price discrimination.¹⁷ This reflects the Agencies' longstanding tendency to challenge mergers when the staff believes that the merging parties can profitably increase prices or reduce product quality to a distinct group of customers. Notwithstanding the recognition of a merger's effect on a subgroup of customers, the proposed Guidelines make clear that the Agencies will not view sales to a single customer as a relevant market in and of itself, even if price-substitution data may suggest the existence of such a market.¹⁸

Finally, the proposed Guidelines acknowledge the usefulness in particular situations of "critical loss" analysis, by which one attempts to examine whether a postmerger price increase would be profitable for the merged firm, even if the firm would have the market power to sustain it.¹⁹ Similarly to the recognition of merger simulation, this section acknowledges a development that occurred since the adoption of the 1992 Guidelines.

Changes to Market Concentration Thresholds

Perhaps one of the most easily identifiable proposed revisions to the Guidelines occurs in the area of market concentration and specifically the Herfindahl-Hirschman Index ("HHI")²⁰ thresholds which the Agencies use to measure concentration in a market. Before the proposed Guidelines were released, it was widely anticipated that the HHI thresholds would increase to more accurately reflect the levels of concentration at which the Agencies actually challenged mergers. As shown below, the HHI thresholds increased significantly.²¹

	1992 Guidelines		Proposed Guidelines	
	HHI	Change in HHI	HHI	Change in HHI
Unconcentrated	< 1000	Less than 50 point change ordinarily requires no further analysis.	< 1500	Less than 50 point change ordinarily requires no further analysis.
Moderately Concentrated	1000 - 1800	Mergers that result in moderately concentrated markets and involve an HHI change of over 100 points potentially raise competitive concerns.	1500 - 2500	Mergers that result in moderately concentrated markets and involve an HHI change of over 100 points potentially raise competitive concerns.
Highly Concentrated	< 1800	Mergers that result in highly concentrated markets and increase HHI by 50-100 points may raise competitive concerns and those with HHI change of over 100 are presumed to likely enhance market power.	< 2500	Mergers that result in highly concentrated markets and increase HHI by 100-200 points may raise competitive concerns and those with HHI change of over 200 are presumed to likely enhance market power.

Although the threshold increases may seem dramatic, they are unlikely to affect the practice at the Agencies, in which the vast majority of mergers that resulted in enforcement decisions occurred in markets that had postmerger HHIs of 2400 or greater.²² Moreover, after setting out the new concentration thresholds, the proposed Guidelines stress the Agencies' attention to effects rather than structure by stating that the HHI thresholds are not intended to "provide a rigid screen to separate acceptable mergers from anticompetitive transactions," but rather provide "one way to identify" potentially harmful transactions.²³

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Acknowledging the Effect of Buyer Power on Competition

In response to some commentators who advocated for the Agencies to consider the effect of buyer power in mergers, the proposed Guidelines contain discussions of buyer power both as a potential basis for an enforcement action and as a potential check against the market power created by a merger. Viewing buyer power in a defensive sense—*i.e.*, examining the potential for buyer power to mitigate anticompetitive effects—is not new, as the 1992 Guidelines acknowledged the possibility that powerful buyers could lessen the likelihood of coordinated postmerger pricing by engaging in long-term contracts.²⁴ The proposed Guidelines expand on the defensive treatment of buyer power, however, by stating that the Agencies will examine the extent to which large buyers can alleviate the merging parties' market power by negotiating favorable purchase terms.²⁵ While the Agencies will consider such arguments, the proposed Guidelines note that the Agencies will not presume that buyer power alone ameliorates the effects of a merger because even powerful buyers can be harmed by a merger of rival suppliers.²⁶

For the first time, the proposed Guidelines also acknowledge the possibility of treating buyer power "offensively" by presenting the possibility of blocking a merger based on that likelihood that it will enhance buyers' market power. Section 12 of the proposed Guidelines notes that buyer-power concerns will be addressed in the same way as seller-side concerns by defining a relevant market and hypothesizing the effects that the merger will have in that market. The proposed Guidelines note, however, that the Agencies will attempt to distinguish between mergers that drive down prices based on buyer power versus those that reduce prices based on other factors, such as by reducing transaction costs.²⁷

Partial Acquisitions

In another section that did not appear in previous iterations of the Guidelines, the Agencies address their treatment of partial acquisition in Section 13 of the proposed Guidelines. Because the proscriptions of Section 7 of the Clayton Act apply to acquisitions of the "whole or any part of" the stock or assets of another, the proposed Guidelines state that the Agencies will review even acquisitions of minority interests in competitors, even if the acquisition does not completely eliminate competition between the two firms.²⁸ The proposed Guidelines note that partial acquisitions can affect competition by altering the competitive incentives of competitors. The proposed Guidelines list several examples of how a firm can harm competition through a partial acquisition, such as by acquiring special governance rights in the target, gaining the right to appoint members to a board of directors, gaining access to nonpublic information, or more

generally gaining "influence [over] the conduct of the target firm." Although the proposed Guidelines' specific treatment of partial acquisitions is new, the Agencies have successfully challenged partial acquisitions in the past, most recently with the Justice Department's victory before the Sixth Circuit in its challenge to the acquisition of Southern Belle Dairy by Dairy Farmers of America.²⁹

