

# Seventeen Years Later: Thoughts on Revising the Horizontal Merger Guidelines

**Darren S. Tucker**

On September 22, 2009, the Federal Trade Commission and the Department of Justice announced plans to hold joint workshops to explore the possibility of updating the Horizontal Merger Guidelines.<sup>1</sup> According to the agencies' press release, the workshops are intended to determine whether the Guidelines "accurately reflect the current practice of merger review at the FTC and DOJ, as well as to take into account legal and economic developments that have occurred since the last significant Guidelines revision in 1992."<sup>2</sup> The agencies plan to solicit comments on particular topics and to hold a series of five public workshops in December 2009 and January 2010. The goal is to complete the review within six to ten months.<sup>3</sup>

The agencies anticipate retaining much of the existing structure of the Guidelines, including the hypothetical monopolist test, the use of the Herfindahl-Hirschman Index (HHI) for establishing an initial structural presumption, the timeliness-likelihood-sufficiency approach to entry analysis, consideration of efficiencies, and a failing firm defense.<sup>4</sup> Many of the proposed revisions appear to have come directly from the 2006 Merger Guidelines Commentary and should not be a surprise to practitioners.<sup>5</sup>

Nevertheless, the announcement may presage fundamental changes to the Guidelines. The agencies are contemplating adding several new topics to the Guidelines, such as the use of direct effects evidence, the role of power buyers, acquisitions of minority interests, and merger remedies.<sup>6</sup> Also under consideration are several noteworthy changes to the current Guidelines' framework. For example, the agencies are considering revising the step-by-step approach to the Guidelines, adjusting the HHI thresholds (which have remained unchanged since the 1982 Guidelines), increasing the default size of the SSNIP test from 5 to 10 percent (which would result in

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<sup>1</sup> Press Release, Fed. Trade Comm'n, Federal Trade Commission and Department of Justice to Hold Workshops Concerning Horizontal Merger Guidelines (Sept. 22, 2009), available at <http://www.ftc.gov/opa/2009/09/mgr.shtm>. The announcement did not indicate any plans to address non-horizontal merger enforcement guidelines.

<sup>2</sup> *Id.*

<sup>3</sup> See John D. McKinnon & Brent Kendall, *Regulators Weigh New Merger Rules*, WALL ST. J., Sept. 23, 2009, at A10.

<sup>4</sup> See Fed. Trade Comm'n & U.S. Dep't of Justice, Horizontal Merger Guidelines: Questions for Public Comment 1–2 (Sept. 22, 2009), <http://www.ftc.gov/bc/workshops/hmg/hmg-questions.pdf> [hereinafter Questions for Public Comment]; Christine A. Varney, Assistant Att'y Gen., Antitrust Div., U.S. Dep't of Justice, Merger Guidelines Workshops 10 (Sept. 22, 2009), available at <http://www.usdoj.gov/atr/public/speeches/250238.pdf>.

<sup>5</sup> U.S. Dep't of Justice & Fed. Trade Comm'n, Commentary on the 1992 Horizontal Merger Guidelines (2006), available at <http://www.ftc.gov/os/2006/03/CommentaryontheHorizontalMergerGuidelinesMarch2006.pdf> [hereinafter Commentary].

<sup>6</sup> See Questions for Public Comment, *supra* note 4, at 2–6.

broader markets), downplaying the role of concentration in a unilateral effects analysis, and giving greater weight to fixed cost savings.<sup>7</sup>

The agencies' announcement was a welcome development. In the seventeen years since the last major revision to the Guidelines, there have been significant advancements in agency practice, merger economics, and federal court case law. This article describes twelve ways that the Guidelines should be revised to better reflect current agency practice, to incorporate aspects of merger analysis absent from the 1992 Guidelines, and to clarify certain aspects of the 1992 Guidelines.

### History of the Merger Guidelines and Need for Revision

The DOJ issued the first merger enforcement guidelines in 1968. These relied on concentration, measured in terms of the four-firm concentration ratio, as the yardstick by which to evaluate horizontal mergers.<sup>8</sup> In 1982, the DOJ, under the leadership of Assistant Attorney General William Baxter, issued revised guidelines that introduced the now-familiar SSNIP test for market definition, established new concentration thresholds based on the HHI, and included factors relevant to an assessment of the competitive effects and the likelihood of entry.<sup>9</sup>

On the same day the DOJ announced its 1982 Guidelines, the FTC issued a statement explaining its approach to horizontal merger enforcement.<sup>10</sup> The FTC's statement was less detailed than the DOJ's 1982 Guidelines but noted that the DOJ's Guidelines would "be given considerable weight by the Commission and its staff in their evaluation of horizontal mergers and in the development of the Commission's overall approach to horizontal mergers."<sup>11</sup> In 1984, the DOJ issued revised Guidelines making some modest changes, including placing less weight on HHI concentration statistics and adjusting the treatment of imports.<sup>12</sup>

In 1992, the FTC and DOJ issued their first joint merger enforcement guidelines.<sup>13</sup> The most significant change from previous iterations was the addition of unilateral effects theories. The 1992 Guidelines also reduced the significance of the HHI thresholds (again) and revised the discussion of entry requirements, partly in response to the D.C. Circuit's *Baker Hughes* decision.<sup>14</sup> In 1997, the agencies updated the Guidelines to take greater account of efficiencies. With the exception of the 1997 efficiencies revision, the Guidelines have been untouched in seventeen years—the longest gap since they were first introduced.

The 1968, 1982, and 1984 Guidelines discussed both horizontal and non-horizontal theories of harm. In contrast, the 1992 Guidelines did not include a discussion of non-horizontal theories,

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<sup>7</sup> *See id.*

<sup>8</sup> U.S. Dep't of Justice, Merger Guidelines § 4 (1968), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,101 ("In enforcing Section 7 against horizontal mergers, the Department accords primary significance to the size of the market share held by both the acquiring and the acquired firms."). Each iteration of the U.S. merger guidelines is available at <http://www.usdoj.gov/atr/hmerger.htm#guidelines>.

<sup>9</sup> U.S. Dep't of Justice, Merger Guidelines (1982), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,102 [hereinafter 1982 Guidelines].

<sup>10</sup> Statement of the Federal Trade Commission Concerning Horizontal Mergers (1982), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,200. Unlike the DOJ's 1982 Guidelines, the FTC's statement did not address non-horizontal concerns.

<sup>11</sup> *Id.* § 1.

<sup>12</sup> U.S. Dep't of Justice, Merger Guidelines (1984), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,103 [hereinafter 1984 Guidelines].

<sup>13</sup> U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines (1992, rev. 1997), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,104 [hereinafter 1992 Guidelines].

<sup>14</sup> *United States v. Baker Hughes Inc.*, 908 F.2d 981 (D.C. Cir. 1990). The 1992 Guidelines added the three-part timely, likely, and sufficiency requirements, replacing the "likelihood and probable magnitude" test in Section 3.3 of the 1984 Guidelines.

leaving the 1984 Guidelines as the last word on the agencies' enforcement policy for vertical mergers and mergers raising potential competition concerns.<sup>15</sup>

Since the 1992 and 1997 revisions, the agencies have sought to explain their application of the Guidelines and impose some transparency on their decision making process through the use of closing statements,<sup>16</sup> speeches,<sup>17</sup> workshops,<sup>18</sup> merger enforcement data,<sup>19</sup> and perhaps most significantly, the Merger Guidelines Commentary. The Commentary, which explains how the agencies applied the Guidelines in specific investigations, was intended to be an alternative to new merger guidelines, which the agencies concluded were "neither needed nor widely desired" at that time because of the flexibility of the Guidelines.<sup>20</sup>

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But notwithstanding the agencies' efforts to keep the public informed as to their evolving interpretation of the Guidelines, it has become increasingly clear that the growing patchwork of glosses on the Guidelines has become unwieldy for all but the most seasoned veterans of the antitrust agencies. This is because the agencies' approach to horizontal merger investigations has moved beyond the Guidelines' approach in a number of respects.<sup>21</sup> There have been sufficient advancements in economic analysis and agency practice, not to mention a host of important federal court

<sup>15</sup> See U.S. Department of Justice and Federal Trade Commission Statement Accompanying Release of Revised Merger Guidelines (1992), reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13,104 ("Neither agency has changed its policy with respect to non-horizontal mergers. Specific guidance on non-horizontal mergers is provided in Section 4 of the Department's 1984 *Merger Guidelines*, read in the context of today's revisions to the treatment of horizontal mergers.").

<sup>16</sup> See, e.g., Press Release, Dep't of Justice Antitrust Div. Statement on the Closing of Its Investigation of Whirlpool's Acquisition of Maytag (Mar. 29, 2006), available at [http://www.usdoj.gov/atr/public/press\\_releases/2006/215326.pdf](http://www.usdoj.gov/atr/public/press_releases/2006/215326.pdf); Statement of the Federal Trade Commission concerning Royal Caribbean Cruises, Ltd./P&O Princess Cruises plc & Carnival Corp./P&O Princess Cruises plc, FTC File No. 021 0041 (Oct. 4, 2002), available at <http://www.ftc.gov/os/2002/10/cruisestatement.htm>. See generally Antitrust Division, U.S. Dep't of Justice, Issuance of Public Statements Upon Closing of Investigations, available at <http://www.usdoj.gov/atr/public/guidelines/201888.htm>.

<sup>17</sup> See, e.g., Deborah Platt Majoras, Chairman, Fed. Trade Comm'n, Remarks at the ABA Antitrust Section Fall Forum (Nov. 18, 2004), available at <http://www.ftc.gov/speeches/majoras/041118abafallforum.pdf> (describing recent developments in merger enforcement policy, merger remedies, merger process reforms, and cooperation with foreign competition authorities).

<sup>18</sup> See, e.g., FTC Unilateral Effects Analysis and Litigation Workshop (Feb. 12, 2008), <http://www.ftc.gov/bc/unilateral/index.shtml>; FTC/DOJ Joint Workshop on Merger Enforcement (Feb. 17–19, 2004), <http://www.ftc.gov/bc/mergerenforce>.

<sup>19</sup> See, e.g., Fed. Trade Comm'n, Horizontal Merger Investigation Data, Fiscal Years 1996–2007 (Dec. 1, 2008), available at <http://www.ftc.gov/os/2008/12/081201hsrmergerdata.pdf>; Fed. Trade Comm'n, Horizontal Merger Investigation Data, Fiscal Years 1996–2005 (Jan. 25, 2007), available at <http://www.ftc.gov/os/2007/01/P035603horizmergerinvestigationdata1996-2005.pdf>; Fed. Trade Comm'n, Horizontal Merger Investigation Data, Fiscal Years 1996–2003 (Feb. 2, 2004, revised Aug. 31, 2004), available at <http://www.ftc.gov/os/2004/08/040831horizmergersdata96-03.pdf>; Fed. Trade Comm'n & U.S. Dept. of Justice, Merger Challenges Data, Fiscal Years 1999–2003 (Dec. 18, 2003), available at <http://www.ftc.gov/os/2003/12/mdp.pdf>.

<sup>20</sup> Commentary, *supra* note 5, at v.

