HORIZONTAL MERGER GUIDELINES:
QUESTIONS FOR PUBLIC COMMENT
FEDERAL TRADE COMMISSION AND U.S. DEPARTMENT OF JUSTICE
HMG REVIEW PROJECT – COMMENT, PROJECT NO. P092900

COMMENTS OF THE
AMERICAN ANTITRUST INSTITUTE
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I. INTRODUCTION

The American Antitrust Institute (AAI) appreciates the opportunity to respond to the questions issued September 22, 2009 by the Federal Trade Commission (FTC) and U.S. Department of Justice (DOJ) (collectively, the Agencies) regarding potential revisions to the Horizontal Merger Guidelines (Guidelines). AAI is an independent Washington-based non-profit education, research, and advocacy organization devoted to advancing the role of competition in the American and world economy, assuring that competition works in the interests of consumers, and challenging abuses of concentrated economic power.[1]

AAI has given significant attention to merger policy. We have published analyses of numerous specific mergers, sector-specific merger review, and general merger policy. Much of our analysis of merger policy and the Guidelines, in particular, is set forth in: (1) "Statement on Horizontal Mergers and the Role of Concentration in the Merger Guidelines" (February 2004); (2) "Comments of the AAI Working Group on Merger Enforcement" in response to the Antitrust Modernization Commission's request for

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[1] For more information please contact Albert Foer, President, American Antitrust Institute (bfoer@antitrustinstitute.org) or visit http://www.antitrustinstitute.org.

public comments (July 2005); and (3) the chapter titled "Tightening Up on Mergers," from AAI's report, THE NEXT ANTITRUST AGENDA: THE AMERICAN ANTITRUST INSTITUTE'S TRANSITION REPORT ON COMPETITION POLICY TO THE 44TH PRESIDENT OF THE UNITED STATES (October 2008) (AAI Transition Report). These documents and further information and details can be found on the AAI website at www.antitrustinstitute.org.[2]

In Section II, we raise a number of overarching issues at the outset that should be considered in any revision to the Guidelines, including the objectives and methodology of the Guidelines themselves, the incipiency doctrine, and consideration of information deficiencies in the analysis of market power. Section III responds to several of the 20 questions set forth for public comment. In Section IV, we suggest two other important specific matters not raised in the questions – monopsony power and potential competition – that deserve attention or further inquiry.

We note that any revisions to the Guidelines must take into account the COMMENTARY ON THE HORIZONTAL MERGER GUIDELINES (Commentary) issued by the Agencies in March 2006. Changes in the Guidelines may necessitate changes in the Commentary. Moreover, while the current Commentary provides useful examples of the application of analytical concepts set forth in the Guidelines, such examples should be revised periodically. At the same time, the current Commentary contains guidance that sufficiently qualifies or expands the analysis in the Guidelines (particularly as to

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[2] These reports are available at http://www.antitrustinstitute.org/archives/files/Mergers%20Chapter%20from%20%20AAI%20Transition%20Report_100520082108.pdf (Transition Report); http://www.antitrustinstitute.org/Archives/296.ashx (Statement); and http://www.antitrustinstitute.org/archives/files/429.pdf (Comments to AMC).

unilateral effects and direct evidence of anticompetitive harm) that the guidance should be incorporated in the Guidelines themselves.

II. General Issues

Objectives of Merger Control. We believe it is worth revising Section 0, "Purpose, Underlying Policy Assumptions and Overview," to emphasize that the overriding purpose of merger enforcement against sellers is to protect purchasers from the creation or exercise of market power that not only may result in near-term price increases, but may result in diminished consumer choice, service, quality, or innovation. See Response to Question 15.

