

Revising the Horizontal Merger Guidelines... And Why It Matters

IN SEPTEMBER 2009, the Federal Trade Commission and the Antitrust Division of the Department of Justice (DOJ, and together, the antitrust agencies) announced plans to hold workshops to explore updating the Horizontal Merger Guidelines (Guidelines) with respect to selected issues. The last significant revision of the Guidelines was in 1992 and the concern of some is that, in the intervening 17 years, much has changed in practice at the agencies, in economic theory, and to some extent, in the positions taken by courts.

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When the Guidelines were first promulgated, they had as an objective to provide greater transparency into the standards then being applied by DOJ in the identification of acquisitions that were likely to be challenged.¹

In the intervening years, the antitrust agencies have undertaken other transparency initiatives to acquaint the business and M&A community, the antitrust bar that deals with merger issues, and other interested groups with the practices of those agencies, including issuing more descriptive press releases to explain why certain transactions were allowed to proceed without an investigation being opened.

In 2006, the antitrust agencies issued a "Commentary on the Horizontal Merger Guidelines." Although this commentary described more current interpretations by the agencies of the existing Guidelines from the perspective of internal agency practice, it did not attempt a more thorough revision of the Guidelines.

Topics for Comment

Some of the topics that the antitrust agencies have suggested for comment are more radical than others. The topics include:

- whether the five-step analytical process described in the Guidelines should be revised to clarify that not all five steps are needed in all cases;
- whether the Guidelines should be revised to address how the antitrust agencies use evidence about likely anticompetitive effects that is not based on inferences drawn from increased market

concentration, including, actual market evidence where a completed merger is being retrospectively reviewed, or "natural experiments" believed to correspond closely to what will happen following a merger;

- whether the Guidelines' discussion of the hypothetical monopolist test (Guidelines §1.1) should include a more detailed discussion of how the "critical loss analysis" is applied. A critical loss analysis attempts to identify the level of sales needed to make a post-merger price increase unprofitable for a "hypothetical monopolist" under the Guidelines' approach. Since the Guidelines were last revised, the antitrust agencies and courts have increased their use of the critical loss analysis;²

- and, on a somewhat related topic, whether the Guidelines' hypothetical monopolist test (i.e., that group of products or services over which a hypothetical monopolist could successfully impose a small but significant and non-transitory increase in price (SSNIP)), should drop the requirement that products and services be added in the order of "next best substitutes";

- whether the thresholds for a concentrated market used in the Guidelines, based upon the Herfindahl-Hirschman Index (HHI), accurately reflect current antitrust agency practice. There is a broad consensus, based upon enforcement statistics,³ that the current HHI thresholds are too low when compared to actual practice;

- whether the Guidelines should reflect more current economic theory about unilateral anticompetitive effects issues, including the relationship between market definition and unilateral effects, diversion ratios and price/cost margins and unilateral effects, and the validity of using market shares as a proxy for diversion ratios;

- whether the Guidelines should reflect agency practice in evaluating the implications of power buyers who have the ability to defeat a post-transaction price increase (at least for themselves).⁴

One of the more radical thoughts is the question of whether, in deemphasizing the "five-step" discussion currently in the Guidelines (including its emphasis on a proper definition of the relevant market) and the expansion of recognized proof on anticompetitive effects, the Guidelines should be revised to recognize the "upward pricing pressure" theory (UPP).

Part of the allure of this theory is that considerable effort and resources go into less than fully satisfying definitions of the markets for certain differentiated products. The UPP has gained interest recently because, although theoretical, it is a theory that was substantially developed and advanced by Joseph Farrell and Carl Shapiro who are currently, respectively, the director of the Bureau of Economics at the FTC and the deputy assistant attorney general for economic analysis.⁵

The argument is that the UPP is a valuable preliminary screening tool, and that the Guidelines' current focus on market definition and concentration is also not meant to be dispositive. Proponents of the UPP suggest that it is entitled to some equal dignity with analysis of a properly defined relevant market.

There is a highly significant difference between market concentrations and the UPP theory, however. The UPP theory may have academic interest, but it does not find support in the caselaw, which mandates an analysis beginning with a properly defined relevant market. See, e.g., *United States v. Marine Bancorp. Inc.*, 418 U.S. 602, 618 (1974) ("Determination of the relevant product and geographic markets is 'a necessary predicate' to deciding whether a merger contravenes [§7 of] the Clayton Act").⁶

Judicial Acceptance

Writing in 1991 and 1992, about the time of the last substantial revision of the Horizontal Merger Guidelines, Steven Newborn and Virginia Snider, then officials at the FTC, described the jurisprudential objectives for the revisions at that time.

"The most important goal of both the 1982 and 1984 revisions was to state the new analytical methods being used and establish predictability..."