<sup>21</sup> Accord ABA SECTION OF ANTITRUST LAW, 2008 TRANSITION REPORT 33 (2008) [hereinafter ABA TRANSITION REPORT] ("[T]here are concerns that some parts of the Guidelines no longer reflect current economic thinking and the approach taken by the agencies or do not adequately address certain issues that arise in merger cases."); Ilene Knable Gotts & Étienne Renaudeau, *Through the Looking Glass: Ruminations on Improving the Current U.S. Merger Enforcement Guidelines*, ANTITRUST SOURCE, Apr. 2009, at 2, <http://www.abanet.org/antitrust/at-source/09/04/Apr09-Gotts4-28f.pdf> (contending that the merger guidelines "have the potential to mislead the business and legal community"); *Roundtable Discussion: Developments—and Divergence—in Merger Enforcement*, ANTITRUST, Fall 2008, at 9, 22 [hereinafter *Merger Roundtable*] (William Kolasky: "[A]gency practice has moved well beyond the Guidelines, so that for unsophisticated clients and lawyers who do not appear before the agencies regularly, the Guidelines are now affirmatively misleading."); John Kwoka, *Some Thoughts on Concentration, Market Shares, and Merger Enforcement Policy* 7 (FTC/DOJ Workshop on Merger Enforcement 2004), available at <http://www.ftc.gov/bc/mergerenforce/presentations/040217kwoka.pdf> ("It is well understood that a gap exists between the Merger Guidelines as written and actual enforcement practice by the FTC and DOJ.").

decisions, to justify a new version of the Guidelines.<sup>22</sup> Revised Guidelines would help practitioners and the business community by describing in a single document the agencies' approach to horizontal mergers.

Revised Guidelines would have benefits beyond the U.S. antitrust community. Updated Guidelines could help influence the development of merger control systems in other countries and other U.S. agencies with competition mandates.<sup>23</sup> Updated Guidelines would also help federal courts in Section 7 cases, which often follow the Guidelines and which may not recognize where the Guidelines have become outdated.<sup>24</sup>

## Challenges

Should the agencies move forward with their plans to revise the Guidelines, a number of challenges await. The most important is the need for consensus between the FTC and DOJ. The agencies have had a number of high-profile disputes in recent years.<sup>25</sup> These differences have generally not been in the area of merger enforcement, but there is certainly potential for disagreements there as well. The likely addition of two new FTC Commissioners in the near future also adds uncertainty to the process.

Another challenge is the need for political consensus. The 1992 Guidelines have been successful in part because of their acceptance by both Democratic and Republican administrations since their issuance. While different administrations have emphasized different aspects of the Guidelines as part of their enforcement efforts, there has not been any serious quarrel with the overall approach of the Guidelines. The next version of the Guidelines will need to attain a similar level of consensus to be successful.

Assuming consensus on the general approach to revised Guidelines can be achieved, subordinate issues will also confront drafters. Should the Guidelines contain economic formulae to better explain, for example, critical loss analysis? To what extent should post-Chicago economic thinking be incorporated?<sup>26</sup> Should the Guidelines attempt to adhere to recent court decisions, or

<sup>22</sup> The Guidelines themselves suggest that revisions should be made "from time to time as necessary to reflect any significant changes in enforcement policy or to clarify aspects of existing policy." 1992 Guidelines, *supra* note 13, § 0 n.4.

<sup>23</sup> See Gotts & Renaudeau, *supra* note 21, at 1 & n.4 (identifying non-U.S. merger enforcement guidelines that have adopted the concepts in the U.S. merger guidelines).

<sup>24</sup> See *Chicago Bridge & Iron Co. v. FTC*, 534 F.3d 410, 431 n.11 (5th Cir. 2008) ("Merger Guidelines are often used as persuasive authority when deciding if a particular acquisition violates anti-trust laws."); *United States v. Kinder*, 64 F.3d 757, 771 & n.22 (2d Cir. 1995) ("Although it is widely acknowledged that the 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 of legality."); Hillary Greene, *Guidelines Institutionalization: The Role of Merger Guidelines in Antitrust Discourse*, 48 WM. & MARY L. REV. 771, 776 (2006) (concluding that the Merger Guidelines "have acted as a stealth force on the development of antitrust merger law").

<sup>25</sup> For example, three of the four FTC Commissioners issued a statement criticizing the DOJ's 2008 Single-Firm Conduct Report as a "blueprint for radically weakened enforcement of Section 2 of the Sherman Act." Statement of Commissioners Harbour, Leibowitz and Rosch on the Issuance of the Section 2 Report by the Department of Justice 1 (Sept. 8, 2008), available at <http://www.ftc.gov/os/2008/09/080908section2stmt.pdf>. See generally U.S. Dep't of Justice, Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act (2008); *Merger Roundtable*, *supra* note 21, at 22 (Deborah Feinberg: "I am not particularly eager to see an attempt at new Merger Guidelines if the agencies are going to have trouble agreeing, as happened with Section 2 guidelines.").

<sup>26</sup> See Remarks of FTC Chairman Jon Leibowitz as Prepared for Delivery at the Third Annual Georgetown Law Global Antitrust Enforcement Symposium 3 (Sept. 22, 2009), available at <http://www.ftc.gov/speeches/leibowitz/090922mergerguideleibowitzremarks.pdf> ("I've been a critic of the extent to which the Chicago School's optimism about efficiencies and about oligopoly conduct has affected merger reviews—as well as antitrust law more generally. But from my perspective, this effort isn't about giving precedence to one antitrust approach or another: it is really about good government, and making sure that the rules of the road are clear and easily understood, especially by those who enforce them.").

conversely, eschew precedent that does not accord with the agencies' views? What role should practitioners and the public play in revising the Guidelines? Should the agencies engage in any studies as a prelude to revised Guidelines?<sup>27</sup>

Notwithstanding these potential challenges, the agencies appear to have picked an opportune time to revise the Guidelines. The current chief economists of both agencies are former colleagues and have penned a number of merger-enforcement-related articles together. And despite the differences between the agencies in the past few years, arguably the agencies are closer aligned on substantive merger policy than they have been in years. The private bar also supports revising the Guidelines. Both the Antitrust Modernization Commission and the ABA Section of Antitrust Law have encouraged the agencies to update the Guidelines.<sup>28</sup>

## Proposals

Below are twelve proposed reforms to the Guidelines. For each of these, the Guidelines do not appear to reflect current agency practice or offer little, if any, guidance on an important aspect of merger analysis. Nine of these proposals address topics to be discussed at the agencies' upcoming workshops. The other three proposals—revising the coordinated effects “checklist,” adding a discussion of potential competition theories, and clarifying monopsony standards—should also be considered. These proposals are listed in the same order as the underlying subject matter in the Guidelines.

**Update the Overall Analytical Framework.** Defining the relevant market and determining concentration levels are the initial steps under both the Guidelines and Supreme Court precedent. The Guidelines describe a five-step process to determine whether an agency will challenge a horizontal merger, starting with defining the market and determining concentration levels.<sup>29</sup> This is consistent with Supreme Court precedent that “[d]etermination of the relevant market is a necessary predicate to a finding of a violation of the Clayton Act.”<sup>30</sup>

Nevertheless, the agencies and, to a lesser extent, the courts have moved away from the rigid structural analysis described in the Guidelines and now focus more on the analysis of market power and competitive effects. The Commentary explains that “the Agencies do not apply the Guidelines as a linear, step-by-step progression that invariably starts with market definition and

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<sup>27</sup> See Gotts & Renaudeau, *supra* note 21, at 13 (“An important preparatory step could be for the agencies to assess the actual effects of the ‘close-call’ consummated mergers. An ex post evaluation of a significant and relevant set of enforcement decisions may help the agencies to gain deeper insight into whether or not their merger analysis always fits with the market conditions and the evidence at hand, and to identify potential rooms for further improvements, if any.”).

<sup>28</sup> See ANTITRUST MODERNIZATION COMMISSION, REPORT AND RECOMMENDATIONS Recommendation 11 (2007) [hereinafter AMC REPORT]; ABA TRANSITION REPORT, *supra* note 21, at 32–38 (2008) (“The agencies should consider revisions to the Merger Guidelines, and ensure that they remain up-to-date on an ongoing basis.”); see also Gotts & Renaudeau, *supra* note 21 (suggestions from the 2009–2010 Chair of the ABA Section of Antitrust Law on ways to revise the merger guidelines); Larry Fullerton, *Divergence at the Agencies*, ANTITRUST, Fall 2008, at 8 (noting that in a recent roundtable of leading practitioners organized by *Antitrust* magazine “most of our panelists agreed that the agencies should revisit and update the Merger Guidelines”).

<sup>29</sup> 1992 Guidelines, *supra* note 13, § 0.2.

<sup>30</sup> *United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 586, 593 (1957); see also *United States v. Gen. Dynamics Corp.*, 415 U.S. 486, 510 (1974) (“a delineation of proper geographic and product markets is a necessary precondition to” a Section 7 claim); *FTC v. Tenet Health Care Corp.*, 186 F.3d 1045, 1051 (8th Cir. 1999) (“[D]etermination of a relevant market is a necessary predicate to the finding of an antitrust violation. Without a well-defined relevant market, a merger’s effect on competition cannot be evaluated.”); *United States v. Engelhard Corp.*, 126 F.3d 1302, 1305 (11th Cir. 1997) (“Establishing the relevant product market is an essential element in the Government’s case.”).

ends with efficiencies or failing assets.”<sup>31</sup> Rather the agencies favor “an integrated approach” where the emphasis is on competitive effects.<sup>32</sup>

In addition, in some mergers, the need to determine the concentration level within a properly defined market may be unnecessary, or at least not very important. For example, concentration may be uninformative in a unilateral effects analysis,<sup>33</sup> which focuses on the loss of localized competition and other competitors’ ability to reposition. The number of other competitors and the extent of concentration have little bearing on these questions.<sup>34</sup> Likewise, where anticompetitive effects are unlikely in any plausible relevant market, market definition is an unnecessary exercise.

The need for a structural analysis may also be unnecessary where direct effects evidence indicates that a merger will or will not substantially reduce competition. The Commentary appears to agree, noting that “evidence of effects may be the analytical starting point.”<sup>35</sup> Examples of direct effects evidence include a natural experiment showing the effect of a change in concentration or the number of competitors, documentary or other evidence showing an acquiring company’s post-merger plans, and changes in prices or output from a consummated merger. Direct effects evidence may also be helpful in “backing into” the appropriate market definition.<sup>36</sup>

The Supreme Court has held that direct effects evidence can establish a violation of the Sherman Act in a non-merger case, even without proof of market power in a relevant market.<sup>37</sup> The D.C. Circuit has twice suggested that a Section 7 violation could be predicated on direct effects evidence. In *Baker Hughes*, Judge (now Justice) Thomas stated that “[m]arket share is just a way

<sup>31</sup> Commentary, *supra* note 5, at 2; *see also* Opinion of the Commission at 54, *Evanston Northwestern Healthcare Corp.*, FTC Docket No. 9315 (Aug. 6, 2007), available at <http://www.ftc.gov/os/adjpro/d9315/070806opinion.pdf> [hereinafter *Evanston* Commission Opinion] (“Although the courts discuss merger analysis as a step-by-step process, the steps are, in reality, interrelated factors, each designed to enable the factfinder to determine whether a transaction is likely to create or enhance existing market power.”); Leibowitz, *supra* note 26, at 3 (“[T]he Guidelines exaggerate the extent to which the agencies follow a single, rigid, step-by-step approach in merger analysis.”).

<sup>32</sup> *See* Commentary, *supra* note 5, at 2.

<sup>33</sup> *Id.* at 16 (“[T]he question in a unilateral effects analysis is whether the merged firm likely would exercise market power absent any coordinated response from rival market incumbents. The concentration of the remainder of the market often has little impact on the answer to that question.”); Kwoka, *supra* note 21, at 6 (“[U]nilateral effects depend upon elasticities and diversion, factors which are at best partially informed by market shares but otherwise not closely related to traditional structural characteristics.”); Jonathan B. Baker & Steven C. Salop, *Should Concentration Be Dropped from the Merger Guidelines?*, 33 *UWLA L. REV.* 3, 11–12 (2001) (“Concentration matters least in predicting the consequence of an acquisition when the competitive concern involves the loss of localized competition among sellers of differentiated products. . . . It is now widely accepted among economists that unilateral effects analysis does not strictly require a single discrete relevant market to be defined with the SSNIP test; demand elasticities and diversion ratios are sufficient.”).