Methodology. Predictability of merger review is limited by the inherent vagaries of market definition and the difficulties of forecasting factors such as future market entry, strategic responses to a merger within an industry, and competitive effects. As such, merger analysis should be seen not so much as a purely technical endeavor but an administrable process of applying educated judgment to careful fact-finding and expert prediction within a commonly accepted, albeit ultimately imprecise, methodological framework. Market definition is an imperfect procedure, and any prescriptive market definition procedures create the potential for systematic errors in defining markets, based on what can be an illusion of certainty. These considerations militate in favor of keeping the Guidelines as simple as practicable so that they may be understood by businessmen and generalist judges, not to mention antitrust lawyers without advanced degrees in economics. It is especially important that the application of merger controls be explainable to the public in a way that resonates with common sense rather than the esoteric language of highly technical merger experts. More technical analysis should be reserved for an appendix or the Commentary.

Incipiency. The Agencies should explicitly and vigorously state that they will evaluate the significance of HHIs and changes in industry concentration in light of the incipiency mandate of Section 7 of the Clayton Act. The Guidelines currently give only scant attention to this important doctrine. Indeed, they contain one conclusory sentence on the subject, at the very end of Section 0.1, which notes that “the Guidelines reflect the congressional intent that merger enforcement should interdict competitive problems in their incipiency.” The Guidelines never explain where the incipiency mandate originated, what it means, or how it should be implemented. No wonder some courts, and often even the Agencies, have ignored Congress’s clear intent in this area. We say this without implying a return to *Von’s Grocery* but rather to emphasize that the legislative intent must remain the primary touchstone of merger policy.

The Guidelines should explain that the Sherman Act, with its prohibition against mergers that would constitute the monopolization or attempted monopolization of a market or an unreasonable restraint of trade, was in effect when the Clayton Act was enacted in 1914 and amended in 1950. This will make clear that the Clayton Act’s prohibition against mergers, the effect of which “may be substantially to lessen competition, or to tend to crease a monopoly,” was meant to lead to stricter enforcement against mergers than occurred under the Sherman Act. The incipiency mandate’s increased stringency should lead to significantly different outcomes for merger enforcement than a Sherman Act standard, and the Guidelines should spell this out.

We believe the incipiency doctrine, as a practical matter, means a number of things. First, the burden should be on those who favor liberalizing the current concentration levels (i.e., permitting more high-concentration mergers) to demonstrate the need for such adjustments, not merely that the levels do not conform to recent Agency practice. Second, the Guidelines should recognize that a lower probability of harm should suffice for a violation of the Clayton Act than for a violation of the Sherman Act. Third, since uncertainty and errors of both over-enforcement and under-enforcement are inevitable, the Guidelines should state that when evaluating mergers the enforcers and the courts should respect Congress's desires and err on the side of over-enforcement. Fourth, enforcement under the Clayton Act should look further into the future for possible harms from mergers. Finally, mergers should be more likely to be blocked if they are likely to cause or exacerbate an industry trend towards concentration, or if they are likely to spark a merger wave in the industry. We believe that an important reason for the decline of the incipiency doctrine in the courts has been the failure of the Merger Guidelines to pay this idea more than lip service. We urge the enforcers to help effectuate Congressional intent in this area by clearly explaining and endorsing this doctrine.[3]

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[3] For an analysis of these issues see Robert H. Lande, "Resurrecting Incipiency: From Von's Grocery to Consumer Choice," 68 Antitrust L. J. 875 (2001), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1134815.

Information deficiencies. The Guidelines should consider the possibility that information deficiencies and other market failures may affect the analysis of market definition and entry. *Kodak*[4] recognizes that information deficiencies and other "consumer protection" market imperfections (such as deception and coercion) may give a firm market power, regardless of conventional market share analysis. Moreover, *Kodak* implicitly recognizes that "consumer protection" market failures can apply to businesses as well as individual consumers. Where significant information or other market imperfections exist, therefore, the Agencies should be wary of defining markets broadly to include products that are not effective substitutes because, for example, customers may be unaware of them, face high search costs, or are locked into expensive existing systems. Moreover, information deficiencies may limit the likelihood of entry.[5]

III. RESPONSES TO QUESTIONS

Question 1

The Guidelines (§0.2) specify a five-step analytical process to determine whether to challenge a horizontal merger. Should the Guidelines be revised to indicate that the Agency's assessment of whether the merger is likely to reduce competition may not entail following the five steps in the order listed and that not all five steps are needed in all cases? If so, what can be said about when such departures are and are not appropriate?

