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The FTC and DOJ's Horizontal Guidelines Review Project: What Changes Might Be In Store for Merger Review?

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What Changes Might Be In Store for Merger Review?**

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I. INTRODUCTION

In September 2009, the Federal Trade Commission ("FTC") and Department of Justice's Antitrust Division ("DOJ") announced a project to review the Horizontal Merger Guidelines[2] and assess whether a revision to the Guidelines is warranted.[3] This project is part of a continuing attempt by the agencies over the last several years to be more transparent as to the procedures and analyses utilized to review mergers, as seen in the increasing use of closing statements in many mergers as well as the issuance of the *Commentaries on the Merger Guidelines* in 2006.[4]

In her speech introducing the review project, Assistant Attorney General Varney indicated that revisions to the Guidelines will be considered if the Guidelines do not fully reflect current practices by the agencies or reflect advances in research or best practices that have occurred in the 17 years since the last major revision of the Guidelines. Indicating the importance the agencies are placing on this process, key senior staff lawyers and economists are spearheading the project, including Molly Boast, Phil Weiser, and Carl Shapiro from DOJ and Rich Feinstein, Joe Farrell, and Howard Shelanski from the FTC.

II. PROCESS

As part of the project, the FTC and DOJ are actively soliciting input from outside the agencies. On September 22, the agencies released 20 questions regarding the Guidelines on which they were soliciting input. These questions are related to (among other topics): (1) whether clarification that the agencies do not use a rigid step-by-step approach would be useful; (2) the use of "direct evidence;" (3) market definition (both product and geographic); (4) use of shares and concentration in the review process; (5) unilateral effects analyses; (6) price discrimination; (7) the role of large buyers in merger review; (8) uncommitted versus committed entry; (9) analysis in dynamic markets and the impact of mergers on innovation; and (10) the types of efficiencies that are cognizable.

Written comments on these questions were due November 9, 2009 and the FTC received 44 written comments, the majority of which were from economists.[5]

In addition, the agencies are conducting a series of workshops discussing these questions, with two sessions in Washington, DC (in November and January), and one each in

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[2] *See* http://www.ftc.gov/bc/docs/horizmer.shtm.

[3] *See* http://www.ftc.gov/speeches/leibowitz/090922mergerguideleibowitzremarks.pdf and http://www.justice.gov/atr/public/speeches/250238.htm.

[4] *See* http://ftc.gov/os/2006/03/CommentaryontheHorizontalMergerGuidelinesMarch2006.pdf.

[5] *See* http://www.ftc.gov/os/comments/horizontalmergerguides/index.shtm. The author submitted comments and was part of the task force that drafted the ABA Antitrust Section comments.

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New York, Chicago, and Palo Alto (in December and January). The first workshop was webcast and transcripts of the other workshops are expected to be available.[6]

The agencies are also conferring with other jurisdictions as well as conducting an internal review. This review will include discussions with staff on how they perceive the Guidelines relative to the practices employed by the agencies.[7]

III. LIKELY KEY ISSUES

I discuss below what I believe will be some of the key issues in the Guidelines review process. Other issues such as large buyers, innovation, and efficiencies may also be important. However, I believe those issues will be less likely to drive whether the Guidelines will be revised but rather may be addressed if a revision is undertaken.

A. Market Definition

An important issue is likely to be whether the Guidelines discussion of market definition should be updated. In several recent challenges where a unilateral effects theory was posited, the agencies have had difficulties, particularly at the district court level, with market definition based on what appear to be, at least at first consideration, relatively narrow relevant markets. In addition, there has been much discussion and controversy over the theoretical underpinnings and application of critical loss analysis with regard to market definition. Price discrimination markets or theories are also frequently raised in merger investigations and were important components of the recent appeals court decision in the *Whole Foods* matter, yet the Guidelines provide only limited guidance as to how such analyses are conducted.

Thus it is possible that a clarification of the approach to market definition in general, and particularly with regard to cases involving potential unilateral effects cases, would be worthwhile. The agencies have stated that market definition will continue to be a part of merger review (contrary to the view of some that market definition may not be particularly relevant in at least some unilateral effects cases). Possible areas of further clarification might include: (1) what is the role of critical loss analysis and, in particular, how does one measure actual loss and what should one assume, if anything, about the relationship between critical loss and actual loss; (2) what is the role of market definition in unilateral effects cases and can one show localized effects even if the market is defined more broadly; and (3) under what circumstances are price discrimination markets appropriate?

Another key market definition issue relates to geographic markets. The current approach in the Guidelines is focused on the locations of the suppliers rather than the locations of customers. While this may be appropriate in some cases; in others, it is more or equally important to assess where the customers are located and what options they have. This is a likely area for clarification if the Guidelines are revised.

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[6] *See* http://htc-01.media.globix.net/COMP008760MOD1/ftc_web/FTCindex.html#Dec03_09 for a link to the webcast of the initial session.

[7] *See* http://www.justice.gov/atr/public/speeches/251858.htm.