<sup>34</sup> The 1982 Merger Guidelines introduced the SSNIP market definition test and associated HHIs in the context of coordinated effects analysis. *See Baker & Salop, supra* note 33, at 11–12. The addition of unilateral effects theories to the 1992 Guidelines was superimposed on this coordinated effects framework. *See id.*; *see also* Kwoka, *supra* note 21, at 7 (“[T]he current Guidelines are organized in a manner that seems misleading. Their logical structure is strictly correct only for concern with coordinated effects, even as they note the importance of unilateral effects.”).

<sup>35</sup> Commentary, *supra* note 5, at 10; *see also id.* at 11 (“In some cases, competitive effects analysis may eliminate the need to identify with specificity the appropriate relevant market . . .”).

<sup>36</sup> *See Evanston* Commission Opinion, *supra* note 31, at 60 (“[I]f a merger enables the combined firm unilaterally to raise prices by a SSNIP for a non-transitory period due to the loss of competition between the merging parties, the merger plainly is anticompetitive, and the merging firms comprise a relevant antitrust market . . . .”); Commentary, *supra* note 5, at 10 (“Evidence pertaining more directly to a merger’s actual or likely competitive effects also may be useful in determining the relevant market in which effects are likely. Such evidence may identify potential relevant markets and significantly reinforce or undermine other evidence relating to market definition.”).

<sup>37</sup> *See FTC v. Indiana Fed. of Dentists*, 476 U.S. 447, 460–61 (1986) (“Since the purpose of the inquires into market definition and market power is to determine whether an arrangement has the potential for genuine adverse effects on competition, proof of actual detrimental effects, such as a reduction of output, can obviate the need for an inquiry into market power, which is but a surrogate for detrimental effects.” (quotations omitted)).



of estimating market power, which is the ultimate consideration . . . . When there are better ways to estimate market power, the court should use them.”<sup>38</sup> In the D.C. Circuit’s *Whole Foods* decision, Judge Brown stated that “defining a market and showing undue concentration in that market . . . does not exhaust the possible ways to prove a § 7 violation on the merits.”<sup>39</sup> In particular, “it might not be necessary to understand the market definition” in a unilateral effects case involving differentiated products, at least at the preliminary injunction stage.<sup>40</sup>

A recent FTC merger decision picks up on the theme that direct effects evidence could supplant market definition in some cases. In *Evanston Northwestern*, the Commission stated that “we do not rule out the possibility that a future merger case may lead us to consider whether complaint counsel must always prove a relevant market.”<sup>41</sup> The Commission explained that market definition “is potentially much less important in merger cases in which the availability of natural experiments allows for direct observation of the effects of competition between the merging parties.”<sup>42</sup>

The Guidelines should recognize the possible use of direct effects evidence, the circumstances under which it could be used, and its potential to supplement or replace the market definition-concentration structural paradigm in certain cases. This would for the most part be a formal recognition of what the agencies have said in a variety of less formal contexts. Nevertheless, such an important development should not be left for practitioners and other interested parties to discover in a speech or agency report; it should be front and center in the Guidelines.

**Revise the HHI Thresholds.** Perhaps the greatest divergence between the Guidelines and actual agency practice involves the role of HHIs. Section 1.51 of the Guidelines states that mergers producing an increase in HHI of more than 100 points in a “moderately concentrated” market (one with a most-merger HHI between 1,000 and 1,800) or an increase of more than 50 points in a “highly concentrated” market (one with a most-merger HHI of more than 1,800) “potentially raise significant competitive concerns.” An HHI increase of more than 100 points in a “highly concentrated” market will result in a presumption that the merger will “create or enhance market power or facilitate its exercise.”

In practice, however, the agencies frequently clear transactions with a post-merger HHI exceeding 1,800 and usually challenge mergers only at far higher levels of concentration.<sup>43</sup> A recent report indicates that the majority of FTC enforcement actions involve post-merger concentration levels above 4,000 and over two-thirds involve post-merger concentration levels above 3,000.<sup>44</sup> Except for the politically charged petroleum and grocery store industries, challenges in markets with post-merger HHIs below 2,400 are exceptionally rare.<sup>45</sup> As then-Chairman Muris explained in connection with the release of a related report, “I hope the data we released . . . will finally put to rest

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<sup>38</sup> *United States v. Baker Hughes Inc.*, 908 F.2d at 992 (quoting *Ball Memorial Hosp. v. Mutual Hosp. Ins.*, 784 F.2d 1325, 1336 (7th Cir. 1986)). Judge (now Justice) Ruth Bader Ginsburg was also on the *Baker Hughes* panel.

<sup>39</sup> *FTC v. Whole Foods Market, Inc.*, 548 F.3d 1028, 1036 (D.C. Cir. 2008) (Brown, J.) (dicta).

<sup>40</sup> *Id.* at 1036 n.1 (Brown, J.) (dicta).

<sup>41</sup> See *Evanston* Commission Opinion, *supra* note 31, at 88 (dicta).

<sup>42</sup> *Id.* at 86–87 (dicta).

<sup>43</sup> See Michael L. Katz & Howard A. Shelanski, *Mergers and Innovation*, 74 ANTITRUST L.J. 1, 9 (2007) (“In actual practice, the U.S. antitrust agencies tend to challenge mergers only at concentration levels much higher than 1800.”).

<sup>44</sup> Fed. Trade Comm’n, Horizontal Merger Investigation Data, Fiscal Years 1996–2007 at Table 3.1 (Dec. 1, 2008), available at <http://www.ftc.gov/os/2008/12/081201hsrmergerdata.pdf>. According to an analysis of earlier data provided by both agencies, the median HHI for a challenged transaction was 4,500 with a median increase of 1,200. See Kwoka, *supra* note 21, at 8.

<sup>45</sup> See Horizontal Merger Investigation Data 1996–2007, *supra* note 44, at Tables 3.1–3.5.

the notion that HHI levels have any specific significance, except at very high levels.”<sup>46</sup>

Given the wide divergence between the Guidelines and actual agency practice, the agencies should give strong consideration to revising the current concentration thresholds. While most practitioners seem to be aware of the significance of the current concentration thresholds, the federal courts, other U.S. agencies with competition mandates, and foreign competition authorities that look to the Guidelines may not.<sup>47</sup> For example, courts frequently cite to the 1,800/100 concentration thresholds in the Guidelines without recognizing that these thresholds are outdated and not reflective of agency practice.<sup>48</sup>

Alternatively, the Guidelines should clarify that the HHI thresholds are merely safe harbors and that failure to meet a safe harbor does not carry with it a presumption of competitive concerns or the enhancement of market power.<sup>49</sup> Either approach would be consistent with the gradual de-emphasis of concentration since the 1982 Guidelines.<sup>50</sup>

**Clarify the Role of the Coordinated Effects “Checklist.”** Coordinated effects analysis under the Guidelines involves defining the relevant market, determining the extent of and increase in concentration, and then assessing whether the relevant market is conducive to coordinated behavior. This final step is done in accordance with an assortment of factors based on the work of Stigler and Posner.<sup>51</sup>

This “Checklist” approach is problematic because it does not explain how the transaction increases the incentive or ability of incumbent firms to coordinate their behavior. The ultimate issue in coordinated effects analysis is the extent to which a transaction mitigates existing impediments to coordinated behavior.<sup>52</sup> The presence or absence of any particular Checklist factor or factors

<sup>46</sup> Timothy J. Muris, Chairman, Fed. Trade Comm’n, Prepared Remarks at the Workshop on Horizontal Merger Guidelines (Feb. 17, 2004), available at <http://www.ftc.gov/speeches/muris/040217hmgwksp.shtm>; see also Timothy J. Muris, Chairman, Fed. Trade Comm’n, Antitrust Enforcement at the Federal Trade Commission: In a Word, Continuity, Remarks Before ABA Section of Antitrust Law Annual Meeting (Aug. 7, 2001), available at <http://www.ftc.gov/speeches/muris/murisaba.shtm> (“Rigid reliance on concentration statistics and structural presumptions . . . no longer suffice; we . . . have to look at the competitive dynamics of the market.”); Varney, *supra* note 4, at 7 (“It is no secret that today the HHI thresholds offer little in the way of meaningful guidance to businesses considering merging.”).

<sup>47</sup> See *Merger Roundtable*, *supra* note 21, at 22 (William Kolasky: “I agree that revising the Merger Guidelines so that they reflect actual agency practice would help with getting other jurisdictions around the world to move away from an overly formalistic structural approach.”); Darren S. Tucker & Bilal Sayyed, *The Merger Guidelines Commentary: Practical Guidance and Missed Opportunities*, ANTITRUST SOURCE, May 2006, <http://www.abanet.org/antitrust/at-source/06/05/May06-Tucker5=24f.pdf> (“The agencies, having adopted the HHI thresholds in 1982, have sufficient experience to support an increase in the thresholds to a level consistent with actual practice; this would have the benefit of encouraging other federal agencies to rethink their reliance on the current numbers.”).

<sup>48</sup> See, e.g., *Chicago Bridge & Iron Co. v. FTC*, 534 F.3d 410, 431 (5th Cir. 2008) (citing to the Guidelines for the proposition that a post-merger HHI of 1,800 with an increase of 100 points or more creates “a presumption of adverse competitive consequences”); *FTC v. Foster*, No. CIV 07-352 JBACT, 2007 WL 1793441, at \*54 (D.N.M. May 29, 2007) (similar). But see *FTC v. Arch Coal, Inc.*, 329 F. Supp. 2d 109, 129 (D.D.C. 2004) (observing that the agencies typically challenge transactions with concentrations that “dwarf” the Guidelines’ thresholds).

<sup>49</sup> *Accord* *United States v. Oracle Corp.*, 331 F. Supp. 2d 1098, 1112 (N.D. Cal. 2004) (describing the Guidelines’ HHI thresholds as establishing safe harbors).

<sup>50</sup> See Thomas B. Leary, *The Essential Stability of Merger Policy in the United States*, 70 ANTITRUST L.J. 105, 116–17, 121 (2002) (“The strong concentration presumptions in the 1982 Guidelines were soon seen to be impractical and began to be softened only two years later.”). Leary notes that the 1982, 1984, and 1992 merger guidelines all contained the “basic tripartite split” between markets that are unconcentrated, moderately concentrated, and highly concentrated, but that the presumption of anticompetitive effects of mergers falling in the highly concentrated category was softened with each revision. *Id.* at 116–17.

<sup>51</sup> RICHARD A. POSNER, ANTITRUST LAW: AN ECONOMIC PERSPECTIVE (1976); George Stigler, *A Theory of Oligopoly*, 72 J. POL. ECON. 44 (1964).

