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On Revising the *Horizontal Merger Guidelines*

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I. INTRODUCTION

To determine whether a proposed merger is anticompetitive, one must compare the world without the merger – which is observed – to the world with the merger, which typically is not. Viewed in this way, the primary problem confronting antitrust enforcers is how to draw inference about the unobserved state of the world. The same problem characterizes monopolization or abuse-of-dominance cases, except that the world with the alleged abuse is observed, while the world without the abuse typically is not.²

Enforcement Guidelines can facilitate inference by institutionalizing the language and analytic framework used by enforcers, but they must also be flexible enough to accommodate the many different ways in which firms compete. In this essay, I warn against one change, and advocate for another. Both the warning and the change are done with an eye towards facilitating inference about the competitive effects of mergers.

II. DON'T PRESUME PRICE—OR ANY OTHER FORM OF—COMPETITION

When I was young and in love (with economics), I used to describe the *Horizontal Merger Guidelines* by telling the old joke about a drunk looking for his keys underneath a street lamp. A passer by stops to help him search, and he asks the drunk “are you sure you lost your keys here?”

“No,” replies the drunk, “I lost them over there, but the light is better over here.”

I used to think that the *Guidelines* were the personification of the drunk searching for his keys underneath the street lamp because I thought they forced us to search for merger effects using market share and concentration measures.

Motivated by skepticism, I did research critiquing market delineation,³ and spent time developing tractable oligopoly models that could be used instead of shares and concentration⁴

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² James Cooper, Luke Froeb, Daniel O'Brien, & Michael Vita, *Vertical Antitrust Policy as a Problem of Inference*, INT'L J. INDUSTRIAL ORG., 23, 639-664 (2005). Available at SSRN: <http://ssrn.com/abstract=699601>.

³ Gregory Werden & Luke Froeb, *Correlation, Causality, and all that Jazz: the Inherent Shortcomings of Price Tests for Antitrust Market Delineation*, REV. INDUSTRIAL ORG. 8, 329-354 (June, 1993); reprinted in 28 J. REPRINTS FOR ANTITRUST L. & ECON. 1, 175 (1998). See Also, Luke Froeb & Gregory Werden, *The Reverse Cellophane Fallacy in Market Delineation*, REV. INDUSTRIAL ORG. 7, 241-247 (1992) and Luke Froeb & Gregory Werden, *Residual Demand Estimation for Market Delineation: Complications and Limitations*, REV. INDUSTRIAL ORG 6, 33-48 (1991) 33-48, reprinted in 28 J. REPRINTS FOR ANTITRUST L. & ECON. 1, 357 (1998).

⁴ We found that market shares and concentration were lousy predictors of merger effects for two reasons:

- market delineation draws bright lines – between “in” and “out” of the market – where there none; and
- shares are often poor proxies for the competitive significance of firms, especially in differentiated products industries.

to predict merger effects. “Merger Simulation,” as it came to be known, caught on and eventually took off.⁵ I became an advocate of the methodology, and left the Justice Department for academia where the bulk of my research was devoted to modeling competition in different settings, and the loss of competition following merger.⁶

By the time I returned to the agencies in 2003, Merger Simulation was being used, or mis-used, in more merger cases than it probably should have been. It was almost as if the drunk had moved on to the next street lamp, and begun looking there for his keys. Subsequently, I spent time critiquing the mechanistic application of merger simulation to different settings, and warned economists to make sure that their models could accurately characterize observed competition before using them to forecast the changes in competition following merger.⁷

I also came to realize that my initial impression of the *Horizontal Merger Guidelines* had been wrong. I now appreciate them for giving us a common framework and language for analyzing mergers without forcing us to look for merger effects in a pre-determined place. The *Guidelines*, as currently written, are pretty clean and short, but they are flexible enough to accommodate advances in our understanding of the many different ways in which firms compete⁸ and how mergers affect such competition.

For example, in recent years competition agencies from around the world have used the *Guidelines* framework—or one very similar to it—to challenge mergers in industries and markets where firms compete in auctions,⁹ by bargaining,¹⁰ by using promotions and advertising,¹¹ by setting capacity, and by managing revenue or yield.¹² The *Guidelines* hypothetical monopolist tells attorneys and economists to look for ways in which market power would be exercised, depending on the particular setting and the form that competition takes. Any revision to the *Guidelines* that presumes a certain form of competition, e.g., that firms compete by simply setting price, would make it more difficult for the *Guidelines* to accurately characterize existing competition and to predict the loss of competition following merger or

Luke Froeb, Timothy Tardiff, & Gregory Werden, *The Demsetz Postulate and the Effects of Mergers in Differentiated Products Industries*, ECONOMIC INPUTS, LEGAL OUTPUTS: THE ROLE OF ECONOMISTS IN MODERN ANTITRUST, (ed. Fred McChesney) 1998.