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[4] Eastman Kodak Co. v. Image Technical Services, 504 U.S. 451 (1992).

[5] See Robert H. Lande, "Market Power Without a Large Market Share: The Role of Imperfect Information and Other 'Consumer Protection' Market Failures," (AAI Working Paper No. 07-06, 2007), available at http://www.antitrustinstitute.org/Archives/wp07-06.ashx; Robert H. Lande, "Chicago Takes it on the Chin: Imperfect Information Could Play a Crucial Role in the Post-Kodak World," 62 Antitrust L. J. 193 (1993), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1138815.

Insofar as market definition is minimized in unilateral effects cases, and direct evidence of likely anticompetitive harm is given prominence, which we endorse (see below), then those qualifications to the five-step analytical framework should be noted.

Question 2

Should the Guidelines be revised to address more fully how the Agencies use evidence about likely competitive effects that is not based on inferences drawn from increases in market concentration? If such revisions are undertaken, what types of such direct evidence are pertinent? How should the following categories of evidence be used?

a. **For an already consummated merger, evidence of actual, adverse competitive effects.**
b. **Evidence based on so-called "natural experiments," such as variations across geographic markets, time periods, customer categories, or similar product markets showing how customers are affected by competitive conditions whose variation may be comparable to the change to be wrought by the merger.**
c. **Evidence of the merging firms' post-merger plans.**
d. **Evidence from customers about how they will respond to, and be affected by, the merger.**
e. **Evidence that the merging firms have engaged in significant head-to-head competition leading to lower prices or other customer benefits.**
f. **Historical evidence of actual or attempted coordination in the industry.**

Each of the above categories should be referenced as relevant examples of evidence that may be weighed by the Agencies in predicting the effects of a merger. The Agencies should be particularly sensitive to the possibility that the "adverse competitive effects" of an already consummated merger could be non-price in nature. These could be short-term decreases in, for example, quality, variety, service, or privacy or they could be long term decreases in innovation. See also our answer to Question 15.

Question 3

Should the Guidelines include a more detailed discussion of how the hypothetical-monopolist test for market definition (§1.11) is applied? This could include discussion of the following points.

a. **Why the hypothetical monopolist approach often leads to properly defined relevant antitrust markets that do not include the full range of functional substitutes from which customers choose.**
b. **How to conduct "critical loss analysis," including the proper use of evidence regarding pre-merger price/cost margins.**

Insofar as courts have misapplied the hypothetical monopolist approach and critical loss analysis, such elaboration would be useful, but probably best situated in an appendix or the Commentary.

<u>Question 4</u>

Should the hypothetical monopolist test in the Guidelines (§1.11) be simplified so that any collection of substitute products constitutes a relevant product market if a hypothetical monopolist over that group of products would find it profitable to impose at least a small but significant and non-transitory increase in price (SSNIP), including the price of a product of one of the merging firms? This would involve dropping the requirement that products be added in the order of "next best substitutes" and the use of the "smallest market" principle.

We do not think that abandoning the smallest market principle is desirable. However, the Guidelines should clarify that relevant markets may be overlapping, and the existence of a particular relevant market where anticompetitive effects are likely does not preclude the existence of other smaller or larger relevant markets.[6]

<u>Question 5</u>

The Guidelines state (§1.11) that the size of the SSNIP will "in most contexts" be five percent. All else equal, the larger the SSNIP, the broader the market. Should the size of the SSNIP "in most contexts" be increased to ten percent? Should the Guidelines provide further explanation of the base price from which the SSNIP is calculated? Should the Guidelines provide further explanation of the conditions under which the Agencies will use a SSNIP other than the standard SSNIP?

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[6] See, e.g., Jonathan B. Baker, "Market Definition: An Overview," 74 Antitrust L. J. 129, 148-151 (2007).