<sup>52</sup> Janusz A. Ordover, *Coordinated Effects in Merger Analysis: An Introduction*, 2007 COLUM. BUS. L. REV. 411, 418 (2007).



sheds little light on this inquiry.<sup>53</sup> This is not to say the Stigler-Posner factors should be irrelevant to merger analysis. Rather, they should be considered in the context of determining “what factors make coordination difficult and how might the merger change things.”<sup>54</sup> Clarification of the role of the Checklist factors could help avoid the all-too-common view that a tabulation of the applicable pre-merger Stigler-Posner factors is somehow relevant.<sup>55</sup>

The discussion of coordinated effects also needs to highlight the important role of mavericks. Unlike the other Checklist factors, the elimination (or creation) of a maverick is a merger-specific event that can affect incumbents’ ability to coordinate. As the *Arch Coal* court noted, “An important consideration when analyzing possible anticompetitive effects is whether the acquisition would result in the elimination of a particularly aggressive competitor in a highly concentrated market. . . . The loss of a firm that does not behave as a maverick is unlikely to lead to increased coordination.”<sup>56</sup> Likewise, the Commentary recognizes that the loss of a maverick firm “may make coordination more likely because the nature and intensity of competition may change significantly.”<sup>57</sup>

Another factor that should be highlighted is a history of prior coordination or attempted coordination, not because it necessarily indicates the likely mechanism of coordination, but because of the tendency for recidivism and because of the likelihood that ongoing coordination will be exacerbated by consolidation. The courts and the agencies have noted the importance of the industry’s history in coordinated effects analysis.<sup>58</sup>

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<sup>53</sup> See David T. Scheffman & Mary Coleman, *Quantitative Analyses of Potential Competitive Effects from a Merger*, 12 GEO. MASON L. REV. 319, 327 (2003) (“[S]uch Check Lists are too crude to provide much assistance in determining whether a coordinated interaction theory is relevant. Specifically, many industries that fit the Check List do not appear to exhibit outcomes that are consistent with coordinated interaction. Moreover, this approach does not focus on why the merger should affect the likelihood of coordination.”); ABA TRANSITION REPORT, *supra* note 21, at 35 (stating that the “checklist approach” does not explain “how the merger would change the potential for coordination”).

<sup>54</sup> See Scheffman & Coleman, *supra* note 53, at 329; see also Ordoover, *supra* note 52, at 424 (stating that the Merger Guidelines’ Checklist is relevant “to the ‘mechanism’ of coordination”). A good example of this approach is the DOJ’s investigation of the Premdore/Masonite merger, in which the Department explained that “the evidence developed in the investigation of the proposed transaction revealed at least four significant factors in the current structure of these markets that make coordination less likely. Based upon the evidence specific to this case, including documents obtained from the defendants, each of these factors would be lessened or eliminated if the proposed transaction were consummated.” *United States v. Premdor Inc.*, 66 Fed. Reg. 45,326, 45,337 (Aug. 28, 2001) (Competitive Impact Statement).

<sup>55</sup> The Commentary appears to recognize this problem, explaining that the various industry characteristics “are not simply put on the left or right side of a ledger and balanced against one another.” Commentary, *supra* note 5, at 21.

<sup>56</sup> See *FTC v. Arch Coal, Inc.*, 329 F. Supp. 2d 109, 146 (D.D.C. 2004) (quoting *FTC v. Libbey, Inc.*, 211 F. Supp. 2d 34, 47 (D.D.C. 2002), *FTC v. Staples Inc.*, 970 F. Supp. 1066, 1083 (D.D.C. 1997), and William J. Kolasky, Deputy Ass’t Att’y Gen., Antitrust Div., Coordinated Effects in Merger Review: From Dead Frenchman to Beautiful Minds and Mavericks, Remarks Before the ABA Section of Antitrust Law Spring Meeting (Apr. 24, 2002) (“[M]averick status is becoming a more important factor in the agencies’ evaluation of coordinated effects in merger cases.”)); see also Jonathan B. Baker, *Mavericks, Mergers, and Exclusion: Proving Coordinated Competitive Effects Under the Antitrust Laws*, 77 N.Y.U. L. REV. 135 (2002); *Foster*, 2007 WL 1793441, at \*48–\*49 (finding that coordinated effects were unlikely because of a lack of “evidence of past competitor coordination or the ability of firms to coordinate in the future. There is also no evidence that Giant has acted as a maverick . . .”).

<sup>57</sup> Commentary, *supra* note 5, at 24–25; see also Paul T. Denis, *The Give and Take of the Commentary on the Horizontal Merger Guidelines*, ANTITRUST, Summer 2006, at 51, 53 (“It is unclear from the Commentary what else, beyond acquisition of a maverick, can facilitate coordinated effects.”).

<sup>58</sup> See, e.g., *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 724 (D.C. Cir. 2001) (finding that the likelihood of tacit collusion was enhanced by “record evidence of past price leadership in the baby food industry”); *FTC v. Elders Grain, Inc.*, 868 F.2d 901, 905 (7th Cir. 1989) (“there is a history of efforts to fix prices in the industry”); *Hosp. Corp. of Am. v. FTC*, 807 F.2d 1381, 1388 (7th Cir. 1986) (“there is a tradition . . . of cooperation between competing hospitals in Chattanooga”); *FTC v. CCC Holdings Inc.*, 605 F. Supp. 2d 26, 60 (D.D.C. 2009) (the lack of “evidence of past coordination” weighs against a risk of coordinated effects); *Arch Coal*, 329 F. Supp. 2d at 132–140 (extensive analysis of whether prior coordination occurred in the relevant market); Commentary, *supra* note 5, at 22–23; see also Denis, *supra* note 57, at 54 (“The only other approach to coordinated effects theories illustrated in the Commentary is through use of evidence of past and ongoing coordination.”); Kolasky, *supra* note 56, at 20 (stating that “cartel participants tend to be recidivists”).

**Describe Additional Unilateral Effects Models.** Revised Guidelines should identify the unilateral effects models that the agencies regularly employ. The Guidelines currently describe two theories of unilateral effects—one for the pricing of differentiated products and one for capacity and output of a homogeneous product—yet the agencies frequently apply other models. Given the important role unilateral effects theories have played in enforcement actions since the promulgation of the 1992 Guidelines, adding a brief description of additional unilateral effects models that the agencies frequently employ would benefit practitioners, courts, and agency staff.<sup>59</sup> Two examples come to mind: auction models and bargaining models, both of which have played a prominent role in recent enforcement decisions.<sup>60</sup>

Buyers sometimes procure industrial or customized products through a single- or multi-stage auction format that may involve the use of requests for proposal or quotation. The agencies have developed auction models designed to describe the effect of a merger involving products purchased through one of these formats. The FTC's challenge in *CCC* and the DOJ's challenge in *Oracle* are recent examples of cases involving potential unilateral effects relating to auctions.<sup>61</sup>

Unilateral effects may also arise in markets where purchases are made as a result of individual negotiations between buyers and sellers. In these markets, the combination of two sellers may give the merged firm the ability to obtain a more favorable bargain. The FTC frequently uses bargaining theory to analyze the effects of hospital mergers on the prices to managed care organizations.<sup>62</sup> Recent examples include the *Evanston* and *Inova* cases.<sup>63</sup>

Given the agencies' frequent use of auction and bargaining models, some description of these models in the Guidelines would fill an existing gap. Explanation of how the agencies' might resolve some of the "sticky and unsettled issues"<sup>64</sup> (the FTC's words) they present would also be helpful.

**Provide a Better Description of Key Econometric Tools.** The agencies should consider describing the econometric methods that they often use to define relevant markets and competitive effects. Clarification would aid not only practitioners but also the courts, which have become

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<sup>59</sup> It would, of course, be impractical for revised Guidelines to address every conceivable unilateral effects model. See Thomas O. Barnett, *Substantial Lessening of Competition—The Section 7 Standard*, 2005 COLUM. BUS. L. REV. 293, 301 (2005) (noting that there has been a "proliferation of unilateral effects theories over the past decade").

<sup>60</sup> Consideration should also be given to including monopoly and dominant firm models, both of which are mentioned in the Commentary.

<sup>61</sup> *CCC*, 605 F. Supp. 2d at 68–72 (discussing the government's auction models for the sale of the relevant products to insurance companies); *United States v. Oracle Corp.*, 331 F. Supp. 2d 1098, 1169–70 (N.D. Cal. 2004) (noting that the government's expert used an English auction model to predict a unilateral price effect). The Guidelines contain a brief discussion of one type of auction model in a footnote. See 1992 Guidelines, *supra* note 13, § 2.21 n.21.

<sup>62</sup> See Commentary, *supra* note 5, at 34; *Evanston* Commission Opinion, *supra* note 31, at 62 (noting that "bargaining markets are quite common" and that "bargaining models are appropriate for hospital markets because bilateral negotiations between MCOs and hospitals determine price that often are unique to the particular negotiation").

<sup>63</sup> See *Evanston* Commission Opinion, *supra* note 31, at 62–63; Administrative Complaint ¶¶ 15, 28–29, *Inova Health Sys. Found.*, FTC Docket No. 9326 (May 8, 2008), available at <http://www.ftc.gov/os/adjpro/d9326/080509admincomplaint.pdf> (alleging that hospital merger would adversely affect bargaining strength of health plans, resulting in higher prices).

<sup>64</sup> *Evanston* Commission Opinion, *supra* note 31, at 63 ("The potential for a merger in a bargaining market to have disparate effects on different customers potentially creates sticky and unsettled issues for merger analysis, most significantly, determining the percentage of a merged firm's revenues that must come from customers who are harmed by the merger for the transaction to violate Section 7."); see also ABA TRANSITION REPORT, *supra* note 21, at 34 ("[W]e believe that it is important that the agencies provide greater clarity and understanding to the use of unilateral effects theories.").

increasingly comfortable with the use of econometrics. Two economic tools in particular stand out as worthy of additional discussion: critical loss analysis and diversion ratios.<sup>65</sup>

Critical loss analysis is used at both agencies to help define relevant markets and model competitive effects.<sup>66</sup> Critical loss analysis seeks to identify the level of lost sales needed to make a price increase by a hypothetical monopolist unprofitable. A number of courts have accepted—or at least acknowledged—critical loss analysis.<sup>67</sup> As two leading economists note, “[m]erging parties have used Critical Loss Analysis regularly, and with considerable success, to argue in court for a broader market than the government asserts.”<sup>68</sup>

Likewise, including a description of diversion ratios in the Guidelines would provide greater transparency as to how the agencies assess unilateral effects and provide guidance to courts when faced with expert testimony on the subject. In a differentiated products merger, diversion ratios can be an important part of the analysis.<sup>69</sup> Under Section 2.21 of the Guidelines, unilateral effects may occur when “a significant share of sales in the market [is] accounted for by consumers who regard the products of the merging firms as their first and second choices.” In practice, the agencies frequently measure the closeness of the merging firms’ products through diversion ratios, which identify the proportion of sales gained by a product relative to the sales loss from an increase in price of a similar product. The greater the diversion ratios between the merging parties’ products, the greater the risk of unilateral effects.<sup>70</sup> Several recent federal court merger decisions relied on diversion ratios in their analysis.<sup>71</sup>

Including an explanation of diversion ratios may also help eliminate some confusion as to the significance of the merging parties being (or not being) closest substitutes.<sup>72</sup> Merging parties sometimes contend that their products are not closest substitutes, pointing to a third competitor that

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<sup>65</sup> Other possibilities include natural experiments, which can provide insight into the competitive effects of a merger by viewing prior changes in concentration in the relevant market, and simulation models.

<sup>66</sup> David Scheffman, Malcolm Coate & Louis Silvia, *Twenty Years of Merger Guidelines Enforcement at the FTC: An Economic Perspective*, 71 ANTITRUST L.J. 277, 285 (2003) (“Critical loss’ analysis is regularly used at both the FTC and DOJ . . . .”); Michael L. Katz & Carl Shapiro, *Critical Loss: Let’s Tell the Whole Story*, ANTITRUST, Spring 2003, at 49, 50 (“Critical loss analysis is commonly used, both by economists for private parties and by economists in the DOJ and the FTC.”).

