April 26, 2010

U.S. Antitrust Agencies Propose Significant Revisions to Merger Enforcement Guidelines

By David L. Meyer and Jeffrey A. Jaeckel

On April 20, 2010, the U.S. Federal Trade Commission and Department of Justice Antitrust Division released for public comment an entirely new version of the Horizontal Merger Guidelines[1] reflecting very substantial proposed changes to the current version, which was issued in 1992 and modestly revised in 1997.

The proposed revisions to the Guidelines signal a desire and intention by the Agencies to carry out relatively more active antitrust enforcement than in recent years, and the proposed Guidelines appear likely to further that goal. Thus, while the proposed Guidelines would improve transparency in enforcement by more accurately reflecting the kinds of issues and evidence that might lead the Agencies to find a competitive problem in a merger or acquisition, they also would revise the Guidelines in many ways that may make it easier for the FTC and DOJ to find a potential competitive problem than would be possible under the framework set forth in the existing Guidelines.

The Guidelines are designed to describe the basic analytical framework the FTC and DOJ ("the Agencies") use when they review mergers and acquisitions involving competitors. The current version of the Guidelines has also been quite influential in shaping the way courts analyze whether a particular transaction violates Section 7 of the Clayton Act.

The purpose of the proposed revisions to the Guidelines is two-fold:

1. The proposed revisions update the analytical framework to reflect the evolution over the past eighteen years in the way the Agencies actually conduct their review of horizontal mergers. In this regard, they incorporate many of the concepts discussed in the Agencies' 2006 Commentary on the Horizontal Merger Guidelines. Agency leaders have taken great pains to say that the goal of the proposed new Guidelines is to further "transparency," in the sense of more accurately describing how merger analysis is actually undertaken by the Agencies.

2. The proposed revisions also appear designed to further the objective of more active antitrust enforcement by setting forth an analytical framework that allows Agency staffs vastly more flexibility in their quest to identify anticompetitive concerns, and describing that framework in a way that may facilitate challenges in court in the event the Agencies conclude that anticompetitive harm is likely.

Consequently, although the new Guidelines do not reflect a sea change in how the Agencies will evaluate any particular transaction, they do signal a desire and intention by the Agencies to carry out relatively more active antitrust enforcement than in recent years.

BACKGROUND

[1] The proposed revisions to the Horizontal Merger Guidelines are available online at http://www.ftc.gov/bc/workshops/hmg/index.shtml.

The current Guidelines date back to 1992, and were the first jointly issued statement of the FTC and DOJ regarding merger enforcement policy and legal analysis. The discussion of efficiencies in the 1992 Guidelines was updated in 1997, but the 1992 Guidelines otherwise have been untouched for eighteen years. In 2006, the Agencies issued a "Commentary" on the 1992 Guidelines describing how the Guidelines had been applied in practice.

The Guidelines have always purported to describe the analytical process the FTC and DOJ use internally to review combinations of horizontal competitors for potential anticompetitive effects. Over time, other audiences – including the courts, state antitrust enforcers, and competition authorities in other countries – also came to accept the Guidelines as persuasive authority regarding the legal requirements for demonstrating that a transaction was likely to substantially lessen competition.

The proposed revisions to the Guidelines are one of the most notable accomplishments of the antitrust team appointed by President Obama in 2009. FTC Chairman Liebowitz and Assistant Attorney General Varney openly discussed during their confirmation hearings the possibility of updating the Guidelines, and those early thoughts led to a series of public hearings on the Guidelines jointly hosted over the past five months by the FTC and DOJ.

PROPOSED REVISIONS PROVIDE FTC & DOJ WITH GREATER FLEXIBILITY

The proposed revisions would change the Guidelines in two major ways.

First, and most fundamentally, the proposed revisions describe an analytical process that is far more flexible than that outlined in the 1992 version. They outline a wide variety of ways in which the Agencies might reach the conclusion that a transaction is likely to harm competition and consumers, including approaches that dispense entirely with the need to define a relevant market, calculate market shares, and measure market concentration, all of which appeared to be preconditions to any finding of anticompetitive harm under the 1992 Guidelines, and which many courts had adopted as a requirement for proof of a violation.

Second, the proposed revisions would significantly alter the manner in which the Agencies address specific issues in the analytical process, such as how markets are defined, the kinds of evidence potentially used to identify the likelihood of anticompetitive harm, the manner in which unilateral and coordinated effects are analyzed, how the potential for entry is considered, and the role of efficiencies in merger analysis. Many of these proposed revisions are significant, and virtually all of them would make it easier for the Agencies to perceive a potential competitive problem than the framework set forth in the existing Guidelines.

The proposed revisions to the Guidelines would mark a significant change from the existing Guidelines in each of the following aspects of merger analysis:

- ***Market Definition*** – The proposed revision would do away with market definition as either a necessary first step in the analysis or a prerequisite to undertaking competitive effects analysis. The proposed Guidelines take the position that defining a relevant market – among the issues that have given the Agencies the most difficulty in litigated enforcement actions – would no be longer be necessary, especially in unilateral effects cases.