The Agencies should continue to use the five-percent SSNIP test in most contexts. Increasing the SSNIP to ten percent when the hypothetical monopolist test would be satisfied at five percent would arbitrarily expand the relevant market, reduce the measure of concentration, and likely doom a substantial number of merger challenges. The Guidelines already take into account the fact that if a hypothetical monopolist would raise prices by more than a SSNIP, the anticompetitive risks of the merger increase. See Guidelines § 1.522. The Guidelines should give more attention to the "five percent of what" question, and help explain when the enforcers will use five percent of sale price, and when they will use five percent of value added. Doing this would lead to more transparency in their decision-making process. In addition, the Agencies should examine whether the prevailing price is likely to approximate the competitive price in every case, not merely when "premerger circumstances are strongly suggestive of coordinated interaction." Guidelines, § 1.11.

Question 6

In defining the geographic market, the Guidelines refer (§1.21) to the locations at which the relevant product is *produced*. The locations of *customers* who are likely to be affected by the merger may be quite different from the locations of the suppliers. Should the Guidelines be revised to state that the geographic market may be defined based on the locations of customers rather than, or in addition to, the locations of suppliers, depending upon circumstances? Should other indicia employed in geographic market definition be discussed, such as legal and regulatory constraints?

No comment at this time.

Question 7

Should the discussion of how market shares are measured (§1.4) or interpreted (§1.52) be expanded? Is the interpretation of market shares, or the probative value of market concentration, different in cases involving unilateral effects than those involving coordinated effects?

No comment at this time. See Response to Question 10.

Question 8

Should the Guidelines be revised to explain more fully than in the current §1.521 how market shares and market concentration are measured and interpreted in dynamic markets, including markets experiencing significant technological change?

The Agencies should additionally consider reasoned predictions of how a market is expected to evolve within specified timeframes. Such predictions could rest on internal planning documents of industry participants, consensus of industry experts, or other methodologies determined to have significant forecasting value. Predictive efforts are inherent in the *General Dynamics* case.

Question 9

Do the HHI thresholds in the Guidelines accurately reflect current Agency practice? Should they be adjusted? If so, to what values?

The thresholds apparently do not reflect recent Agency practice. The Agencies have largely focused their enforcement efforts on horizontal mergers in markets that are very highly concentrated, well above the levels in the Guidelines (§1.51(c)) when mergers are supposed to be presumed to create or enhance market power or facilitate its exercise (i.e., post-merger HHI of 1,800; change exceeding 50 HHI points). FTC data show that since 1996, 75 percent of the markets in which the FTC has taken merger enforcement actions were markets where the post-merger HHI exceeded 2400 and the change in HHI was over 500.[7] Malcolm Coate's recent paper shows that from 1989-

[7] See FTC Horizontal Merger Investigation Data, Fiscal Years 1996-2007, Table 3.1 (Dec. 1, 2008), available at http://www.ftc.gov/os/2008/12/081201hsrmergerdata.pdf. Of

2008, the enforcement rate at the FTC was around 80 percent for 3-2 mergers, just over 50 percent for 4-3 mergers, about 25 percent for 5-4 mergers (HHI exceeding 2500), and about 10 percent for transactions that leave at least 5 rivals.[8] Other data show a similar, if not more lax, pattern at the DOJ.[9]

The *de facto* relaxation of the Guidelines thresholds appears to reflect an informal, but flawed, policy determination that concentration short of very high levels is seldom worthy of challenge. We do not believe that economic evidence supports such a conclusion, particularly in light of Congress's incipiency mandate. Neither economic theory nor empirical economic research supports a single "bright line" level of concentration that separates anticompetitive from benign mergers in all or even most industries. However, empirical results are generally consistent with the current Guidelines, namely, that in general a substantial increase in an already high level of seller concentration creates a *rebuttable* presumption that a merger transaction is likely to have anticompetitive effects. On the other hand, small mergers producing a low level of concentration generally are unlikely to be associated with consumer harm and ordinarily require no further analysis.