<sup>67</sup> See, e.g., *FTC v. Whole Foods Market, Inc.*, 548 F.3d 1028, 1038 (D.C. Cir. 2008) (Brown, J.); *id.* at 1047–48 (Tatel, J.); *FTC v. Tenet Health Care Corp.*, 186 F.3d 1045, 1050, 1053 (8th Cir. 1999); *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 potentially 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.”); *California v. Sutter Health Sys.*, 130 F. Supp. 2d 1109, 1128–32 (N.D. Cal. 2001) (lengthy discussion and application of critical loss analysis); *FTC v. Swedish Match*, 131 F. Supp. 2d 151, 160–61 (D.D.C. 2000).

<sup>68</sup> Joseph Farrell & Carl Shapiro, *Improving Critical Loss*, ANTITRUST SOURCE, Feb. 2008, <http://www.abanet.org/antitrust/at-source/08/02/Feb08-Farrell-Shapiro.pdf>.

<sup>69</sup> Commentary, *supra* note 5, at 27–31; Carl Shapiro, *Mergers with Differentiated Products*, ANTITRUST, Spring 1996, at 23, 27 (“Diversion Ratios and Gross Margins are key variables to explore in a merger investigation involving differentiated products . . . .”).

<sup>70</sup> Shapiro, *supra* note 69, at 26 (“[H]igh Gross Margins and high Diversion Ratios suggest large post-merger price increases.”).

<sup>71</sup> See, e.g., *Whole Foods*, 548 F.3d at 1044 (Tatel, J.), 1056 n.4 (Kavanaugh, J.); *CCC*, 605 F. Supp. 2d at 70–71 (discussing diversion ratios); *United States v. Oracle Corp.*, 331 F. Supp. 2d 1098, 1113–18, 1172–73 (N.D. Cal. 2004) (extensive discussion of economics behind unilateral effects and diversion ratios); *Swedish Match*, 131 F. Supp. 2d at 169 (“[T]he diversion ratio is important because it calculates the percentage of lost sales that go to National. High margins and high diversion ratios support large price increases, a tenet endorsed by most economists.”).

<sup>72</sup> See Baker & Salop, *supra* note 33, at 12 (“[W]e think that the Merger Guidelines should explain more carefully the proper role of diversion ratios, demand elasticities, and relevant market definition in unilateral effects analysis, so that economically extraneous arguments about market definition and concentration can be avoided in the analysis of unilateral competitive effects of mergers among sellers of differentiated products.”).

allegedly offers the most similar products or the most aggressive competition. Implicit in this argument is that only if the merging parties are closest competitors can unilateral effects arise. The agencies themselves have occasionally suggested that a “closest competitor” standard is appropriate.<sup>73</sup>

But in fact, unilateral effects can arise where the merging parties are not closest competitors if the diversion ratios between them are sufficiently high.<sup>74</sup> Likewise, parties could be closest competitors yet not raise unilateral effects concerns if the diversion ratios are sufficiently low.<sup>75</sup>

Better explanation of diversion ratios might also help clear some of the confusion regarding the 35 percent unilateral effects threshold.<sup>76</sup> The Guidelines state that the agencies will presume the existence of unilateral effects when the combined share of the merging companies exceeds 35 percent and market shares reflect consumers’ first and second product choices.<sup>77</sup> Practitioners have generally viewed combined market shares short of 35 percent as falling within a safe harbor. The Commentary indicates that this view is misplaced and that “the Agencies may challenge mergers when the combined share falls below 35% if . . . the merging products are especially close substitutes.”<sup>78</sup>

Revised Guidelines should clarify the significance, if any, of the 35 percent threshold. Despite some concerns with the economic significance of this figure,<sup>79</sup> a market-share-based safe harbor for unilateral effects—even if at a lower percentage—would be a helpful bright-line test. And as the Commentary itself notes, the 35 percent test has worked well in practice.<sup>80</sup> On the other hand, if the agencies do not follow a safe harbor approach, there seems to be little reason to retain the 35 percent threshold.

**Include a Discussion of Innovation Markets.** Revised Guidelines would benefit from an explanation of how the agencies analyze innovation competition. The 1995 Intellectual Property Guidelines first identified innovation markets as potential relevant markets,<sup>81</sup> but noted that the acquisi-

<sup>73</sup> See Denis, *supra* note 57, at 55 & n.4 (identifying FTC closing statements that applied a “closest competitor” standard). Some DOJ competitive impact statements describe heightened concern because the merging parties were “closest competitors.” See, e.g., Competitive Impact Statement at 8, *United States v. Verizon Commc’ns Inc.*, Civil Action No 1:08-cv-993-EGS (D.D.C. June 10, 2008); Competitive Impact Statement at 9, *United States v. CBS Corp.*, Civil Action No. 1:99-CV3212 (D.D.C. Dec. 6, 1999).

<sup>74</sup> Commentary, *supra* note 5, at 27–28; Shapiro, *supra* note 69, at 26 (“Nor is a merger immunized merely because the merging brands are not next-closest substitutes, as some parties claim, any more than a merger is immunized merely because the merged entity still faces some post-merger competition.”).

<sup>75</sup> This might occur, for example, where there are a large number of non-merging competitors, each with a diversion ratio slightly below that of the acquired company.

<sup>76</sup> See Baker & Salop, *supra* note 33, at 12.

<sup>77</sup> 1992 Guidelines, *supra* note 13, § 2.211.

<sup>78</sup> Commentary, *supra* note 5, at 26.

<sup>79</sup> See Baker & Salop, *supra* note 33, at 12 (“[W]e recommend that the Merger Guidelines remove any suggestion of a 35% market share ‘safe harbor’ . . . in the evaluation of the possibility of unilateral effects among firms selling differentiated products.”).

<sup>80</sup> See Commentary, *supra* note 5, at 26 (“As an empirical matter, the unilateral effects challenges made by the Agencies nearly always have involved combined shares greater than 35%.”).

<sup>81</sup> U.S. Dep’t of Justice & Fed. Trade Comm’n, Antitrust Guidelines for the Licensing of Intellectual Property § 3.2.3 (1995), *reprinted* in 4 Trade Reg. Rep. (CCH) ¶ 13,132, available at <http://www.ftc.gov/bc/0558.pdf> [hereinafter IP Guidelines]. Section 3.2.3 of the IP Guidelines defines an innovation market as follows:

An innovation market consists of the research and development directed to particular new or improved goods or processes, and the close substitutes for that research and development. The close substitutes are research and development efforts, technologies, and goods that significantly constrain the exercise of market power with respect to the relevant research and development, for example by limiting the ability and incentive of a hypothetical monopolist to retard the pace of research and development. The Agencies will delineate an innovation market only when the capabilities to engage in the relevant research and development can be associated with specialized assets or characteristics of specific firms.

tion of intellectual property rights should be analyzed through application of the Guidelines. A 1996 FTC staff report advocated the use of innovation markets in merger analysis and proposed standards with respect to several aspects of a Guidelines analysis.<sup>82</sup> The Competitor Collaboration Guidelines also discuss innovation markets, but note that its guidance does not apply to “competitor collaborations to which a merger analysis is applied.”<sup>83</sup> Both agencies have challenged a number of mergers on an innovation market theory,<sup>84</sup> although the DOJ has not challenged any mergers on this basis in a number of years.<sup>85</sup>

After more than fifteen years of analyzing the effects of mergers on innovation, guidance in this area would be appropriate if the agencies continue to believe that innovation markets are a useful component of merger analysis.<sup>86</sup> Some key questions include:

- How should participants in an innovation market be identified?
- Are innovation market concerns exclusively unilateral—that a merged firm will have less incentive to devote resources to innovation generally, or to innovation related to a specific future good? Or are the agencies also concerned about coordination in research and development, and under what factual circumstances?<sup>87</sup>

<sup>82</sup> 1 FED. TRADE COMM’N, OFFICE OF POLICY PLANNING, ANTICIPATING THE 21ST CENTURY: COMPETITION POLICY IN THE NEW HIGH-TECH GLOBAL MARKETPLACE ch. 7 (May 1996) [hereinafter FTC GLOBAL COMPETITION REPORT], available at [http://www.ftc.gov/opp/global/report/gc\\_v1.pdf](http://www.ftc.gov/opp/global/report/gc_v1.pdf).

<sup>83</sup> U.S. Dep’t of Justice & Fed. Trade Comm’n, Antitrust Guidelines for Collaborations Among Competitors § 4.3 (2000), reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13,161.

<sup>84</sup> See Katz & Shelanski, *supra* note 43, at 64–76 (describing key innovation market cases); Ronald W. Davis, *Innovation Markets and Merger Enforcement: Current Practice in Perspective*, 71 ANTITRUST L.J. 677, 687–93 (2003) (same); Richard J. Gilbert & Willard K. Tom, *Is Innovation King at the Antitrust Agencies? The Intellectual Property Guidelines Five Years Later*, 69 ANTITRUST L.J. 43 (2001) (same).

<sup>85</sup> This may change given the support for innovation market analysis by the new Assistant Attorney General for Antitrust. See Christine A. Varney, *Antitrust and the Drive to Innovate: Innovation Markets in Merger Review Analysis*, ANTITRUST, Summer 1995, at 16 (“[I]nnovation market analysis is a necessary and proper inquiry within the existing antitrust regime. . . . This [enforcement] role is especially vital in the area of merger policy, where the merger of two innovating corporations can, depending on the circumstances, have either pro- or anti-competitive effects.”); see also Sean Gates, *Obama’s Antitrust Enforcers: What Can We Expect?*, ANTITRUST SOURCE, Apr. 2009, <http://www.abanet.org/antitrust/at-source/09/04/Apr09-Gates4-28f.pdf> (“During her tenure at the FTC, Ms. Varney was on the leading edge of the development of innovation market analysis. . . . She also joined in several decisions applying innovation market analysis to require that merging parties make divestitures to protect innovation.”).

<sup>86</sup> *Accord* AMC REPORT, *supra* note 28, Recommendation 11c (“The agencies should update the Merger Guidelines to explain more extensively how they evaluate the potential impact of a merger on innovation.”); ABA TRANSITION REPORT, *supra* note 21, at 37 (“If the agencies undertake revisions to the Guidelines, then they should consider addressing the issues of potential competition and innovation competition.”); *Merger Roundtable*, *supra* note 21, at 23 (William Kolasky: “[I]nnovation markets are an area that is of growing concern. . . . I think the agencies have developed a coherent way of looking at innovation markets and that this should be embodied in the Guidelines.”). *But see Merger Roundtable*, *supra* note 21, at 23 (Deborah Feinstein: arguing that prior agency enforcement in innovation markets has been questionable and that “before the agencies launch an exercise of codifying what it is that they have done, they ought to conduct a retrospective look as to what has happened in the industries where they have taken enforcement action”).

<sup>87</sup> See FTC GLOBAL COMPETITION REPORT, *supra* note 82, ch. 7 at 35 (“The hearings testimony clearly stressed that unilateral anticompetitive effects, rather than coordinated interaction, are much more likely to be the problem in the context of innovation combinations. . . . Nevertheless, coordinated interaction regarding innovation is clearly not impossible.”).



