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Revising the Merger Guidelines: Looking Back to Move Forward

Deborah L. Feinstein
Arnold & Potter LLP

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Revising the Merger Guidelines: Looking Back to Move Forward

Deborah Feinstein[1]

I. INTRODUCTION

The Federal Trade Commission ("FTC") and Department of Justice ("DOJ") have announced plans to consider revising the Horizontal Merger Guidelines "in light of changes in economic learning, the case law, and practice at the Antitrust Division and the FTC."[2] There can be little doubt that aligning the Guidelines to actual practice and providing greater transparency to parties on the analysis the agencies will use is beneficial. There is, of course, a threshold question as to whether what the agencies have done—and may do differently in the future—is appropriate. Merger analysis is by necessity forward-looking and it can be difficult to make predictions about the future. In that vein the last question the agencies ask in their list of questions for public comment is "Should the Guidelines be revised to reflect learning based on merger retrospective studies?"[3] In some respects that should be the first question—and the answer should be yes. The agencies should, in some form, examine their analytical approach to determine whether they made accurate predictions and, if not, why not.

Merger retrospectives are challenging and they can be time-consuming and inconclusive; further, the necessary data can be difficult to obtain. Yet over the years they have been done. The FTC can examine those retrospective analyses to try to determine why predictions may have been incorrect: Did they have insufficient facts, were the facts ambiguous, did they believe there were likely to be anticompetitive effects but believe they did not have the evidence to go to court, was the economic model imprecise? There can be any number of reasons why the predictions were incorrect, and comparing the initial analysis to the ultimate outcome can be instructive.

Notwithstanding the difficulty of conducting merger analyses, there are several areas of the guidelines that are fruitful areas for examination. It would be in the agencies' interest to consider what they have predicted well and what they have not before embarking to codify what they have been doing.

II. PRODUCT MARKET

The ultimate question in market definition is whether customers will switch to other alternatives in response to price increases—and will those switches be enough to make the price increase unprofitable. The agencies often must answer that question in situations where the market is evolving—sometimes rapidly.One interesting case study would be the Hollywood-Blockbuster transaction. The FTC investigated whether the combination of the companies, both

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[1] Deborah L. Feinstein is a Partner at Arnold & Porter LLP.

[2] Welcome Remarks of Christine A. Varney, Horizontal Merger Guidelines Review Project's First Workshop, December 3, 2009, *available a*t http://www.justice.gov/atr/public/speeches/252614.htm.

[3] Horizontal Merger Guidelines: Questions for Public Comment Federal Trade Commission and U.S. Department of Justice, September 22, 2009, *available at* http://www.ftc.gov/bc/workshops/hmg/hmg-questions.pdf ("Horizontal Merger Guidelines Questions").

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of which rented videos and games in bricks and mortar stores, would lead to higher prices. The FTC staff had enough questions to issue a Second Request and later go to court to force the parties to provide additional data. The parties abandoned the transaction before the Commission decided whether to seek to block it, but the Commission was clearly looking hard at the transaction. The parties were undoubtedly arguing that changes in the industry—particularly the emergence of Netflix as a rival in on-line, mail-order rentals—were dramatically altering the competitive landscape for bricks and mortar stores. They likely also argued that the efficiencies from the transaction were necessary to enable the parties to compete better against Netflix and, perhaps, to change their model to add or grow an on-line component. The Commission, at least at the staff level, had likely reached some tentative ideas about effects by the time they went to court seeking more data.

Were those views correct? Blockbuster and Hollywood still exist but both have closed numerous stores since abandoning the transaction.Blockbuster declined from 5,696 stores in late 2005 to 4,585 stores in 2009, and Hollywood from 1,920 stores in 2003 to 1,646 stores in 2008 (even after its acquisition by Movie Gallery). Meanwhile, Netflix's sales grew from $500 million in 2004 to $1.3 billion in 2008. It may be that Commission staff predicted this shift, but nevertheless determined that sufficient numbers of consumers would continue to rent from bricks and mortar stores that anticompetitive effects from the combination were likely. But if they did not anticipate the rate of this dramatic shift, then they should ask why not—and what they might do differently in a similar case next time—to make better predictions about the changing dynamics of a market.

III. ENTRY

Entry is another area in which it may be fairly easy to determine whether the agencies' predictions are accurate. There are undoubtedly cases where the government had no concerns about a transaction, because they believed new entry would thwart any possible anticompetitive conduct. They can look to see whether, in fact, entry occurred. If it did, then their conclusion about ease of entry was correct. If it did not, then the analysis becomes a little more complicated. It may be that no entry occurred because the parties did not attempt to engage in any anticompetitive conduct, knowing that entry would occur if they did. But, as a basic check on what has happened post-transaction, the agencies can ask customers whether they believe the market is as competitive now as it was prior to the merger.