In light of this, AAI has argued for a flexible sliding-scale approach. That is, the higher the degree of concentration and the larger the magnitude of increase in concentration, the stronger the rebuttal evidence that should be required to overcome

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the remaining 25% of markets where relief was sought, almost two thirds were oil markets. *See id.*, Table 3.3.

[8] See Malcolm B. Coate, "Bush, Clinton, Bush: Twenty Years of Merger Enforcement at the Federal Trade Commission" 16 and Table 5 (Sept. 2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1314924.

[9] See AAI Transition Report at 157.

the presumption of consumer harm. Such a sliding scale is already explicit in the treatment of efficiencies.[10] However, insofar as the Agencies apply any presumption of harm to mergers in concentrated markets, the presumption not only kicks in at much higher levels of concentration than called for in the Guidelines, it is much weaker than the law was thought to require a generation ago.

Public identification of rebuttable threshold presumptions has served as a useful policy guide, channeling enforcement discretion and yielding an important degree of predictability for business planning. AAI believes that current economic thinking and evidence still support the presumption that concentration implies anticompetitive potential, and the use of concentration measures – even at levels below those relied upon at present – remains an efficient and effective enforcement tool. However, some refinements to the discussion of concentration thresholds in the Guidelines would be helpful.

For example, the AAI urges the Agencies to systematically identify various factual showings from which harm to competition from a merger should be presumed and the showings that would rebut those harms. The Agencies should base those presumptions on careful analysis of the contemporary economic literature and merger enforcement history, with attention to the significance of high and increasing market concentration. The Guidelines could also be revised to say that as HHI levels increase beyond the levels giving rise to a presumption of anticompetitive effects, it is less likely that other factors

[10] The Guidelines (§ 4) provide that the "greater the potential adverse competitive effect of a merger . . . the greater must be cognizable efficiencies in order for the Agency to conclude that the merger will not an anticompetitive effect in the relevant market."

will overcome the presumption. Moreover, to clarify the strength of the presumption, the Agencies should indicate by way of example that when the post-merger HHI substantially exceeds 2,500 points and the change substantially exceeds 200 points, particularly strong evidence will be necessary to overcome the presumption. Indeed, Merger Guidelines of the National Association of Attorneys' General provide that the presumption "will be rarely overcome" when the HHI exceeds 2,500 and the change exceeds 200 points.[11]

It is also important to consider potential revisions to the Guidelines that would recognize the factual basis for other presumptions of harm that might arise at lower concentration levels, and specify the rare circumstances where a challenge to a merger that produces low increased in concentration might nevertheless be appropriate. These exceptions should be made explicit and transparent, and should be limited to situations involving an industry with a history of collusion, or mergers that involve the elimination of a maverick or a weakening of a maverick's behavioral incentives. For example, the Guidelines assume that coordinated effects (either express or tacit) are unlikely to occur in unconcentrated or moderately concentrated industries and under other conditions not conducive to reaching coordination and detecting and punishing any cheating. Yet the DOJ has prosecuted cartels that have had many members and that have operated over a long time period of time in circumstances where the Guidelines may otherwise suggest that collusion should have been difficult.

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[11] See National Association of Attorneys General Horizontal Merger Guidelines (1984), at 19 n. 35, available at http://www.abanet.org/antitrust/at-committees/at-state/pdf/state-practices/mergerguides.pdf.

In light of the foregoing concern, uncritical reliance on the Guidelines' existing HHI concentration levels may therefore lead to false negatives. More empirical research is needed across industries to determine the relationship between concentration levels (and changes thereto as a result of mergers) and the likelihood of tacit or express collusion. One useful approach would be for the Agencies to study prosecuted cartels, including the number of firms prosecuted, entry barriers, etc. Other analyses that could inform this question could include analysis of the pre- and post-merger competitive role of mavericks and other merger-induced changes in the likelihood of coordination.