- Does the five-firm safe harbor identified in the IP Guidelines or the four-firm safe harbor identified in the Competitor Collaboration Guidelines apply in the merger context?<sup>88</sup>
- Should there be any structural presumption in innovation market mergers?<sup>89</sup>
- Do the Guidelines' usual entry requirements apply and, if so, how should the likelihood and timeliness standards be applied in the context of future research and development efforts?<sup>90</sup>

**Include a Discussion of Potential Competition Theories.** Given the importance of potential competition theories—at least in certain industries—and the considerable time since the agencies have provided relevant enforcement guidelines, updated guidelines for potential competition theories are in order.<sup>91</sup> The agencies have not provided formal guidance on potential competition theories of harm in over twenty-five years, during which time they have challenged a number of mergers on that basis, particularly in the technology<sup>92</sup> and health care<sup>93</sup> industries. In the last year, the

<sup>88</sup> See IP Guidelines § 4.3 (“Absent extraordinary circumstances, the Agencies will not challenge a restraint in an intellectual property licensing arrangement that may affect competition in an innovation market if (1) the restraint is not facially anticompetitive and (2) four or more independently controlled entities in addition to the parties to the licensing arrangement possess the required specialized assets or characteristics and the incentive to engage in research and development that is a close substitute of the research and development activities of the parties to the licensing agreement.”); Competitor Collaboration Guidelines, *supra* note 83, § 4.3 (“Absent extraordinary circumstances, the Agencies do not challenge a competitor collaboration on the basis of effects on competition in an innovation market where three or more independently controlled research efforts in addition to those of the collaboration possess the required specialized assets or characteristics and the incentive to engage in R&D that is a close substitute for the R&D activity of the collaboration.”). The Competitor Collaboration Guidelines specifically note that the safe harbor does not apply “to competitor collaborations to which a merger analysis is applied.” Competitor Collaboration Guidelines, *supra* note 83, § 4.3. A 1995 FTC staff report on global competition calls for applying the IP Guidelines’ five-firm safe harbor to mergers. See FTC GLOBAL COMPETITION REPORT, *supra* note 82, ch. 7 at 33.

<sup>89</sup> See Katz & Shelanski, *supra* note 43, at 5 (“Even those who favor the use of innovation markets by merger authorities divide over whether, once such markets are defined, the anti-concentration presumptions of merger law should apply to them or should instead be withdrawn in favor of a neutral, fact-intensive inquiry into whether the merger will hinder innovation.”). Compare Statement of Chairman Timothy J. Muris, Genzyme Corporation/Novazyme Pharmaceuticals, Inc., FTC File No. 021 0026 (Jan. 13, 2004), available at <http://www.ftc.gov/os/2004/01/murisgenzymestmt.pdf> (“[N]either economic theory nor empirical research supports an inference regarding the merger’s likely effect on innovation (and hence patient welfare) based simply on observing how the merger changed the number of independent R&D programs. Rather, one must examine whether the merged firm was likely to have a reduced incentive to invest in R&D, and also whether it was likely to have the ability to conduct R&D more successfully.”), with Dissenting Statement of Commissioner Mozelle W. Thompson, Genzyme Corporation/Novazyme Pharmaceuticals, Inc., FTC File No. 021 0026 (Jan. 13, 2004), available at <http://www.ftc.gov/os/2004/01/thompsongenzymestmt.pdf> (“One important feature of the Horizontal Merger Guidelines is that they establish a rebuttable presumption of competitive effects for mergers if the change in, and resulting level of, market concentration is significant. I see no compelling reason why innovation mergers should be exempt from the Horizontal Merger Guidelines or the presumption of anticompetitive effects for mergers to monopoly and other mergers as discussed therein.”).

<sup>90</sup> See FTC GLOBAL COMPETITION REPORT, *supra* note 82, ch. 7 at 36–38 (noting that some question “whether entry analysis could be transferred to innovation market analysis” and that “additional research into the mechanisms that induce firms to enter into new innovation efforts” is needed before creating entry standards for innovation markets).

<sup>91</sup> Accord ABA TRANSITION REPORT, *supra* note 21, at 37 (“If the agencies undertake revisions to the Guidelines, then they should consider addressing the issues of potential competition and innovation competition.”); *Merger Roundtable*, *supra* note 21, at 23 (Kolasky: “Potential competition is another area of growing concern that needs more focus and that is not receiving as much attention as it should.”).

<sup>92</sup> See, e.g., Statement of Federal Trade Commission Concerning Google/DoubleClick 8–9, FTC File No. 071-0170, available at <http://www.ftc.gov/os/caselist/0710170/071220statement.pdf> (closing merger investigation involving Internet advertising that was premised in part on potential competition theory); ABB AB, 64 Fed. Reg. 3130 (FTC Jan. 20, 1999) (analysis to aid public comment) (potential competition for process mass spectrometers); Analysis to Aid Public Comment on the Provisionally Accepted Consent Order, In the Matter of AutoDesk, Inc./SoftDesk, Inc., FTC File No. 971 0049, Docket No. C-3756 (Mar. 31, 1997), available at <http://www.ftc.gov/os/1997/03/autodesk.pdf> (computer aided design).

<sup>93</sup> See, e.g., Allergan Inc., 71 Fed. Reg. 13,128 (FTC Mar. 14, 2006) (analysis to aid public comment) (cosmetic botulinum toxins for treatment of wrinkles); Cephalon Inc., 138 F.T.C. 583, 635-36 (2004) (prescription drug treatments for cancer pain); Pfizer Inc., 135 F.T.C. 608, 779-80 (2003) (extended-release OAB products); Baxter Int’l, 135 F.T.C. 49, 97-99 (2003) (propofol); Amgen Inc., 134 F.T.C. 333, 404 (2002) (soluble TNF receptor products); Press Release, Fed. Trade Comm’n, FTC Seeks to Block Cytoc Corp.’s Acquisition of Digene Corp. (June 24, 2002) (cervical cancer test); Zeneca Group, 64 Fed. Reg. 15,166 (FTC Mar. 30, 1999) (analysis to aid public comment) (long-lasting local anesthetics); see also Statement of the Federal Trade Commission Concerning Pfizer/Wyeth 2–3, FTC File No. 091-0053 (Oct. 14, 2009), available at <http://www.ftc.gov/os/caselist/0910053/091014pwyethstmt.pdf> (noting that investigation considered “whether the evidence supported a challenge based upon a theory that the transaction threatened to eliminate potential future competition in any relevant market”).



agencies have brought three cases (Thoratec/Heartware, Microsemi/Semicoa, Ovation/Merck)<sup>94</sup> and settled another one (Inverness/Acon)<sup>95</sup> under a potential competition theory (at least in part). Yet, the 1984 Merger Guidelines remain the most recent explanation of the agencies' treatment of potential competition theories.<sup>96</sup> Updated guidelines could help clarify several issues not addressed by the 1984 Guidelines, including:

- How likely must it be for a potential competitor to enter?<sup>97</sup> In particular, for products regulated by the FDA, is there a particular developmental milestone, e.g., beginning critical clinical trials, at which point the agencies will presume entry is likely?<sup>98</sup>
- To what extent do the agencies consider unilateral or coordinated effects as part of their analysis?
- How should markets be defined for future goods?

Some might dispute the idea of including potential competition theories in horizontal merger guidelines, given that they are sometimes classified as conglomerate or non-horizontal theories.<sup>99</sup> However, the better approach would be to consider potential competition theories under the rubric of horizontal mergers, given that, as the 1984 Guidelines note, the analysis of potential competition concerns is “analogous to that applied in horizontal mergers.”<sup>100</sup>

**Add a Discussion of Power Buyers.** One of the revisions under consideration by the agencies is adding a discussion of so-called power buyers to the Guidelines.<sup>101</sup> Several courts have held that the sophistication and bargaining power of buyers is an important consideration in assess-

<sup>94</sup> See, e.g., Press Release, Fed. Trade Comm'n, FTC Challenges Thoratec's Proposed Acquisition of HeartWare International (July 30, 2009), available at <http://www.ftc.gov/opa/2009/07/thoratec.shtm> (announcing challenge to medical device maker whose competing product was in clinical trials); Verified Complaint ¶¶ 33–36, 40–42, United States v. Microsemi Corp., Case No. 8:09-cv-00275-AG-AN (C.D. Cal. Dec. 18, 2008), available at <http://www.usdoj.gov/atr/cases/t240500/240537.htm> (challenging consummated acquisition partly on the ground that the acquired company was likely to obtain qualification and compete against Microsemi for certain diodes); Press Release, Fed. Trade Comm'n, FTC Sues Ovation Pharmaceuticals for Illegally Acquiring Drug Used to Treat Premature Babies with Life-Threatening Heart Condition (Dec. 16, 2008), available at <http://www.ftc.gov/opa/2008/12/ovation.shtm> (announcing challenge to acquisition of rights to competing drug for treatment of patent ductus arteriosus six months before its launch).

<sup>95</sup> Inverness Med. Innovations, Inc., 74 Fed. Reg. 293 (Jan. 5, 2009) (analysis to aid public comment for consent decree resolving FTC claim that acquisition between makers of consumer pregnancy tests would prevent future competition).

<sup>96</sup> The portion of the 1984 Guidelines relating to potential competition represents the official position of both agencies today. See Statement Accompanying Release of Revised Merger Guidelines, *supra* note 15 (“Neither agency has changed its policy with respect to non-horizontal mergers. Specific guidance on non-horizontal mergers is provided in § 4 of the Department’s 1984 *Merger Guidelines*, read in the context of today’s revisions to the treatment of horizontal mergers.”).

<sup>97</sup> The courts of appeals’ answer to this question has run the gamut. See, e.g., *FTC v. Atl. Richfield Co.*, 549 F.2d 289, 294–95 (4th Cir. 1977) (requiring “clear proof” of entry absent the merger); *Tenneco, Inc. v. FTC*, 689 F.2d 346, 352 (2d Cir. 1982) (requiring that entry “would likely” have occurred in the relevant market); *Mercantile Tex. Corp. v. Board of Governors*, 638 F.2d 1255, 1268–69 (5th Cir. 1981) (adopting “reasonable probability” of entry standard); see also PHILLIP E. AREEDA & HERBERT HOVENKAMP, *ANTITRUST LAW* ¶ 1121b (3d ed. 2007) (suggesting that the standard should be that the potential entrant “would probably have entered the market within a reasonable period of time”).

<sup>98</sup> ABA TRANSITION REPORT, *supra* note 21, at 37 (“[P]articularly in deals involving pipeline pharmaceutical and medical device products, there is not a clear basis for identifying the circumstances under which concerns should be raised when there is a great deal of uncertainty as to which products will succeed and how products are likely to compete.”).

<sup>99</sup> See, e.g., 1984 Guidelines, *supra* note 12, § 4; ABA SECTION OF ANTITRUST LAW, *ANTITRUST LAW DEVELOPMENTS* ch. 3.C.1 (6th ed. 2007).

<sup>100</sup> 1984 Guidelines, *supra* note 12, § 4.13; see also ABA TRANSITION REPORT, *supra* note 21, at 37 (advocating the addition of potential competition to the 1992 Guidelines). This is also consistent with the Guidelines’ treating any firm as “in the market” that could enter within a year. See 1992 Guidelines, *supra* note 13, § 1.32. Likewise, innovation market analysis, which typically is concerned with the development of products even further out than under a potential competition theory, is widely viewed as falling under the horizontal merger rubric.

<sup>101</sup> See Questions for Public Comment, *supra* note 4, at 5.

ing the effects of a proposed transaction. In *Baker Hughes*, the D.C. Circuit held that the existence of power buyers, along with the ease of entry, was sufficient to rebut the government's prima facie case.<sup>102</sup> In *Chicago Bridge*, the Fifth Circuit noted that “courts have found that the existence of power buyers can be considered in their evaluation of an antitrust case”<sup>103</sup> and went on to assess whether several factors suggestive of buyer power existed in the relevant market. In *Elders Grain*, the Eleventh Circuit explained that a “concentrated and knowledgeable buying side makes collusion by sellers more difficult.”<sup>104</sup> Several district courts have also acknowledged that the existence of a sophisticated or concentrated customer base is a relevant consideration in the competitive effects analysis.<sup>105</sup>

The Guidelines contain no discussion of a power buyer defense, and the Commentary expresses considerable skepticism. The Commentary claims that even the largest buyers can fall victim to the exercise of market power by merging suppliers.<sup>106</sup> Furthermore, even if large buyers could protect themselves, there are invariably smaller customers against which market power can be exercised, according to the Commentary.<sup>107</sup> The Commentary does leave the door open to one type of power buyer argument: a customer's ability to sponsor new entry.<sup>108</sup>

**Several courts have held that the sophistication and bargaining power of buyers is an important consideration in assessing the effects of a proposed transaction.**

<sup>102</sup> *United States v. Baker Hughes Inc.*, 908 F.2d 981 (D.C. Cir. 1990).

<sup>103</sup> *Chicago Bridge & Iron Co. v. FTC*, 534 F.3d 410, 439–40 (5th Cir. 2008) (quoting *FTC v. Cardinal Health, Inc.*, 12 F. Supp. 2d 34, 58 (D.D.C. 1998)). The Fifth Circuit adopted the test for power buyers set forth in *United States v. Archer-Daniels-Midland, Co.*, 781 F. Supp. 1400, 1417–18 (S.D. Iowa 1991). Under *Archer-Daniels*, factors suggestive of a sophisticated customer include:

- (a) Refusing to reveal the prices quoted by other suppliers and the price which a supplier must meet to obtain or retain business, creating uncertainty among suppliers.
- (b) Swinging large volume back and forth among suppliers to show each supplier that it better quote a lower price to obtain and keep large volume sales.
- (c) Delaying agreement to a contract and refusing to purchase product until a supplier accedes to acceptable terms.
- (d) Holding out the threat of inducing a new entrant into [relevant product] production and assuring the new entrant adequate volume and returns.

*Id.* at 1418. The Guidelines consider the first *Archer-Daniels* factor—the extent of price transparency—as part of a coordinated effects analysis, and the Commentary considers the fourth *Archer-Daniels* factor—the ability to sponsor entry—a relevant consideration as to the likelihood of entry. See Commentary, *supra* note 5, at 39–42.

<sup>104</sup> *FTC v. Elders Grain, Inc.*, 868 F.2d 901, 908 (7th Cir. 1989).

<sup>105</sup> *FTC v. CCC Holdings Inc.*, 605 F. Supp. 2d 26, 64 (D.D.C. 2009) (“A sophisticated customer base makes price coordination more difficult.”); *FTC v. Foster*, No. civ. 07-352 JBACT, 2007 WL 1793441, at \*37–\*38 (D.N.M. May 29, 2007) (finding that some customers have “substantial buyer-power” and that customers could “discipline any unilateral attempt to reduce output”); *Cardinal Health*, 12 F. Supp. 2d at 58–59 (“Although the courts have not yet found that power buyers alone enable a defendant to overcome the government's presumption of anti-competitiveness, courts have found that the existence of power buyers can be considered in their evaluation of an anti-trust case, along with such other factors as the ease of entry and likely efficiencies.”); *Archer-Daniels*, 781 F. Supp. at 1417–22 (approving a merger in part because of “the negotiating power of the power buyers and large buyers”); *FTC v. RR Donnelley & Sons Co.*, 1990-2 Trade Cas. (CCH) ¶ 69,239, at 64,885 (D.D.C. 1990) (“Well-established precedent and the [1984] *United States Department of Justice Merger Guidelines* recognize that the sophistication and bargaining power of buyers play a significant role in assessing the effects of a proposed transaction. Here the evidence demonstrates that even if these customers constituted a separate market, their own size and economic power, and the other characteristics of the ‘market,’ make any anticompetitive consequences very unlikely.” (citations omitted)); *United States v. Country Lake Foods, Inc.*, 754 F. Supp. 669, 674 (D. Minn. 1990) (refusing to enjoin merger where three large customers that had the ability to monitor prices and seek alternative sources of supply outside the relevant geographic market accounted for nearly all purchases in the relevant market). *But see* *United States v. United Tote, Inc.*, 768 F. Supp. 1064 (D. Del. 1991) (holding that the existence of some power buyers would not protect numerous smaller customers from potentially anticompetitive pricing postmerger).

<sup>106</sup> See Commentary, *supra* note 5, at 17–18 (“[E]ven very large buyers may be unable to thwart the exercise of [market power].”).

<sup>107</sup> See *id.*

<sup>108</sup> See *id.* at 39–42.

It seems unlikely that in practice the agencies take such a narrow view of power buyer claims.<sup>109</sup> And given the fairly widespread adoption of the defense by the federal courts, including a discussion of the subject in the Guidelines might help shape the development of the subject in the federal courts. In any event, the absence of a discussion of power buyers in the Guidelines omits an important element of merger analysis, even if it is not determinative.<sup>110</sup>

*Eliminating the distinction between committed and uncommitted entry would align the Guidelines with agency practice and also eliminate unnecessary complexity.*

**Eliminate the Concept of Uncommitted Entrants.** The Guidelines make a distinction between so-called uncommitted entrants, which can enter a market within a year without significant sunk costs,<sup>111</sup> and committed entrants, which take at least a year to enter and at significant sunk cost. Uncommitted entrants are considered to be current market participants and are included in the calculation of concentration. Committed entrants are not part of the concentration calculation but may rebut competitive concerns if entry is timely, likely, and sufficient.<sup>112</sup> To muddy things further, uncommitted entrants may be analyzed as committed entrants if they meet the standard entry tests of timeliness, likelihood, and sufficiency.<sup>113</sup>

Eliminating the distinction between committed and uncommitted entry would align the Guidelines with agency practice and also eliminate unnecessary complexity. Aside from the practical difficulty of pigeonholing potential entrants into one of these categories, it seems unlikely that the agencies are devoting serious attention to mergers in industries where entry can readily occur in less than a year.<sup>114</sup> Furthermore, uncommitted entry analysis requires a number of time-consuming inquiries—including an examination of a potential entrant’s sunk costs, the likelihood that consumers will purchase its product, and the profitability of alternative uses of its assets—which seem ill-suited for an initial concentration screen.<sup>115</sup>

Another aspect of entry analysis that should be reconsidered is the twenty-four month requirement for entry. With only minor exceptions, the Guidelines require entry to occur within twenty-four months of the merger.<sup>116</sup> This is inconsistent with the analysis of competitive effects, which has no

<sup>109</sup> Tucker & Sayyed, *supra* note 47, at 4 (“The Commentary does not appear to reflect current enforcement patterns in cases involving power buyer claims.”).

<sup>110</sup> Accord ABA TRANSITION REPORT, *supra* note 21, at 36 (“Other areas for future clarification include . . . countervailing buyer power”).

<sup>111</sup> 1992 Guidelines, *supra* note 13, § 1.32.

<sup>112</sup> *Id.* § 3.0.

<sup>113</sup> *Id.* § 1.32 n.13.

<sup>114</sup> See Leary, *supra* note 50, at 121 (“The hypothetical ‘uncommitted entrants,’ which can enter and exit without incurring significant costs, have proven as elusive as the Abominable Snowman; the category appears to be an empty box.”); A. Douglas Melamed, Outline of Comments Regarding Uncommitted Entry 1 (Draft Presentation to DOJ/FTC Merger Workshop Feb. 9, 2004), available at <http://www.ftc.gov/bc/mergerenforce/presentations/040218melamed%20.pdf> (“uncommitted entrant[s] are likely to be rare”); see also Jonathan B. Baker, *Responding to Developments in Economics and the Courts: Entry in the Merger Guidelines*, 71 ANTITRUST L.J. 189, 203 (2003) (“When a merger takes place in a market in which entry requires little in the way of sunk investments or time, and the number of prospective entrants are not limited, the agency likely recognizes the situation right away and allows the merger to proceed without the need for an extensive investigation.”).

<sup>115</sup> See Timothy P. Daniel, Uncommitted Entry in the Merger Guidelines: It’s Not Whether—It’s When, Presentation to Department of Justice/Federal Trade Commission Merger Workshop 4 (Feb. 18, 2004), available at <http://www.ftc.gov/bc/mergerenforce/presentations/040218daniel.pdf>; Melamed, *supra* note 114, at 1–2 (stating that “the notion of uncommitted entry neither streamlines the process nor enhances the analysis”).

<sup>116</sup> 1992 Guidelines, *supra* note 13, § 3.2 (“The Agency generally will consider timely only those committed entry alternatives that can be achieved within two years from initial planning to significant part impact.”); see also Commentary, *supra* note 5, at 45 (indicating that the two-year period specified in the Guidelines remains operative).

such time restriction, and with the SSNIP test, which is adjusted to reflect the industry at issue.<sup>117</sup> The Antitrust Modernization Commission has called for flexibility in the twenty-four-month rule so that the agencies can “appropriately take account of competitive dynamics in the markets at issue and [so] that they will not seek to block mergers that, as a result of innovation, may not present a longer-term threat to competition and consumer welfare.”<sup>118</sup> While the AMC’s suggestion appears to be focused on extending the twenty-four-month period, consideration should also be given to situations where the twenty-four-month cutoff may be too long.

**Greater Recognition of Fixed-Cost Savings.** The Guidelines were revised in 1997 to recognize the importance of efficiencies in merger analysis. The Guidelines acknowledge that “the primary benefit of mergers to the economy is their potential to generate . . . efficiencies.”<sup>119</sup> Updated Guidelines should acknowledge that fixed-cost savings, like incremental cost savings, offer significant benefits to both consumers and producers and should be accorded significant weight in the efficiencies analysis.

The current Guidelines place the greatest weight on efficiencies that reduce marginal costs in the short run because these savings may “reverse the merger’s potential to harm consumers in the relevant market, e.g., by preventing price increases.”<sup>120</sup> Nevertheless, a footnote in the Guidelines states that the agencies will also consider fixed-cost savings and other “efficiencies with no short-term, direct effect on price” but that these benefits “will be given less weight.”<sup>121</sup>

In practice, however, the agencies appear to give fixed-cost savings substantially more weight than the Guidelines would suggest. A recent study by two FTC economists of efficiencies claims from 1997 to 2007 found that FTC staff “were as likely to accept fixed-cost savings as they were to accept claims of variable-cost savings.”<sup>122</sup> Recent closing statements confirm that fixed-cost savings played a role in closing several DOJ investigations.<sup>123</sup> Likewise, the Commentary notes that the agencies credit fixed-cost efficiencies and describe several types of fixed cost savings that should be given particular weight.<sup>124</sup>

The Antitrust Modernization Commission and ABA Section of Antitrust Law have urged that the agencies give greater recognition to fixed-cost efficiencies, particularly in high-technology indus-

<sup>117</sup> See 1992 Guidelines, *supra* note 13, § 1.11 (“[W]hat constitutes a ‘small but significant and nontransitory’ increase in price will depend on the nature of the industry, and the Agency at times may use a price increase that is larger or smaller than five percent.”).

<sup>118</sup> AMC REPORT, *supra* note 28, at 60; see also *FTC v. CCC Holdings Inc.*, 605 F. Supp. 2d 26, 59 (D.D.C. 2009) (suggesting that “two years may be a short time frame by which to judge successful entry in this industry”); *Gotts & Renaudeau*, *supra* note 21, at 7 (observing that “there have been other situations in which entry beyond two years was considered relevant”).

<sup>119</sup> 1992 Guidelines, *supra* note 13, § 4.0.

<sup>120</sup> *Id.*

<sup>121</sup> *Id.* § 4 n.37.