Equally, if not more interesting, are those occasions in which the agencies blocked a deal—and yet the entry that the parties predicted occurred anyway. An example of this is the supermarket industry in Las Vegas. In 1999, Albertson's sought to acquire American Stores.Las Vegas was among the numerous markets in which there were overlaps. At the time, Wal-Mart was making a steady westward move with its Wal-Mart "Supercenters," which are full-size grocery stores combined with traditional Wal-Mart stores. Although Wal-Mart had not yet entered Las Vegas with Supercenters, the parties argued that such entry was inevitable and would make anticompetitive effects from the transaction implausible in that market. The

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Commission disagreed and required Albertson's to divest 19 stores and one undeveloped store site in Las Vegas.[4]

Three years later, the Commission addressed the Las Vegas supermarket much differently.In 2002, Kroger sought to make an acquisition in Las Vegas; it entered into an agreement to acquire 18 Raley's supermarkets.Although that acquisition reduced the number of competitors to the same number that would have remained absent a consent in Albertson's/American Stores, the Commission determined that no remedy was required. It issued a statement on the transaction, the heading of which—"Unanticipated Entry and Expansion Since Issuance of Prior Order Make Anticompetitive Effects Unlikely"—pretty well sums up their analysis.[5] The Commission noted that since the Albertson's consent agreement, Wal-Mart had opened five Supercenters in Las Vegas. It noted further that: "Wal-Mart's current share of supermarket sales in Las Vegas is significant and is likely to grow. Wal-Mart is not the only de novo entrant since 1999; for instance, K-Mart has opened a Supercenter, and King Ranch has entered the market with three supermarkets and a fourth under construction."

The agency also observed "the major competitors in 1999—Albertson's, Kroger, and Safeway Corporation (operating under the Von's name)—have added over 25 new supermarkets in Las Vegas. When accounting for both expansion and entry, the number of supermarkets in Las Vegas has grown by about 45 percent since the Albertson's/American Stores divestiture. Because Las Vegas is a rapidly growing city, the supermarket industry likely will continue to grow." The Statement identified other relevant factors to the decision not to take action, including Raley's declining significance, but entry/expansion was plainly the most significant.

Just three years after it predicted the effects in Las Vegas from the Albertson's/American Stores transaction, the Commission called the intervening entry and expansion there "unanticipated." It would be interesting to know why the Commission's 1999 prediction was inaccurate. Did they not see the tremendous growth in the Las Vegas population? Did they doubt Wal-Mart's western push? Did the expansion by other competitors come only in response to Wal-Mart's entry and thus could not have been predicted by then-current market conditions? The Commission may well have answered these questions internally in making its decision on the Kroger transaction, but it is important that any learning that is more broadly applicable to general entry analysis be incorporated inany revisit of the Merger Guidelines.

IV. INNOVATION

Among the questions the agencies ask is whether the Guidelines should address more explicitly "the non-price effects of mergers, especially the effects of mergers on innovation."[6] While the agencies, particularly the FTC in pharmaceutical cases, have brought enforcement actions based on a "reduction in innovation" theory, they have never put forth guidelines on the subject. There is every reason to question whether they should do so now. The literature is

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[4] Agreement Containing Consent Order, Albertson's, Inc., File No. 981 0339 (FTC 1999) *available at* http://www.ftc.gov/os/1999/06/alameristoresagree.pdf.

[5] Press Release, Fed. Trade Comm'n, Investigation of Kroger/Raley's Supermarket Transaction Closed (Nov. 13, 2002) *available at* http://www.ftc.gov/opa/2002/11/krogerraley.shtm.

[6] Horizontal Merger Guidelines Questions, *supra* note 3.

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at best mixed on the question of whether a reduction in the number of research "competitors" can be presumed to adversely affect the likelihood of innovation.[7] Before the agencies issue guidelines on this subject, they should undertake a serious examination of whether transactions that combined two innovators ever harmed consumers. Did the would-be merging parties bring to market products in a reasonable period of time? Were they ahead of other competitors in doing so? By way of example, much was made in the Ciba/Sandoz case of the need to require a licensing remedy, since Ciba and Sandoz "were two of only a few" entities capable of commercially developing gene therapy products and controlled substantial proprietary rights and patents.[8] Yet, twelve years later, there are no gene therapy products on the market. In retrospect, there would seem to have been no likelihood of anticompetitive effects from that transaction to justify a remedy.

V. EXITING ASSETS

Another area where it may not be difficult to assess whether the agencies' predictions were correct is in the area of exiting assets. There are many transactions where the agencies hear from the merging parties that they will be forced to exit the market absent the proposed transaction. The agencies typically meet these arguments with great skepticism—and perhaps appropriately so. But there are situations in which companies did exit after a transaction was blocked. The agencies could study these transactions to learn whether their skepticism was misplaced.