Question 10

The concept of unilateral effects was explicitly introduced into the Guidelines in 1992. Since then, the Agencies and private parties have acquired a great deal of experience evaluating unilateral effects using a variety of evidence and methods, and economic learning regarding unilateral effects has advanced. Should the Guidelines be updated to reflect this experience and learning? Please comment on the value of including expanded discussion of the following topics:

a. **The relationship between market definition and unilateral effects.**
b. **Localized effects within a relevant market.**
c. **Unilateral effects in markets with auctions or negotiations.**
d. **The role of diversion ratios and price/cost margins in evaluating unilateral effects.**
e. **The use of market shares as a proxies for diversion ratios.**
f. **The thirty-five percent combined market share threshold in §2.211 of the Guidelines.**
g. **The use of merger simulation models to predict unilateral effects.**
h. **The role of product repositioning in evaluating unilateral effects.**

We agree that the Guidelines' treatment of unilateral effects should be updated. The current treatment does not reflect Agency practice and is confusing for courts. As was revealed in Oracle-PeopleSoft, for example, the hypothetical monopolist approach in the Guidelines is not very useful for building a unilateral effects case for a merger of differentiated products because it is too close to the question of whether the merger will raise prices. The Guidelines could therefore clarify the information needed to demonstrate unilateral competitive effects through direct evidence (i.e., without need for market definition), particularly for differentiated products mergers. Simulation models are often used as a method of demonstrating the magnitude of unilateral effects. Simulation models, however, remain extremely sensitive to assumptions. The Guidelines should list simulation models as one possible tool, as long as the parties can demonstrate their relevance, robustness, and credibility.

In unilateral effects analysis, market shares of the merging firms can sometimes be used as a rough proxy of the closeness of substitution between the brands of the merging firms. However, market shares are at best a rough indicator of substitution and generally are inferior to careful factual and empirical analysis of actual cross elasticities and diversion ratios. The Guidelines should emphasize this point. While the 35 percent market share threshold in the Guidelines may be retained to indicate likely unilateral effects (absent repositioning) in the absence of other evidence, it should not provide the sanctity of a safe harbor. Proof that the estimated diversion ratios and gross margins give the merged firm an incentive to raise prices should be sufficient to create a presumption of harm (absent repositioning) without any showing of market shares or market definition.[12]

Question 11

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[12] See, e.g., Federal Trade Comm'n v. Whole Foods Market, Inc., 548 F.3d 1028, 1037 n.1 (D.C. Cir. 2008) (noting that it "might not be necessary to understand the market definition to conclude a preliminary injunction should issue" in a merger between two close competitors in a highly differentiated market).

The discussion of price discrimination in the Guidelines (chiefly §1.12 and §1.22) is quite limited. Should this discussion be expanded? Specifically, please comment on the value of elaborating on the identification of "targeted buyers" and on the analysis of competitive effects in markets where prices are negotiated.

No comment at this time.

Question 12

The Guidelines do not explicitly address the implications of large buyers. Merging firms commonly argue that the merged entity would not be able profitably to raise price because it will be selling to large, powerful buyers. Should the Guidelines be revised to discuss the implications of large buyers for merger analysis? For example, even if large buyers are able to negotiate more favorable terms than smaller buyers, what further evidence is required to establish that they are immune from harm due to the loss of competition resulting from the merger? Are large buyers less susceptible to non-price effects than small buyers? Even if large buyers are protected, under what circumstances should antitrust analysis attend to the interests of smaller buyers?

Question 12 only focuses on one side of the coin, i.e., when there are large powerful buyers that may offset the increased selling power of the merged firm. The other side of the coin is when the merger itself creates a more powerful buyer who may be in position to exercise undue power over its suppliers. Both questions must be considered in merger analysis in order to identify what constitutes undue bargaining power in vertical relationships. Section III below includes a discussion of mergers that lead to monopsony concerns.