⁵ See Gregory Werden & Luke Froeb, *The Effects of Mergers in Differentiated Products Industries: Logit Demand and Merger Policy*, J. L., ECON., & ORG. 10, 407-426 (1994), reprinted in ANTITRUST AND COMPETITION POLICY (ed. Andrew N. Kleit, 2005) and Gregory Werden & Luke Froeb, *Simulation as an Alternative to Structural Merger Policy in Differentiated Products Industries*, THE ECONOMICS OF THE ANTITRUST PROCESS, Ch. 4 (eds. Malcolm Coate & Andrew Kleit), 1996.

⁶ Luke Froeb & Gregory Werden, *An Introduction to the Symposium on the Use of Simulation in Applied Industrial Organization*, 7 INT’L J. OF THE ECON. OF BUS. 2, 133-137.

⁷ Gregory Werden, Luke Froeb, & David Scheffman, *A Daubert Discipline for Merger Simulation*, 18 Antitrust 3, 89-95 (Summer, 2004).

⁸ Gregory J. Werden & Luke M. Froeb, *Unilateral Competitive Effects of Horizontal Mergers*, in HANDBOOK OF ANTITRUST ECONOMICS, 43-104 (ed. Paolo Buccirossi, 2007). Available at SSRN: <http://ssrn.com/abstract=927913>

⁹ Lance Brannman & Luke Froeb, *Mergers, Cartels, Set-Asides and Bidding Preferences in Asymmetric Second-price Auctions*, 82 REV. ECON. & STATISTICS 2, 283-290 (2000).

¹⁰ Gregory Werden & Luke Froeb, *Unilateral Competitive Effects of Horizontal Mergers II: Auctions and Bargaining*, ISSUES IN COMPETITION LAW AND POLICY, ABA SECTION OF ANTITRUST LAW Vol. 2, 1343, (ed. W. Dale Collins, 2008). Available at SSRN: <http://ssrn.com/abstract=956400>

¹¹ Steven Tenn, Luke Froeb, & Steven Tschantz, *Merger Effects When Firms Compete by Choosing Both Price and Advertising*, Owen Working paper (2007). Available at SSRN: <http://ssrn.com/abstract=980941>

¹² Luke Froeb, Steven Tschantz, & Philip Crooke, *Bertrand Competition with Capacity Constraints: Mergers Among Parking Lots*, 113 J. ECONOMETRICS 1, 49-67 (March, 2003).

monopolization. Specifying the form that competition takes, without taking account of how firms actually compete, would only send us to another street lamp.

In particular, I think it is really important that the *Guidelines* not be re-written into a dense, lengthy catalog of possibilities (like the U.K.'s latest guidelines); or that it include discussions of non-horizontal theories of harm (the U.K. guidelines serve as a good warning here as well). The theory of harm should flow from the facts and particulars of the industry, not the other way around.

III. IN RARE CASES, ALLOW ANALYSIS TO BYPASS MARKET DELINEATION

Despite my appreciation for the *Guidelines*, I do have one suggestion for change: In the rare case where there is better information about the effects of the merger than there is about the relevant market, I would change the *Guidelines* to allow analysis that bypasses market delineation.

My attorney colleagues would immediately point me to section 7 of the Clayton Act that seems to demand market definition because of its reference to a "line of commerce" and "section of the country." Indeed, Judge Brown in *Whole Foods* said that the FTC's proposal to dispense with market definition was "in contravention of the statute itself."

However, I would naively point them to section 1 of the Sherman Act that dispenses with market definition in establishing market power or monopoly power; and in establishing anticompetitive effects under the rule of reason. Why should it be different for mergers?

For consummated mergers, like the FTC's *Evanston* case, effects were proven directly; and in many unilateral effects cases, "more direct" proof of effects is possible. In the *Oracle* case, for example, the court encouraged the use of merger simulation instead of unreliable market share data. If we view market delineation as a means to the end of predicting merger effects and we have better information about the end, "why bother" with the means?¹³

IV. CONCLUSIONS

The *Horizontal Merger Guidelines* have brought discipline to the unruly world of merger analysis by giving us a common framework and language for analyzing the competitive effects of mergers. The *Guidelines* have also facilitated international convergence and provided guidance to courts and other regulatory agencies on a wide range of enforcement issues that require market definition. They have been proven flexible enough to accommodate advances in our understanding of the myriad ways in which firms compete and how mergers affect such competition. Let's keep it that way.

¹³ William Blumenthal, *Why Bother?: On Market Definition under the Merger Guidelines*; Statement before the FTC/DOJ Merger Enforcement Workshop, Washington, DC, February 17, 2004, available at <http://www.justice.gov/atr/public/workshops/docs/202600.htm> (last visited December 4, 2009).