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Horizontal Merger Guidelines Review: A Midterm Report

Law360, New York (December 17, 2009) -- On Sept. 22, 2009, the U.S. Department of Justice and Federal Trade Commission (collectively, the “agencies”) announced they would solicit public comments and hold joint public workshops to explore the possibility of updating the Horizontal Merger Guidelines used by the agencies to evaluate the potential competitive effects of mergers and acquisitions.

The goal of the initiative is to determine whether the Guidelines accurately reflect the current practice of merger review at the agencies, taking into account legal and economic developments that have occurred since the last significant Guidelines revision in 1992.

The Guidelines were first adopted by the DOJ in 1968, and were subsequently revised, first in 1982, and then again in 1992 when they were adopted jointly by the DOJ and the FTC.

A subsequent revision in 1997 was limited only to clarifications regarding the agencies’ treatment of merger-induced efficiencies. The agencies also issued a detailed Commentary on the Horizontal Merger Guidelines in 2006.

To get the ball rolling in this latest review, the agencies posted a series of questions that cover many aspects of the five-step analytical process of merger review described in the 1992 Guidelines.

These aspects include market definition, the use of market concentration to form presumptions about competitive effects, unilateral effects analysis, and the use of direct evidence of competitive effects. One issue with relatively less coverage is coordinated effects analysis.

The agencies explained their choice of questions as relating to areas where “an examination of the 1992 Guidelines may be most valuable” and encouraged the public

to submit written responses to these questions well in advance of the first public workshop held on Dec. 3 in Washington, D.C.

Two other workshops took place on Dec. 8 and 10 in New York and Chicago, respectively, and the two final workshops will be conducted on Jan. 14 and 26.

In posting these questions, the agencies clarified that if the 1992 Guidelines were revised, it would be “primarily to articulate the analytical framework that the agency applies in determining whether a merger is likely substantially to lessen competition, not to describe how the agency will conduct litigation of the cases it decides to bring.”

The agencies do not expect to replace the basic elements of the analytical framework set forth in the 1992 guidelines. These elements include market definition, measurement of market concentration, consideration of merger induced efficiencies, the likelihood of entry, and the failing firm defense.

However, the agencies feel that a number of meaningful revisions might be possible while retaining these basic elements of analysis.

These clarifications were echoed by the opening remarks of Christine Varney, the Assistant Attorney General for Antitrust in the DOJ during the first workshop when she said that “drastic revision of the Guidelines does not at this time appear to be appropriate because the core elements of the Guidelines — like their use of market definition to build a structural case — remain fundamentally sound.”

Public Comments

The agencies received a total of 45 written comments — 24 from economists, 16 from lawyers (including from lawyers with the American Bar Association and the American Antitrust Institute), and five from industry groups (including the American Medical Association and the Biotechnology Industry Organization).

Some commentators responded to only a few of the questions that were posted by the agencies whereas other commentators responded to all of the questions.

For example, lawyers with the Section of Antitrust Law of the American Bar Association (the “Section”) submitted comments to each of the 20 questions posed by the Agencies.

The Section’s main points are that market concentration thresholds should be raised to reflect more accurately agency practice, and that presumptions based solely on market concentration levels should be removed in order to conform to modern merger analysis and economic theory.

Specifically, the Section believes that the agencies should not investigate mergers for which the post-merger Herfindahl-Hirschman Index (“HHI”) is 2,500 or less (e.g., a merger that leads to four post-merger firms of about equal size) and that there should

not be a presumption of anti-competitive effects based solely on the concentration level in mergers that raise the HHI above 2,500.

The written comments received by the agencies show some consensus on certain issues.

In particular, many commentators seem to agree that the agencies should clarify that the five-step analytical framework set forth in the 1992 Guidelines is applied through an integrated analysis and not as a rigid step-by-step approach; that merger analysis often uses information other than market shares and concentration, including direct evidence of likely competitive effects (as for example in *FTC v. Staples*); and that, in accordance with the Commentary, fixed cost savings generated by a merger may result in lower prices in the short term as well as long-term benefits to consumers.