With respect to a power buyer defense, we believe the Agencies' skepticism expressed in the Commentary is warranted. See Commentary at 17-18 ("Large buyers rarely can negate the likelihood that an otherwise anticompetitive merger between sellers would harm at least some buyers. Most markets with large buyers also have other buyers against which market power can be exercised even if some large buyers could protect themselves. Moreover, even very large buyers may be unable to thwart the exercise of market power.”). Moreover, accepting a countervailing power defense to a merger by sellers may well prompt further consolidation by buyers, who will assert their own countervailing power defense, and so on, ultimately leaving tight oligopolies or monopolies to share their monopoly profits at the expense of consumers.

Question 13

The Guidelines distinguish between uncommitted and committed entry. Uncommitted entrants (§1.32) are treated as market participants and can be assigned positive market shares. Committed entrants (§3.0) are not. How useful in practice is the distinction between uncommitted and committed entry? How should the market presence of uncommitted entrants be measured?

No comment at this time.

Question 14

The Guidelines ask (§4) whether cognizable efficiencies are sufficient to reverse the merger’s potential to raise price. In making this determination, the Guidelines distinguish between fixed and marginal costs, with savings in marginal costs more likely to influence price. Should the Guidelines be updated to state that any cognizable cost reductions are relevant to the extent that they are likely to generate benefits for customers in the foreseeable future? Who should bear the burden of making this showing?

Claims of efficiency benefits arising from a merger should generally be viewed skeptically given the extensive economics and finance literature that shows that many mergers do not improve efficiency.[13] The Guidelines also should make it clear that mergers that are likely to lead to higher prices, reduced quality, service, choice, innovation, or other facets of competition will not be saved because they also may lead to efficiencies. Efficiency gains from a merger only should count in favor of a merger when they are so great that the merger is unlikely to cause prices to rise or other

[13] For a sampling, see AAI Transition Report at 152 n. 53. To be sure, a small portion of horizontal mergers have led to very significant efficiencies.

anticompetitive effects to occur. While the current Guidelines go a long way toward adopting a "price" (or consumer welfare) standard,[14] they arguably could be construed as adopting an "efficiency" (or total welfare) standard in certain circumstances.[15] The Guidelines should be changed to clearly state they are using a "price" standard. Any reasonable likelihood of a non-trivial wealth transfer from purchasers to the post-merger firm should be prevented.

Efficiencies from a merger, by their very nature, are forward looking. In many cases, the procedural exigencies of merger-making prevent the parties from conducting a serious joint analysis of cost-saving possibilities. Given the uncertainties that pervade merger-making, it is not surprising that even the merging parties cannot confidently predict in advance whether their plans will unfold favorably. Moreover, there are informational asymmetries in considering efficiencies. Much of the necessary information for determining the likelihood of efficiencies is in the merging parties' control, with no penalties for puffery and rank speculation. Uncertainty, the frequency with which anticipated efficiencies are not achieved, and the substantial variation in outcomes across mergers generally argues for caution in weighing efficiency claims and

[14] The Guidelines provide that "the Agency considers whether cognizable efficiencies likely would be sufficient to reverse the merger's potential to harm consumers in the relevant market, e.g., by preventing price increases in that market." See also Commentary at 57 ("Merger-specific, cognizable efficiencies are most likely to make a difference in the Agencies' enforcement decisions when the efficiencies can be expected to result in direct, short-term, pro-competitive price effects.").

[15] For the distinction between merger efficiency and price standards, the reasons why Congress preferred the latter, and the necessary amount of efficiencies to prevent price rises under various conditions, see Fisher et. al., "Price Effects of Horizontal Mergers," 77 Cal. L. Rev. 777 (1989).

arguably reduces the worry that an aggressive merger enforcement policy would systematically discourage pro-competitive acquisitions.