  On the other hand, the Agencies have preserved the potential for presuming anticompetitive effects when a transaction significantly increases concentration in a relevant market, and thus continue to address how markets will be defined. In that regard, however, the proposed Guidelines emphasize several points that would favor defining markets in which competitive harm is relatively more likely. They also emphasize that markets might be defined around a narrow group of targeted customers, perhaps even individual customers when prices are negotiated individually with customers. They emphasize that relevant markets "need not have precise metes and bounds," may not correspond with how industry members use the term "market," and may well exclude some substitutes to which some customers would turn in the face of a price increase.

- ***Unilateral Effects Analysis*** – The proposed revisions revamp the Guidelines analysis of potential unilateral effects, emphasizing that such analysis need not rely on market definition or calculation of markets shares and concentration. Instead, the proposed Guidelines emphasize various means of assessing whether the products of the merging firms are particularly close substitutes. Among these techniques is a mathematical analysis of the merging firms' incentives to raise prices based on their margins and diversion ratios. This analytical technique will often lead to the conclusion that a proposed merger is likely to result in increased prices when margins are high and there is some degree of substitutability between the differentiated products of the merging firms.

- ***Coordinated Effects Analysis*** – The Guidelines also thoroughly revise the discussion of how the Agencies will assess whether a transaction is likely to lead to anticompetitive coordination. The new emphasis is on whether a market is "vulnerable" to coordinated conduct, in which case anticompetitive effects will be presumed to flow from a significant increase in concentration if the Agencies have any theory they "deem plausible" of how the merger would make coordination more likely.

- ***Non-Price Effects*** – The proposed revisions expressly recognize for the first time that transactions may have non-price effects that would be regarded as anticompetitive. In particular, the Agencies point to potential reductions in innovation and product variety as harms that might warrant blocking a transaction.

- ***Entry and Repositioning*** – The proposed Guidelines continue to recognize that entry of new competitors – or repositioning by existing participants – may prevent or overcome anticompetitive effects of a transaction, but the proposed revisions demand a higher degree of proof that such supply responses are likely and would be sufficient (both in terms of timeliness and scale) to replace the lost competition.

- ***Effects of Buyer Power*** – The proposed revisions contain a new section that describes for the first time how the Agencies will evaluate whether large, powerful buyers might prevent the merging parties from raising prices. The proposed Guidelines allude to the potential that the negotiating leverage of large purchasers might serve as a bulwark against anticompetitive behavior, but they emphasize that even in such cases mergers might cause harm – to large customers whose bargaining leverage is reduced and to smaller customers who lack sufficient leverage to protect themselves.

- ***Role of Efficiencies*** – The proposed revisions would retain the potential that efficiencies generated by a transaction might prevent or overcome potential anticompetitive harms but in several respects appear to make it less likely that the parties could advance a successful efficiencies defense. The proposed Guidelines, for example, emphasize the potential need for efficiencies to be "passed through to consumers" and underscore that the antitrust laws give "competition, not internal operational efficiency primacy, in protecting consumers."

- ***Harms from Partial Acquisitions*** – The proposed revisions contain an entirely new section explaining how the Agencies evaluate potential anticompetitive effects from partial acquisitions. The analysis is consistent with how the Agencies have been examining such transactions, but notably contains no reference to any percentage-based or other safe harbor where anticompetitive harms are deemed sufficiently unlikely to avoid the need to conduct a full analysis of the competitive effects of transactions that bring together minority investments in competing firms.

As these changes illustrate, the proposed revisions to the Guidelines would make explicit that the Agencies' evaluation of the potential competitive effects of transactions is more flexible and more creative than that set forth in the 1992 Guidelines. In one sense, these revisions would provide guidance to parties that more accurately reflects the kinds of issues and evidence that might lead the Agencies to conclude there is a competitive problem. But by leaving on the table every conceivable theory of competitive harm, and preserving for the Agencies every available source of evidence and analytical technique that might identify such harm, these Guidelines will likely call upon parties to carry out more sophisticated up-front assessments of the enforcement risks – informed by the same sort of analysis the Agencies are likely to perform – before proceeding with their proposed transaction.

By expanding Agency discretion, these Guidelines no doubt will make it harder for the parties to cite the Guidelines against the Agencies in contested litigation. At the same time, however, the Agencies may find that elimination of any readily apparent limits on Agency discretion will also cause courts to be less inclined to give these Guidelines affirmative persuasive force when they apply Section 7 precedent. It may take a number of years before the full impact of the proposed structural changes becomes clear.

The FTC is accepting comments on the proposed revisions until May 20. Please contact Morrison & Foerster LLP's antitrust practice if you have any questions about the proposed Guidelines or would like assistance in submitting comments to the FTC.

About Morrison & Foerster:

We are Morrison & Foerster—a global firm of exceptional credentials in many areas. Our clients include some of the largest financial institutions, Fortune 100 companies, investment banks and technology and life science companies. Our clients count on us for innovative and business-minded solutions. Our commitment to serving client needs has resulted in enduring relationships and a record of high achievement. For the last six years, we've been included on *The American Lawyer*'s A-List. *Fortune* named us one of the "100 Best Companies to Work For." We are among the leaders in the profession for our longstanding commitment to pro bono work. Our lawyers share a commitment to achieving results for our clients, while preserving the differences that make us stronger. This is MoFo. Visit us at www.mofo.com.

Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations.