

WSGR ALERT

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DOJ AND FTC RELEASE PROPOSED REVISIONS TO HORIZONTAL MERGER GUIDELINES

On April 20, 2010, the Department of Justice (DOJ) and Federal Trade Commission (FTC, and collectively, the agencies) published for public comment a comprehensive revision of the Horizontal Merger Guidelines. The current version of the guidelines was issued by the agencies in 1992 and last revised in 1997.²

In releasing the proposed guidelines, FTC Chairman Jon Leibowitz noted that it had been "[e]ighteen years . . . since the Horizontal Merger Guidelines were revised. During that time the Agencies' approach has evolved significantly, and the Guidelines should reflect that." According to the agencies, "[t]he proposed Guidelines . . . reflect the current state of merger analysis at the FTC [and DOJ], and will help make the process more transparent to American businesses and courts."³

The proposed guidelines will not have the force of substantive law, but the agencies hope that the changes will influence how courts decide merger cases. The revisions provide a greater level of detail about the "principal analytical techniques, practices, and . . . enforcement policy" underlying the process of merger analysis conducted by the agencies.⁴ They also adopt a more flexible approach to merger analysis, recognizing that such analysis "does not consist of uniform

application of a single methodology," but rather is "a fact-specific process through which the Agencies . . . apply a range of analytical tools to the reasonably available and reliable evidence to evaluate competitive concerns in a limited period of time."⁵ To aid in the pursuit of greater transparency with regard to this process, the guidelines provide examples of specific conduct that the agencies may consider anticompetitive in nature.

The salient features of the proposed guidelines are summarized below (with the relevant section in parenthesis):

Evidence of Adverse Competitive Effects (Section 2). The proposed guidelines begin with a new section titled "Evidence of Adverse Competitive Effects," which discusses various categories and sources of evidence the agencies have found to be the most informative in predicting the likely competitive effects of mergers. The language downplays the current guidelines' focus on market shares and concentration, and recognizes that market definition is an inherently flawed tool. While market definition can provide a useful measure of anticompetitive effect, the proposed guidelines emphasize that it should not be viewed as an end itself or as a necessary starting point of merger analysis.

In addition to market definition, the proposed guidelines note that a comprehensive merger analysis must utilize alternative mechanisms to assess anticompetitive effects. These include: merger simulation models, economic tests of upward pricing pressure, the use of win/loss data, whether the merging parties have been head-to-head competitors in the past, whether the merger would eliminate a "maverick," and historical "natural experiments." The agencies will look for reliable evidence from the merging parties themselves (significantly, the proposed guidelines state that ordinary course documents "are more probative than documents created as advocacy materials in merger review"), customers, and other industry participants and observers.

Price Discrimination (Section 3). Whereas the current guidelines examine the effects of price discrimination insofar as it relates to market definition, the proposed guidelines expand on the notion that merged firms can impose price increases on certain customers. In situations where a seller selectively increases prices for a defined set of customers and discrimination is reasonably likely, the agencies may evaluate competitive effects separately by type of customer. For price discrimination to be feasible, the guidelines indicate that two conditions typically must be met: differential pricing (the

¹ U.S. Department of Justice & Federal Trade Commission, Horizontal Merger Guidelines (released for public comment April 20, 2010), available at <http://www.ftc.gov/os/2010/04/100420hmg.pdf> [hereinafter proposed guidelines].

² U.S. Department of Justice & Federal Trade Commission, 1992 Horizontal Merger Guidelines (revised April 8, 1997), available at <http://www.ftc.gov/bc/docs/hmg080617.pdf>.

³ Press Release, Federal Trade Commission, "Federal Trade Commission Seeks Views on Proposed Update of the Horizontal Merger Guidelines" (April 20, 2010), available at <http://www.ftc.gov/opa/2010/04/hmg.shtm>.

⁴ Proposed guidelines at 1.

⁵ *Id.*

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ability of the seller to identify and target certain customers) and limited arbitrage (the inability of targeted customers to purchase indirectly from or through other customers such that a seller's price increase would be defeated).

Hypothetical Monopolist Test (Section 4.1.1).

Under the proposed guidelines, the hypothetical monopolist test will continue to be the primary market-definition principle to define relevant antitrust markets. The proposed guidelines clarify the hypothetical monopolist test, and explain how the agencies implement that test in practice. In addition to focusing on whether a hypothetical monopolist could profitably impose a small but significant increase in price to assess the relevant market, the agencies also will analyze the closeness of competition among potential substitutes. Where there are differentiated products or the potential for price discrimination, these revisions may encourage very narrow market definitions.

Herfindahl-Hirschman Index (Section 5.3).

The Herfindahl-Hirschman Index (HHI) thresholds have been upwardly revised. The proposed guidelines raise the HHI for an unconcentrated market from 1000 to 1500, and for a highly concentrated market from 1800 to 2500. Mergers in unconcentrated markets and mergers in more concentrated markets that increase the HHI by less than 100 points are unlikely to have adverse competitive effects and ordinarily require no further analysis. Meanwhile, mergers in highly concentrated markets that increase the HHI by more than 200 points are likely to enhance market power. Although high levels of concentration do raise concerns, presumptions of competitive effects can be rebutted by persuasive evidence showing that the merger is unlikely to enhance market power. Instead of asserting fixed criteria, the thresholds propose general guidelines; mergers with high HHIs will be subject to further agency scrutiny rather than automatic challenge.

Unilateral Effects (Section 6). The proposed guidelines expand the discussion of unilateral-effects analysis in mergers involving differentiated products. They formally introduce certain methods for evaluating price effects (such as upward pricing pressure and diversion ratios), including in bargaining and auction situations where buyers can play competing sellers off one another. In contrast to the current guidelines, they do not contain the presumption that harmful unilateral effects would not arise if the merging parties have a combined market share below 35 percent.