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However, *the real test of the success of the guidelines would be their acceptance by the bench; if the Courts ignored the Guidelines, [DOJ] and the FTC could be forced to ignore them as well. Guidelines that are not accepted by the courts will reduce predictability of enforcement and impose significant costs.* For example, business would have less guidance in self-policing potentially problematic mergers, which would result in (1) discouraging some otherwise legal mergers by cautious companies; (2) increasing enforcement and litigation costs for companies more willing to test uncertain antitrust cases; and (3) increasing the government's enforcement costs if there were litigation and if the government were forced to assume more of the industry's role in evaluating the likely competitive effects of proposed mergers.⁷

Newborn and Snider's report card on judicial acceptance of the Guidelines as of that last substantive revision was, at a minimum, checked. They noted that, in earlier days, "the courts [were] reluctant to give the enforcement agencies' policy statements the force of law and few [had] done so."⁸

The guidelines were given some deference but, often in cases that the government lost, where the court relied on the lack of support for the government's arguments under the Guidelines.⁹ The objective as of the 1992 revision appears to have been to gain judicial acceptance for the Guidelines, if only to secure their predictable use by the antitrust agencies, which would benefit the business community in reducing transaction costs and in giving some reassurance that particular transactions were not of antitrust concern and were unlikely to be challenged.

If "the real test of success" is judicial acceptance, the Guidelines have had enormous success. They are widely relied upon and cited by courts in government challenges to mergers under §7 of the Clayton Act.¹⁰

An Objective Far Exceeded

While that level of judicial acceptance is what the 1992 revisers hoped to attain, that objective was far exceeded and the Guidelines are frequently cited in analyses of state claims,¹¹ private merger litigation under §7 of the Clayton Act;¹² retrospective analyses of completed acquisitions;¹³ and, most significantly, even in private antitrust litigation of non-merger claims where market power is in issue.¹⁴ This last category of cases has given the Guidelines far wider reach than the name "Horizontal Merger Guidelines" would imply.

In *Chicago Bridge & Iron Co. N.V. v. FTC*,¹⁵ the Fifth Circuit summarized the judicial attitude as being that the Guidelines are recognized as "highly persuasive authorities as a 'benchmark of legality.'"¹⁶ A similar observation was made by Second Circuit Judge Pierre Leval in a non-antitrust context.

In a 1995 dissent in a drug sentencing case, Judge Leval chose the Guidelines as a singular example of judicial deference to agency expertise. He observed that "[a]lthough it is widely acknowledged that Merger Guidelines do not bind the judiciary in determining whether to

sanction a corporate merger or acquisition for anticompetitive effect, ...courts commonly cite them as a benchmark for legality."¹⁷

Two recent decisions further underscore how established the approach taken by the Guidelines has become. In one case, a court permitted an expert witness to testify on issues of market definition and market power, in part, because of his use of the Guidelines, which the court termed a recognized tool to define a relevant market.¹⁸ In another *Daubert* context, the Sixth Circuit held that a district court properly excluded an expert's testimony because he "did not perform the standard [Guidelines'] SSNIP test."¹⁹

The Challenge Has Changed

It is precisely because the Guidelines have achieved such a high degree of judicial acceptance that the antitrust agencies now face a serious jurisprudential challenge.

Whereas in 1992, the agencies' objectives included gaining sufficient judicial acceptance to secure the Guidelines as meaningful agency policy, that objective has been accomplished and, if anything, the challenge now comes from the opposite direction.

Although it may be necessary to update the Guidelines in certain respects, in undertaking such change, the FTC and the antitrust division of the DOJ must take into account that the courts have come to rely on the existing Guidelines approach.

Although it may be necessary to update the Guidelines in certain respects to reflect more current practice at the antitrust agencies, in undertaking such change, the agencies must take into account that the courts have come to rely on the existing Guidelines approach. It would be ironic if, in pursuing the worthy regulatory objective of keeping interested parties accurately informed of current agency thinking, the agencies recreated the unpredictability that the 1992 revisers seemed intent on addressing.

The workshops will produce ideas worthy of consideration but, as a matter of jurisprudence, wider peripheral thought needs to be given as to whether any particular change deviates too substantially from the law that the courts have evolved in their reliance on the existing Guidelines.



1. Steven A. Newborn, Virginia L. Snider, selected articles from "The Cutting Edge of Antitrust: Market Power:" The Growing Acceptance of the Merger Guidelines, 60 Antitrust L.J. 849 (1991/1992).

2. See *FTC v. CCC Holdings Inc.*, 605 F. Supp. 2d 26, 40-41 & n.16 (D.D.C. 2009) ("Critical loss analysis is a standard tool used by economists to study relevant markets"); *FTC v. Arch Coal Inc.*, 329 F. Supp. 2d 109, 120-22 & n.7 (D.D.C. 2004) ("To measure the volume of diverted sales needed to make a particular price increase unprofitable under the hypothetical monopolist test, economists generally perform a critical loss analysis.").

3. FTC Horizontal Merger Investigation Data, Fiscal Years 1996-2007, available at <http://www.ftc.gov/os/2008/12/081201thsmrgerdata.pdf>. See also J. Kwoka, "Some Thoughts on Concentration, Market Shares and Merger Enforcement Policy" 7-8 available at <http://www.ftc.gov/bc/mergerenforce/presentations/0410217kwoka.pdf> (according to an analysis of data provided by both Antitrust Agencies, the median HHI for a challenged transaction was 4,500 with a median post-transaction increase of 1,200).

4. See DOJ Statement on the Closing of Its Investigation of Whirlpool's Acquisition of Maytag, DOJ Press Release (March 29, 2006) available at http://www.justice.gov/atr/public/press_releases/2006/215326.pdf.

5. An abstract accompanying their November 2008 article explained:

"Under current antitrust policy, the government can establish a presumption that a proposed horizontal merger will harm competition by defining the relevant market and showing that the merger will lead to a substantial increase in concentration in that market. However, this approach can perform poorly in markets for differentiated products, where market boundaries are unclear and the proximity of the products sold by the merging firms is a key determinant of the merger's effect on competition. Our test looks for upward pricing pressure (UPP) resulting from the merger. We develop a simple diagnostic for UPP based on the price/cost margins of the products sold by the merging firms and the magnitude of direct substitution between the two firm's products."

6. See also *Golden Gate Pharmacy Servs. Inc. v. Pfizer Inc.*, No. C-09-3854 (MMC), 2009 WL 4723739 at *3 (N.D. Cal. Dec. 2, 2009) ("claims are subject to dismissal for failure to allege a cognizable product market"); *FTC v. Freeman Hosp.*, 69 F.3d 260, 268 (8th Cir. 1995) (holding that defining the relevant market is a necessary prerequisite to establishing likelihood of prevailing on merits of §7 claim); *PepsiCo Inc. v. Coca-Cola Co.*, 315 F.3d 101, 105, 111 (2d Cir. 2002) (reaching same conclusion for claims under §§1 and 2 of the Sherman Act); *Apani Southwest Inc. v. Coca-Cola Enters.*, 300 F.3d 620, 629-33 (5th Cir. 2002) ("Where the Plaintiff fails to define its proposed relevant market with reference to the rule of reasonable interchangeability and cross-elasticity of demand, or alleges a proposed relevant market that clearly does not encompass all interchangeable substitute products even when all factual inferences are granted in plaintiff's favor, the relevant market is legally insufficient, and a motion to dismiss may be granted.").

7. Steven A. Newborn and Virginia L. Snyder, selected articles from "The Cutting Edge of Antitrust Market Power:" The Growing Judicial Acceptance of the Merger Guidelines, 60 Antitrust L.J. 849 (Issue 3, 1991/1992) (emphasis added).

8. *Id.*

9. See generally *United States v. Baker Hughes Inc.*, 908 F.2d 981, 985-86, 988 (D.C. Cir. 1990); *FTC v. R.R. Donnelley & Sons*, 1990-2 Trade Cas (CCH) ¶69,239 at 64,855 (D.D.C. 1990).

10. See generally *FTC v. Whole Foods Mkt. Inc.*, 548 F.3d 1028, 1038 (D.C. Cir. 2008); *United States v. Oracle Corp.*, 331 F. Supp. 2d 1098, 1111-12, 1113, 1117 (N.D. Cal. 2004); *FTC v. Swedish Match*, 131 F. Supp. 2d 151, 160 (D.D.C. 2000).

11. See, e.g., *New York v. Kraft General Foods Inc.*, 926 F. Supp. 321 (S.D.N.Y. 1995).

12. See, e.g., *Hart Intercivic Inc. v. Diebold Inc.*, Civil No. 09-678 (RBK), 2009 WL 3245466 (D. Del. Sept. 30, 2009).

13. See, e.g., *Chicago Bridge & Iron Co. N.V. v. Federal Trade Commission*, 534 F.3d 410 (5th Cir. 2008).

14. See, e.g., *PepsiCo Inc. v. The Coca-Cola Co.*, 315 F.3d 101 (2d Cir. 2002); *Atlantic Exposition Services Inc. v. SMG*, 262 Fed. Appx. 449, 2008 WL 227854 (3d Cir. 2008); *E.I. du Pont de Nemours and Co., v. Kolon Industries Inc.*, Civ. Action No. 3:09cv58 (REP), 2009 WL 4927159 (E.D.VA Dec. 18, 2009).

15. 534 F.3d 410, 434 n.13 (5th Cir. 2009) (a post-consumption review of a merger under §7 of the Clayton Act and §5 of the FTC Act).

16. *Chicago Bridge & Iron Co. N.V. v. Federal Trade Commission*, 534 F.3d 410, 434 n.13. (emphasis added).

17. *United States v. Kinder*, 64 F.3d 757, 771 (2d Cir. 1995) (Leval, J., dissenting).

18. *Park West Radiology v. Carecore National LLC*, No. 06 Civ. 13516 (VM), 2009 WL 4277106 (S.D.N.Y. Nov. 19, 2009).

19. *Kentucky Speedway, LLC v. National Association of Stock Car Auto Racing Inc.*, 588 F.3d 908, 918 (6th Cir. 2009).