Unaltered Sections of the Guidelines

Although several sections of the proposed Guidelines are either revised or entirely new, some aspects remained the same despite calls for change. For instance, the proposed Guidelines maintain essentially the same efficiencies defense that was incorporated into the current Guidelines in 1997. Under this framework, the Agencies acknowledge that mergers can create efficiencies but, for antitrust purposes, they consider only those efficiencies that are likely to be accomplished and are merger-specific.³⁰ Moreover, both before and after the proposed revisions, the Agencies require that efficiencies be "cognizable," in that they do not arise from aspects of the merger that harm competition and are verified by documents generated in the ordinary course of business. The proposed Guidelines do, however, add a cautionary word, which reflects current practice before the Agencies, that efficiency projections will be viewed skeptically when they are generated outside of the ordinary course of business.³¹

Similarly, especially in light of the recent economic downturn, some commentators expected the proposed Guidelines to expand the "failing firm" defense. The drafters of the proposed Guidelines did not accept this invitation, and kept the new document to the same standard as the current Guidelines.³² Under this standard, a "failing firm" can justify an otherwise anticompetitive merger only if three conditions are met: (i) the failing firm would be unable to meet its financial obligations in the future; (ii) the firm would not be able to successfully reorganize in bankruptcy under Chapter 11; and (iii) it has made "unsuccessful good faith efforts" to sell to an acquirer whose acquisition would be pose a smaller likelihood of harm to competition.³³

Conclusion

While the horizontal merger guidelines have never superseded Section 7 of the Clayton Act as the "law of the land" on merger analysis, they are important for understanding the analytical process at the Antitrust Agencies, which have the primary role in implementing day-to-day merger policy. The proposed revisions to the Guidelines are significant in that they more closely reflect the realities of how the agency staff evaluate proposed mergers. Thus, even though the proposed Guidelines do not bring about

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fundamental change in merger review, the revisions improve the functionality of the Guidelines as a tool for companies contemplating mergers or acquisitions.

1 Press Release, FTC, Federal Trade Commission Seeks Views on Proposed Update of the Horizontal Merger Guidelines (Apr. 20, 2010), available at <http://www.ftc.gov/opa/2010/04/hmg.shtm>.

2 Antitrust Div., U.S. Dept. of Justice & FTC, Horizontal Merger Guidelines: For Public Comment § 2 (Apr. 20, 2010, available at <http://www.ftc.gov/os/2010/04/100420hmg.pdf> ("Proposed Guidelines").

3 *Id.*

4 Compl. ¶¶ 36-42, *FTC v. Whole Foods Market, Inc.*, No. 1:07-cv-01021 (D.D.C. Jun. 6, 2007); *FTC v. Staples, Inc.*, 970 F.Supp. 1066, 1075-76 (D.D.C. 1997).

5 Proposed Guidelines, § 2.

6 *Id.*

7 *Id.*

8 *Id.*

9 *Id.* § 6.1.

10 *Id.* § 6.

11 *Id.* § 6.1.

12 Proposed Guidelines §§ 6.2, 6.4.

13 *Id.* § 6.4.

14 *Id.* § 6.2.

15 *Id.* § 4.1.1.

16 *Id.*; Antitrust Div., U.S. Dept. of Justice & FTC, Horizontal Merger Guidelines § 1.1.1 (revised Apr. 8, 1997) ("1992 Guidelines").

17 Proposed Guidelines § 4.1.4.

18 *Id.*

19 *Id.*

20 The HHI is computed by summing the squares of the market shares of the participants in the relevant market. For example, a market with 10 firms, each with 10% market shares would have an HHI of 1000 ($10^2 = 100$; $100 \times 10 = 1000$) whereas a market with four firms with 25% market shares would be 2500 ($25^2 = 625$; $625 \times 4 = 2500$). See Proposed Guidelines § 5.3 & n.8.

21 Proposed Guidelines § 5.3; 1992 Guidelines § 1.5.1.

22 FTC, Horizontal Merger Investigation Data, Fiscal Years 1996-2005 at Table 3.2 (displaying merger enforcement statistics by HHI at the FTC between 1996 and 2005), available at <http://www.ftc.gov/os/2007/01/P035603horizmergerinvestigationdata1996-2005.pdf>.

23 Proposed Guidelines § 5.3.

24 1992 Guidelines § 2.12.

25 Proposed Guidelines § 8.

26 *Id.* § 8.

27 *Id.* § 12.

28 15 U.S.C. § 18; Proposed Guidelines § 13.

29 *United States v. Dairy Farmers of Am.*, 426 F.3d 850 (6th Cir. 2005).

30 Proposed Guidelines § 10; 1992 Guidelines § 4.

31 Proposed Guidelines § 10.

32 Proposed Guidelines § 11.

33 *Id.*



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