United States Department of Justice and Federal Trade Commission Issue Revised Horizontal Merger Guidelines

On August 19, 2010, the Antitrust Division of the U.S. Department of Justice ("DOJ") and the Federal Trade Commission ("FTC") jointly issued the first major revision to the Horizontal Merger Guidelines (the "Guidelines") in 18 years. The Guidelines provide the analytical framework and describe the types of evidence used by the antitrust agencies to evaluate the likely competitive impact of mergers, acquisitions, and partial acquisitions. While the Guidelines provide a statement of the rationale for deciding whether a transaction should be challenged under Section 7 of the Clayton Act or other relevant statutory provisions, they recognize that antitrust cases are so fact-specific that no publication could adequately provide an exhaustive list of the decision-making parameters.

The revised Guidelines are organized significantly differently from preceding versions. To experienced practitioners, however, the revisions reflect much of current-day practice at the agencies. The revised Guidelines were issued jointly by the DOJ and the FTC, following a unanimous vote of the FTC Commissioners. However, Commissioner Rosch released a separate statement expressing his disappointment on several points. Among other things, he criticized the revisions for over-emphasizing economic models and minimizing non-price factors such as innovation, product quality, and product variety; in his opinion, the revised Guidelines do not provide an accurate description of the agencies' analysis.

Highlights of the Revisions

Competitive effects

The revised Guidelines place greater emphasis on the potential anticompetitive effects of a proposed transaction. Under the revised Guidelines, the agencies will contemplate adverse competitive effects first, before looking at market definition and market shares. In contrast, the 1992 Guidelines considered market definition and market shares first, and then considered competitive effects only if the Herfindahl-Hirschman Index ("HHI") and the change in the HHI exceeded certain thresholds.

Market definition

Once a "potential competitive concern" is identified, the agencies will turn to defining the markets, to determine who the market participants are, and to calculate market shares and concentration levels. The "hypothetical monopolist test" remains largely intact as a tool to determine which products are reasonably interchangeable and therefore are part of the relevant market. However, the revised Guidelines suggest an alternative method of defining markets based on "critical loss analysis," which could lead to defining very narrow markets, especially where the merging firms have high margins.

Unilateral effects

The revised Guidelines contain significant and somewhat controversial modifications to the analysis of whether a proposed transaction would enable the merged company to unilaterally raise prices. They eliminate the market share presumption of the 1992 Guidelines, which provided that a merger resulting in a market share of less than 35 percent was largely exempt from unilateral effects analysis. Instead, the revised Guidelines state that the agencies may rely on "any reasonably available and reliable information to evaluate the extent of direct competition" between the merging firms. Under the revised Guidelines, the agencies may seek to quantify the amount of direct competition between the merging firms by calculating diversion ratios (the sales lost by one merging firm to the other as a result of a price increase) and may construct economic models designed to predict unilateral price effects resulting from the merger. The problem with these models is that, unless they take into account efficiencies created by the merger, new entry, and/or repositioning by existing competitors, they will always show that a merger will cause a price increase. The revised Guidelines do not provide any details about how these models may be used, which raises questions whether there will be an increase in merger enforcement activity.

Entry

The effect of new entry is a critical component of merger analysis, but the revised Guidelines provide less, rather than more, guidance as to the time within which entry must occur in order to be considered timely enough to save a merger from challenge. Under the old Guidelines, as a general (but admittedly not hard-and-fast) rule, if parties could show that a new competitor would likely enter within two years of a merger, the agencies were unlikely to challenge the transaction. This two-year time frame has been eliminated under the revised Guidelines, which instead merely state that "entry must be rapid enough to make unprofitable overall the actions causing ... [anticompetitive] effects."

Presumptions based on HHIs

The revised Guidelines update the thresholds that determine whether a transaction warrants further scrutiny by the agencies. The HHI measures for market concentration have been raised in order to be more consistent with current agency practice: markets with HHIs below 1500 (formerly 1000) are considered relatively unconcentrated; those with HHIs between 1500 and 2500 (formerly between 1000 and 1800) are considered moderately concentrated; and those with HHIs above 2500 (formerly 1800) are considered highly concentrated. Mergers resulting in unconcentrated markets or which raise the HHI by less than 100 points "are unlikely to have adverse competitive effects." Mergers resulting in moderately concentrated markets that raise the HHI by more than 100 points "potentially raise significant competitive concerns." Finally, mergers resulting in highly concentrated markets that increase the HHI by between 100 and 200 points "raise significant competitive concerns," and mergers resulting in highly concentrated markets that increase the HHI by more than 200 points "will be presumed to be likely to enhance market power."

Prospective nature of merger enforcement

The revisions emphasize the prospective nature of merger enforcement in a manner intended to be helpful to the agencies in cases brought before the courts. Specifically, the revised Guidelines emphasize that merger enforcement is, by statute, forward-looking, which dictates a consequent lack of precision:

> "[M]erger analysis is necessarily predictive, requiring an assessment of what will likely happen if a merger proceeds as compared to what will likely happen if it does not" and therefore, "certainty about anticompetitive effect is seldom possible and not required for a merger to be illegal."

This is a reaction to several federal court decisions that have gone against the government and cited the then-existing Guidelines as a rationale for requiring more definitive proof of competitive harm.

Customer testimony

The revised Guidelines also emphasize the importance and reliability of information from customers. This, again, is an outgrowth of court decisions that, in the agencies' view, failed to give customer testimony adequate weight. Although recognizing that customers may oppose, or favor, a merger for reasons unrelated to the antitrust issues raised by that merger, the revised Guidelines state that "conclusions of well-informed and sophisticated customers" are "highly relevant" because "customers typically feel the consequences of both competitively beneficial and competitively harmful mergers."

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A literal reading of the revised Guidelines suggests that the agencies are going to be more aggressive in challenging proposed mergers. However, a significant change in enforcement policy is unlikely, largely because courts are likely to thwart any effort to expand the case law, and the agencies do not like to bring losing cases. Rather, the revised Guidelines' emphasis on competitive effects and its explanation that merger analysis does not employ a single methodology, along with a number of other changes, will make it much more difficult for courts to cite the Guidelines against the agencies.

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