While the current guidelines note that sellers with market power could lessen competition through decreased innovation, this revised section in the proposed guidelines explicitly spells out the agencies' concern that merged firms often may face decreased incentives to sustain their innovative efforts at the level that would prevail in the absence of a merger, and thus, once merged, firms may curtail product development efforts or cease the development of certain new products altogether. To ensure continued competition, the agencies will evaluate such factors as (1) the existence of current efforts, or the capability to conduct future efforts, to develop new products; (2) whether the merger combines two of a very small number of firms that have the ability to successfully innovate; (3) the extent to which successful innovation by one merging firm is likely to take sales from the other; and (4) whether a merger is likely to reduce incentives to innovate post-merger or enable innovation that would not otherwise take place. The agencies also will consider the effect of a merger on product variety and whether a merged firm would have an incentive to cease offering one of the relevant products sold by the merging parties (and if so, whether the reduction in variety is ultimately bad for consumers).

Coordinated Effects (Section 7). The proposed guidelines employ a more flexible approach to assessing theories of potential harm resulting from coordinated conduct. If

markets are sufficiently concentrated, the agencies will be concerned even with a range of conduct not otherwise condemned by the antitrust laws if there exist factors that make a market "vulnerable" to coordinated effects. This may be the case even in situations in which each rival's response to competitive moves made by others is individually rational, and not motivated by retaliation or deterrence, if such responses embolden price increases and weaken competitive incentives to reduce prices or offer customers better terms.

Entry (Section 9). According to the proposed guidelines, entry can alleviate concerns about adverse competitive effects only when it can successfully "deter" or "counteract" harmful effects such as post-merger price increases. Rather than hypothesize about the potential for entry, the agencies will place more emphasis on the actual history of entry (a lack of successful and effective entry tends to suggest that entry is slow or difficult) and focus on identifiable firms that have sufficient assets and incentives to enter (based on "reliable evidence"). Further, reference to a two-year standard for "timely" entry into the market to prevent the enhancement of market power by a merged firm is omitted from the proposed guidelines. Instead of providing a specific timeframe, the proposed guidelines note that in order to deter anticompetitive effects, "entry must be rapid enough to make unprofitable overall the actions leading to those effects and to entry, even though those actions would be profitable until entry takes effect," or "be rapid enough that customers are not significantly harmed by the merger, despite any anticompetitive harm that occurs prior to the entry."⁶ The proposed guidelines no longer reference "minimum viable scale" in the analysis of the likelihood of entry, and in terms of sufficiency, the proposed guidelines indicate that the agencies will seek reliable evidence that entry will replicate at least the scale and strength of one of the merging firms.

⁶ *Id.* at 28.

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Efficiencies (Section 10). The proposed guidelines still recognize the benefits of valid efficiencies and that the agencies will credit only “merger specific efficiencies.” However, two significant changes have been made to the efficiencies section of the current guidelines. First, efficiency claims that are supported by analogous past experiences are the most likely to be accepted. Second, the notion that mergers can have the effect of creating cognizable efficiencies in innovation is now acknowledged. That is, when evaluating efficiencies claims in innovation markets, the agencies will credit efficiencies that spur innovation, even where the efficiencies do not affect the merged firm's short-term pricing.

Added Sections. In addition to the added section regarding adverse competitive effects, referenced above, the proposed guidelines also introduce new sections on several other topics.

- **Section 8.** The agencies will consider the ability of powerful buyers to constrain post-merger price increases. However, the existence of powerful buyers is not a shield—even powerful buyers that can negotiate favorable terms may be harmed by an increase in market power, and even if some buyers can protect themselves, such an increase can still work to the detriment of other buyers.
- **Section 12.** This new section reflects the agencies' concerns about the creation of monopsony power as the result of mergers of competing buyers. If such mergers are likely to lessen competition on the buying side of the market (i.e., harm to suppliers of the merged firm), an enforcement action is likely even if there are no anticompetitive effects on the selling side (i.e., harm to customers of the merged firm).
- **Section 13.** The proposed guidelines also include a new section that addresses “partial acquisitions,” in which a firm acquires a minority stake in one or more competitors. Since the 1992 guidelines were published, the agencies have brought several enforcement actions against acquisitions of minority interests. The proposed guidelines lay out three factors to determine the extent of competitive harm from partial mergers: (1) the ability of the acquiring firm to influence the target's competitive conduct, (2) a reduction in the acquiring firms' incentives to compete (because it shares in the target's profits via its ownership interest), and (3) access by the acquiring firm to the target's competitively sensitive information.

Practical Effects of Revisions on Merging Parties. Rather than set forth a radically different paradigm for merger analysis, the proposed guidelines simply reflect the current state of the agencies' existing merger-review policy and practices, and provide a greater level of detail regarding the types of evidence and theories the agencies use to predict competitive effects. In fact, most of the changes outlined in the proposed guidelines have been incorporated into the merger-analysis process during the past several years. However, it remains to be seen whether the proposed guidelines will offer more transparency and clarity for the market, which was a stated goal of the agencies. Moreover, the language and tone of the proposed guidelines, along with a number of specific changes made, suggest that the agencies may challenge mergers that would not have received close scrutiny in the past. This position reflects the pro-enforcement perspective of the Obama administration and likely will produce an increase not only in the number of investigations, but also in the length of those investigations and cases ultimately litigated.

For more information or any questions regarding the current or proposed Horizontal Merger Guidelines, please contact Scott Sher, Charles Biggio, Renata Hesse, or any other member of Wilson Sonsini Goodrich & Rosati's antitrust practice.



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