The comments also exhibit a lack of consensus on several important issues. In the context of market definition, there is some disagreement about the usefulness of the “smallest market principle.”

In industries where firms supply differentiated products, some commentators recommend to abandon critical loss analysis for the purpose of defining markets, while other commentators recommend to augment critical loss analysis with additional information inferred from profit margin data.

In the context of unilateral effects analysis, there is some disagreement about whether a presumption based on a 35 percent combined market share should be retained. There also are contrasting views on the usefulness of merger simulation models.

In industries where firms supply differentiated products and compete mainly by posting prices, some commentators recommend the use of “price pressure indices” based on diversion ratios and profit margins, while other commentators recommend against using such new measures of potential unilateral effects.

Public Workshops

At the time of writing this article, the initial workshop in Washington, D.C. and the second and third workshops, respectively in New York and Chicago, have already been conducted.

The agenda in each of these three workshops consisted of four different topics. Typically, a panel of four or five speakers was convened to discuss each topic.

The topics of discussion were organized to reflect groups of inter-related questions for which the agencies sought public comments. The topics of market definition and structural presumptions, unilateral effects analysis, and the use of direct evidence of competitive effects were discussed in multiple workshops.

These topics were complemented by discussions about supply-side considerations like the role of entry and efficiencies, and the failing firm defense.

Two other topics that were the subject of panel discussions were implications of any Guidelines' revisions for the prospect of coordination among federal, state and international antitrust enforcement authorities, and whether or not the revised Guidelines should address the issue of merger remedies.

Panel members were mostly drawn from amongst prominent private antitrust attorneys and economists, including several speakers who have at one time or another served in an enforcement capacity.

In addition, some panels featured state attorneys general and foreign antitrust officials whose presence seemed to reflect the importance of working towards convergence between U.S. federal antitrust policies and those enforced at the state level or in foreign jurisdictions.

One panel also included Jonathan Baker, the current Chief Economist of the Federal Communications Commission, which is one of several regulatory agencies that have antitrust jurisdictions over specific industries.

Unlike the focused and technical nature of some of the written comments, the panel discussions were relatively broad and offered a variety of perspectives on the topics.

Individual panel members discussed which aspects of the 1992 Guidelines they have found in their experience to be helpful and which ones they have found to be unhelpful.

These experiences formed the bases of individual opinions regarding which aspects of the 1992 Guidelines are in need of revision and what the nature of those revisions should be.

One area of broad consensus that seemed to emerge was that market definition should continue to be part of the merger review process although it need not be the first step of the review process as described in the 1992 Guidelines; instead, market definition should be undertaken in the context of any specific competitive harm that the agency might suspect.

An area in which consensus was harder to come by was whether or not the Guidelines should be revised to prescribe the use of specific state-of-the-art analytical tools or whether the revised Guidelines should only set forth the broad principles of merger analysis.

Conclusion

The Guidelines Review Project is well underway. The agencies received many constructive comments from lawyers, economists and industry experts, both through public written submissions and during the first three public workshops.

The fourth and fifth workshops are scheduled to be held during January 2010, respectively at the campus of Stanford University in California, and back again in Washington, D.C.

While the agenda for the two final workshops is yet to be available at the time of this writing, it will not be surprising if the topics of market definition, unilateral effects analysis, and use of direct evidence of competitive effects will feature prominently in these workshops as well.

There also could be additional comments and discussions on topics that have not yet received much attention in this Guidelines Review Project, such as coordinated effects analysis, merger analysis in two-sided markets, and merger effects on nonprice competition (e.g., R&D competition).

Given the comments and ideas that have been advanced so far, it seems unlikely that the agencies will make significant changes to the Guidelines with respect to merger analysis in industries where firms supply homogeneous products (e.g., commodities).

Areas where significant changes seem likely include market definition and unilateral effects in industries where firms supply branded or differentiated products.

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