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B. Market Share and Concentration Screens and Presumptions

The current Guidelines utilize HHI concentration screens as a starting point to the analysis. The Guidelines state that mergers that result in a post-merger HHI less than 1,000; less than 1,800 with a change less than 100; or greater than 1,800 with a change less than 50 typically require no further analysis. The Guidelines further state that mergers that result in post-merger HHIs less than 1,800 but with a change greater than 100 or greater than 1,800 with a change greater than 50 raise "significant" competitive concerns. In the latter case, if the change is greater than 100, there is a rebuttable presumption that the merger would create or enhance market power or facilitate its exercise. In addition, the unilateral effects section of the Guidelines indicates that where a differentiated products merger falls outside of the safe harbor of the HHI screens and the combined share is greater than 35 percent, the agencies will presume that the two companies' products are next-best substitutes for a significant number of customers, making unilateral effects more likely.[8]

However, it is well known that agency practice is not consistent with these screens. As shown in data released by the agencies, other than in the petroleum industry, mergers are generally never challenged with post-merger HHIs less than 1,800 or with a change less than 250.[9] Moreover, it is unclear whether HHI measures are particularly helpful in assessing the potential for unilateral effects and the practical relevance of the 35 percent screen (other than it provides some guidance to business in assessing the likelihood that unilateral effects will be argued).

It thus may be an important, albeit challenging, aspect of the review process that if the Guidelines are to be revised, the screens—or at least the wording—should be updated to be more reflective of actual agency practice. This would provide more transparency to practitioners (particularly those who only infrequently do merger analysis), business and importantly other agencies—both within the United States and abroad. It is not unusual, given the language, for those not familiar with the practice of the FTC and DOJ to assume that the 1,800 limits, for example, are stricter than is actually the case in practice.

C. Clarification on Unilateral Effects

Another key issue is likely to be the unilateral effects discussion. Prior to the 1992 Guidelines unilateral effects were not a significant part of merger analysis, but they have since become a very common (if not the more common) concern raised in merger review. There has clearly been much more learning and improvement in how unilateral effects analyses have been conducted in the last 17 years. Thus, some greater amplification in the Guidelines on unilateral effects may be worthwhile. As noted above, one important issue is the role of market definition in a unilateral effects case and how to assess the potential for localized effects within broader markets.

There may also be an opportunity to clarify the different types of unilateral effects theories and the types of evidence most relevant to them (particularly bidding models which are barely mentioned in the Guidelines). We often think about differentiated consumer products

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[8] *See* Guidelines at § 1.51 and 2.211.

[9] *See* http://www.ftc.gov/os/2007/01/P035603horizmergerinvestigationdata1996-2005.pdf and http://www.ftc.gov/os/2003/12/mdp.pdf.

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with an underlying Bertrand model in the context of unilateral effects but there are other theories that are also common—instances with idiosyncratic customer-by-customer competition or homogenous products where the combined firm would have a large share of production and/or capacity. In many cases, the agencies employ auction or "bid" models in the former case, yet such models are barely mentioned in the current Guidelines. More guidance with regard to these issues, including distinctions regarding the types of information that are most relevant, may be useful.

In addition, unilateral effects analyses in many cases involve the estimation of diversion ratios (particularly in consumer products matters but in other cases as well). In these cases, the agencies (and outside parties) attempt to estimate, under current market conditions, what fraction of sales that one of the parties would lose due to a price increase in its product would shift to the product of the other party. In fact, the two current chief economists at the agencies have advocated the use of an "upward pricing pressure" test as a screening tool in unilateral effects cases that employs estimates of diversion ratios and margins. In addition, in some cases the agencies and outside parties will use simulation models that employ the diversion ratios (among other things) to estimate the change in price due to the merger (although the impact of such models on enforcement decisions is unclear). It will be interesting to see if a revision to the Guidelines will clarify the role of diversion ratios (the types of evidence used to calculate them and how they factor into the assessment of unilateral effects) as well as the use of simulation models. Given the technical nature of the latter, it is unclear whether such models would be mentioned in the Guidelines other than perhaps at a very high level.

D. Use of Direct Evidence

The review project also asks whether the Guidelines should clarify the use of direct evidence. Exactly what the agencies mean by direct evidence versus other types of evidence is not completely clear; however, it appears to distinguish between evidence that is used within some sort of a structural model that would then be used to predict the impact of the merger versus evidence that might be more directly capture the potential effects of the merger. From an economic viewpoint, I consider this comparing a "structural" approach to a "reduced form" approach.

Examples of "direct" evidence that are discussed in the questions posed by the agencies include: (1) pricing evidence in consummated deals; (2) the use of natural experiments; (3) evidence of past coordination in coordinated effects cases; and (4) qualitative evidence (customer concerns and "hot documents").

Clearly, the agencies use this sort of direct evidence as part of their standard merger review where it is available. A key question is how much detail should be included in the Guidelines. If discussed, providing some detail as to the types of analyses conducted would be useful, but it would also be important to describe the potential caveats to such analyses. For example, observing simply that prices went up following a consummated merger would not be enough to infer competitive harm but rather it would be important to analyze whether there are other factors that might explain the price increase.

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IV. POTENTIAL OUTCOME OF THE PROCESS

The Guidelines review process is clearly still in its early stages and the ultimate outcome is still highly uncertain. The process itself will, of course, provide some additional information to both the agencies and practitioners. Ultimately the process may result in revised Guidelines. However, coming up with a revised set of Guidelines will not be an easy process. First, both agencies will have to agree on what changes should be made not only in terms of the broad areas for change but also in the specific language. Moreover, it will be challenging to determine the appropriate language to make the Guidelines: (1) understandable for all practitioners; and (2) flexible enough to address the range of industries and issues that arise. An alternative and/or supplement to revisions in the Guideline would be to provide more information in speeches or possibly an updated Commentary. It will be interesting to see what develops in the next year.

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