<sup>122</sup> Malcolm B. Coate & Andrew J. Heimert, *Merger Efficiencies at the Federal Trade Commission 1997–2007*, at vi (FTC Bureau of Economics Feb. 2009), available at <http://www.ftc.gov/os/2009/02/0902mergerefficiencies.pdf>. The same study found that that agency staff accepted dynamic efficiency claims at a higher rate than variable and fixed cost efficiency claims. See *id.* at Tables 2, 3. If the agencies are, in fact, acknowledging so many dynamic efficiency claims, the Guidelines should describe what evidence may help to substantiate such a claim.

<sup>123</sup> See, e.g., 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.usdoj.gov/atr/public/press\\_releases/2008/231467.pdf](http://www.usdoj.gov/atr/public/press_releases/2008/231467.pdf) (“The Division’s investigation confirmed that the parties are likely to realize significant variable and fixed cost savings through the merger.”); see also Commentary, *supra* note 5, at 57–59 (identifying merger investigations in which the DOJ took fixed cost savings into consideration).

<sup>124</sup> See Commentary, *supra* note 5, at 57–59 (stating that fixed cost savings should be given weight where prices are determined on a cost-plus basis or where cost savings are required to be passed through by contract).

tries where marginal costs are typically low but where mergers have the potential to stimulate innovation.<sup>125</sup> Indeed, fixed-cost savings can provide a variety of benefits, including societal welfare enhancement and funding for new products, that can benefit consumers in the long run.

Clarifying how the agencies actually consider fixed-cost savings and how they weigh these benefits against the potential competitive harm would provide significant guidance to lawyers and economists that practice before the agencies. Acknowledging the importance of these efficiencies may also encourage parties to make more of an effort to develop supporting evidence in presentation to the agencies<sup>126</sup> and for courts to be more willing to consider this type of efficiency.<sup>127</sup>

**Clarifying Monopsony Concerns.** While the Guidelines' framework for analyzing monopsony concerns is essentially sound, the Guidelines would benefit from clarifying procompetitive buying power (i.e., merger-specific efficiencies) from anticompetitive buyer power. The Guidelines recognize that mergers can create or enhance market power on the part of buyers as well as sellers and state that "to assess potential monopsony concerns, the Agency will apply an analytical framework analogous to the framework of the Guidelines."<sup>128</sup> The Commentary offers little more guidance, explaining only that by "eliminating an important alternative for input suppliers, a merger can lessen competition for an input significantly."<sup>129</sup> The agencies have challenged a handful of mergers on the basis of creating or exercising market power by buyers.<sup>130</sup>

The Guidelines should clarify that a monopsony count in a merger challenge makes sense only if the merger will allow the merged entity to drive price down *and* reduce the quantity demanded from input suppliers. This reduced price is a welfare loss, rather than an efficiency. The agencies

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<sup>125</sup> AMC REPORT, *supra* note 28, Recommendation 7 ("The Federal Trade Commission and the Antitrust Department of Justice should increase the weight they give to certain types of efficiencies. For example, the agencies and courts should give greater credit for certain fixed-cost efficiencies, such as research and development expenses, in dynamic, innovation-driven industries where marginal costs are low relative to typical prices."); *see also id.* at 58 ("In the longer run, however, some (if not all) [fixed-cost] efficiencies are also likely to benefit consumers in the form of lower prices or improved quality."); ABA TRANSITION REPORT, *supra* note 21, at 33 ("In the context of a transaction involving high-technology companies, the merger often will benefit consumers primarily by making innovation more likely or less costly—not by reducing marginal costs, which typically are already very low in such industries.")

<sup>126</sup> *See* William H. Page & John R. Woodbury, *Paper Trail: Working Papers and Recent Scholarship*, ANTITRUST SOURCE, Aug. 2009, <http://www.abanet.org/antitrust/at-source/09/08/Aug09-pTrail8-12f.pdf> (reviewing Coate & Heimert study, *supra* note 122) ("My experience has been that economists typically focus on the variable cost savings, with little or no analysis of the fixed cost savings."); Denis, *supra* note 57, at 56 ("Parties, based on their understanding of past practice, tend to be skeptical that the agencies will give much weight to efficiencies evidence and therefore often do not expend the effort to bring forward a strong efficiencies case.")

<sup>127</sup> *See, e.g.*, FTC v. CCC Holdings Inc., 605 F. Supp. 2d 26, 74 (D.D.C. 2009) (discounting alleged fixed cost savings because "these advantages could show up in higher profits instead of benefiting customers or competition").

<sup>128</sup> 1992 Guidelines, *supra* note 13, § 0.1.

<sup>129</sup> Commentary, *supra* note 5, at 36.

<sup>130</sup> *See, e.g.*, United States v. Syufy Enters., 903 F.2d 659, 663–71 (9th Cir. 1990) (rejecting claim that merger of movie exhibitors resulted in reduced competition for movie licensing rights); United States v. Rice Growers Ass'n of Cal., 1986-2 Trade Cas. (CCH) ¶ 67,288 (E.D. Cal. 1986) (finding that merger of rice millers violated Section 7 based on elimination of competition for the purchase of paddy rice in California); Complaint ¶ 36, United States v. JBS S.A., Case No. 08CV5992 (N.D. Ill. Oct. 20, 2008) ("JBS's purchase of National would reduce the number of competitively significant actual or potential bidders for fed cattle from 4 to 3 in the High Plains, resulting in less aggressive competition and lower prices for feedlots and producers of fed cattle."); United States v. UnitedHealth Group Inc., 71 Fed. Reg. 13,991 (2006) (competitive impact statement) (merger of health plans caused competitive effects in the purchase of physician services); BP Amoco, p.l.c., 65 Fed. Reg. 21,434 (Apr. 21, 2000) (analysis to aid public comment) (merger of oil companies would substantially lessen competition for certain oil field bidding rights); United States v. Aetna Inc., 64 Fed. Reg. 44,946 (1999) (competitive impact statement) (similar); United States v. Cargill, Inc. 64 Fed. Reg. 44,046 (1999) (competitive impact statement) (merger of grain processors would substantially lessen competition for purchase of certain grains).



appear to have adopted this approach outside of the merger context. The Competitor Collaboration Guidelines characterize monopsony power as a decrease in both price and output of the purchased product.<sup>131</sup> Likewise, the Supreme Court in *Weyerhaeuser* explained that a monopsonist seeks to “restrict its input purchases below the competitive level, thus reduc[ing] the unit price.”<sup>132</sup>

**Consummated Mergers.** The agencies should clarify how the analysis of consummated mergers differs from unconsummated mergers, in particular the weight given to different types of post-consummation evidence. Since the Hart-Scott-Rodino filing threshold increased in 2001, both agencies have made a priority of investigating consummated mergers. During the Bush administration, the agencies brought eighteen post-consummation merger challenges.<sup>133</sup> The agencies’ interest in consummated acquisitions has continued into the Obama Administration.<sup>134</sup>

The Guidelines and Commentary are silent on the analysis of consummated mergers. Given the agencies’ continuing interest in reviewing consummated transactions, guidance on how, if at all, the analysis of these transactions varies from unconsummated transactions would be helpful. Practitioners would benefit, for example, from understanding what post-consummation evidence the agencies find probative. Agency closing statements for consummated mergers often refer to post-acquisition evidence as a basis for closing the investigation.<sup>135</sup> Likewise, in the FTC’s *Evanston* decision, the Commission considered post-acquisition evidence suggesting anticompetitive effects, as well as potentially exculpatory post-acquisition evidence.<sup>136</sup> Yet the Fifth Circuit’s *Chicago Bridge* decision suggests that most post-acquisition evidence put forth by the respondent is of limited probative value because it can be subject to manipulation.<sup>137</sup> Given this precedent, practitioners would benefit from clarification of how the agencies evaluate post-consummation evidence, particularly evidence suggesting a lack of competitive harm.

*Given the agencies’ continuing interest in reviewing consummated transactions, guidance on how, if at all, the analysis of these transactions varies from unconsummated transactions would be helpful.*

<sup>131</sup> Competitor Collaboration Guidelines, *supra* note 83, § 3.31(a), at 14 (explaining that monopsony is “the ability or incentive to drive the price of the purchased product, and thereby depress output, below what likely would prevail in the absence of the relevant agreement”).

<sup>132</sup> *Weyerhaeuser Co. v. Ross-Simmons Hardware Lumber Co.*, 549 U.S. 312, 320–21 (2007) (quoting Steven C. Salop, *Anticompetitive Overbuying by Power Buyers*, 72 ANTITRUST L.J. 669, 672 (2005)).

<sup>133</sup> See Ilene Knable Gotts & James F. Rill, *Reflections on Bush Administration M&A Antitrust Enforcement and Beyond*, COMPETITION POL’Y INT’L, Spring 2009, at 101, 108.

<sup>134</sup> See, e.g., Carillion Clinic, FTC Docket No. 9338 (July 23, 2009) (complaint), available at <http://www.ftc.gov/os/adjpro/d9338/090724carillioncmpt.pdf> (challenging consummated acquisition of outpatient imaging services and outpatient surgical services in Roanoke, Virginia).

<sup>135</sup> See, e.g., Muris Statement in Genzyme/Novazyme, *supra* note 89, at 16–17 (closing investigation of consummated merger in part because there “is no evidence that the merger reduced R&D spending on either the Genzyme or the Novazyme program or slowed progress along either of the R&D programs”); Statement of the Federal Trade Commission, Victory Memorial Hospital/Provena St. Therese Medical Center, FTC File No. 011 0225 (July 1, 2004), available at <http://www.ftc.gov/os/caselist/0110225/040630ftcstatement0110225.shtm> (closing investigation of consummated hospital merger in part based on lack of actual anticompetitive effects such as price increases or a stronger negotiating position with payors).

<sup>136</sup> *Evanston* Commission Opinion, *supra* note 31, at 16–18, 64–67 (finding that transaction led to a merger-induced price increase), 70 (considering claim that transaction did not result in decline in output), 70–2 and 81–85 (considering claim that transaction resulted in substantial efficiencies), 74–75 (considering claim that entry or expansion reduced *Evanston*’s post-acquisition market power).

<sup>137</sup> *Chicago Bridge & Iron Co. v. FTC*, 534 F.3d 410, 434–35 (5th Cir. 2008) (“The probative value of such evidence is deemed limited not just when evidence is actually subject to manipulation, but rather is deemed of limited value whenever such evidence *could arguably* be subject to manipulation.” (emphasis in original)). This standard leads to the absurd result that the agencies could cite to post-merger price effects as evidence of the transaction’s illegality, but the respondent would not be able to counter with evidence of new entry. See *id.* at 435. Under the Fifth Circuit’s standard, virtually any pro-competitive outcome of a transaction—including lower prices, increased output, actual entry, or achievement of cost savings—will be disregarded or given little weight, because these developments “could arguably” be subject to manipulation.



## Conclusion

The agencies' decision to study whether to update the Guidelines is a laudable development at an appropriate time. Updated Guidelines have the potential to provide better transparency into agency decision making, to clarify the existing Guidelines' framework, and to help ensure that the Guidelines continue to serve as a model for enforcement agencies around the globe.

Some of the agencies' proposals for revising the Guidelines should be uncontroversial and adopted with relative ease, particularly for those that closely track the discussion in the Commentary. Consensus may be more challenging on other proposals that seek to break new ground (e.g., direct effects evidence and power buyers) or that address topics that have stirred controversy in the past (e.g., innovation markets). While the agencies should not shy away from addressing the more challenging topics, they should strive to revise the Guidelines in a way that will engender widespread support within the agencies and the private bar and across the political spectrum. ●