One example was Kroger's proposed 2000 acquisition of Winn-Dixie's operations in Dallas/Ft. Worth and a few surrounding areas. The parties argued that, absent the transaction, Winn-Dixie would soon exit. It had no immediate plans to exit, but its financial condition and competitive position made it difficult, if not impossible, to survive. The Commission nevertheless blocked the transaction. Within two years, Winn-Dixie exited. It did so in the face of competition from numerous sources, including substantive entry and expansion, which the parties had argued was coming. It is possible the Commission would have blocked the transaction anyway, on the grounds that two years of competition, even from a weakened competitor, was worth it by concluding that (i) intense rivalry between Kroger and Winn-Dixie existed; (ii)it would continue; and (iii) other rivals would not replace the competition between them if the transaction was to occur. Yet, within about two years, Winn-Dixie did exit the Dallas/Ft. Worth market in the face of dramatic competition from numerous other players. And, Kroger acquired a number of the Winn-Dixie stores. Other competitors also acquired some of the Winn-Dixie stores, and many other stores simply went dark. Had the Commission known that would be the result after a limited period of continued competition, would they have challenged the transaction?

Another interesting "exiting asset" case is the Commission's challenge last year to CCS's proposed acquisition of Newpark Environmental Services.Both companies were providers of waste disposal services to the offshore oil and natural gas exploration and production industry. CCS argued that, absent the transaction, the economics of the business would force it to exit. In

[7] *See* Dennis W. Carlton & Robert H. Gertner, *Intellectual Property, Antitrust and Strategic Behavior*, in 3 INNOVATION POLICY AND THE ECONOMY.

[8] In re *Ciba-Geigy*, FTC Docket No. C-3725 (Mar. 24, 1997), *available at* http://www.ftc.gov/os/1997/04/c3725cmp.pdf.

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response, the Commission press release said"CCS's last-minute threats to shut down its entire Gulf Coast business if the merger is challenged are mere pretext and cannot justify this anticompetitive transaction."[9] The parties abandoned the deal, and, thereafter, CCS notified customers that it would stop providing service in the Gulf Coast and has not re-entered.

VI. COMPETITIVE EFFECTS

Without question, competitive effects is the most difficult area to assess whether the agencies got it right. When the DOJ closed its investigation of Whirlpool's acquisition of Maytag, it pointed to strong rivals, newer entrants, and substantial efficiencies.[10] Three years later, then-Assistant Attorney General Tom Barnett gave a speech in which he reported on analysis done by the Division that, while not dispositive, suggested there had been no anticompetitive increase in price.[11]

A recent lawsuit may allow for a comprehensive merger retrospective on the competitive effects of one of the most controversial cases the DOJ handled.In the merger of XM Satellite with Sirius Satellite, the DOJ found the evidence lacking to establish that the combination likely would substantially reduce competition. It concluded that there was limited competition between the parties, the market was not limited to satellite radio in some segments, there were substantial efficiencies, and "the likely evolution of technology in the future" made it unlikely there would be consumer harm.[12] At least some consumers believe DOJ got it wrong. A putative class action alleges that Sirius XM has obtained an unlawful monopoly and abused its monopoly position in the market for satellite digital radio service.[13] Whether the litigation will provide the facts to help answer the question of whether DOJ got it right or wrong is unclear, but anyone trying to figure out whether merger analysis has been done correctly or should be revised should hope that it does.

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[9] Press Release, Fed. Trade Comm'n, FTC Moves to Block CCS's Proposed Acquisition of Rival Newpark Environmental Services (Oct. 23, 2008) *available at* http://www.ftc.gov/opa/2008/10/redsky.shtm.

[10] Press Release, U.S. Dep't of Justice, Department of Justice Antitrust Division Statement on the Closing of Its Investigation of Whirlpool's Acquisition of Maytag (Mar. 29, 2006) *available at* http://www.justice.gov/atr/public/press_releases/2006/215326.pdf.

[11] Remarks by Thomas O. Barnett, Current Issues in Merger Enforcement: Thoughts on Theory, Litigation Practice, and Retrospectives, June 26, 2009, *available at* http://www.justice.gov/atr/public/speeches/234537.htm

[12] Press Release, U.S. Dep't of Justice, Statement of the Department of Justice Antitrust Division on Its Decision to Close Its Investigation of XM Satellite Radio Holdings Inc.'s Merger with Sirius Satellite Radio Inc. (Mar. 24, 2008) *available at* http://www.justice.gov/atr/public/press_releases/2008/231467.pdf.

[13] Blessing et al. v. Sirius XM Radio, Inc., Case No. 09-cv-10035 (S.D.N.Y.) December 8, 2009.

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