Accordingly, the Guidelines appropriately place on the merging parties the burden of "substantiat[ing] efficiency claims so that the Agency can verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved (and the costs of doing so), how each would enhance the merged firm's ability and incentive to compete, and why each would be merger specific." Given the challenges of predicting the likelihood of anticipated efficiencies, the Agencies should carefully consider any track record of merging parties achieving efficiencies in prior transactions as evidence of the companies' ability to deliver on their plans. The evaluation of efficiency claims should also be sought and weighed from independent observers, such as Stanford Research Institute on chemicals or Dataquest on electronics. Other third party sources to consider are securities analysts, competitors, suppliers, and customers. Moreover, empirical evidence supporting claims of efficiency gains should be based on the specific cost structure and technology of the firms, and should be accompanied by further evidence that demonstrates how these cost reductions will benefit consumers.

<u>Question 15</u>

Should the Guidelines be updated to address more explicitly the non-price effects of mergers, especially the effects of mergers on innovation?

Yes. Horizontal mergers can harm competition and consumers by facilitating collusion, creating opportunities and incentives for unilateral price increases, reducing incentives to innovate, and by creating a market structure that excludes or artificially disadvantages rivals or suppliers. These dynamics may lead to higher prices, higher costs, lost opportunities for mutually beneficial trades, lower quality, a lower rate of development of new and better products, and a reduction in product variety and consumer choice. In certain industries, price may far less significant than these other dimensions of competition.

The foregoing theories are well established in the economics literature and therefore the implications of the non-price effects of mergers should be explicitly articulated in the Guidelines.[16] Any such revisions should be based on empirical research on what has actually happened post-merger (other than simply whether list prices increased) in a cross-section of cases. For example, did the company retain any cost savings longer than it had in the past? What became of discounts? What happened to other non-price components of competition, such as choice, service, quality, and most importantly innovation? Choice models, in particular, should be incorporated in analysis of non-price effects of mergers.[17]

The effects of merger activity on innovation (i.e., innovation competition) have been recognized by the Agencies. Innovation markets in industries where R&D plays a significant role, including pharmaceuticals, agricultural, biotechnology, and computer technologies, deserve particular attention. In many cases, incentives for merger are

[16] The Guidelines currently only mention non-price aspects of competition in a footnote, noting that "Sellers with market power also may lessen competition on dimensions other than price, such as product quality, service, or innovation." Guidelines § 0.1 n.6.
[17] See, e.g., Neil Averitt & Robert Lande, "Using the 'Consumer Choice' Approach to Antitrust Law," 74 Antitrust L. J. 175 (2007), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1121459.

driven by the desire to augment or create patent strongholds that, post-merger, can create a number of adverse effects. These include slower rates of innovation, lower quality innovation, higher licensing royalties, foreclosure of rivals from access to critical technologies needed to bring new products to markets, or restrictions on the ability of downstream manufacturers to modify or adapt upstream technologies. Aside from the analysis of innovation markets in such mergers, it is important for the Guidelines to explain how mergers can affect incentives to innovate, entry of potential innovators, and how higher concentration in innovation markets can affect prices and availability of licensed technologies, particularly through aggravation of pre-existing patent thicket, hold-up, and reach-through problems.

<u>Question 16</u>

Should the Guidelines be updated to address acquisitions involving minority interests?

No comment at this time.

<u>Question 17</u>

Should Section 5 of the Guidelines, "Failure and Exiting Assets," be revised?

No comment at this time.

<u>Question 18</u>

Should the Guidelines be revised to include a discussion of how the Agencies approach merger remedies? Such a discussion could include the following topics:

a. The overall goal of protecting customers by preserving pre-merger levels of competition.
b. The relationship between the remedy and adverse competitive effects.
c. The shortcomings of behavioral remedies in horizontal merger cases.

No. A discussion of remedies would be out of place in the Guidelines and is more likely to reduce the necessary flexibility than to provide enlightened guidance. The Guidelines are a methodological approach to evaluating the competitive effects of mergers. As such, a discussion of remedies does not fall within the purpose and function of the Guidelines, and their value in the courts may be diminished to the extent they are loaded up with administrative considerations unrelated to their central function.

Both the DOJ and the FTC have issued important policy documents pertaining to remedies in the last decade (e.g., ANTITRUST DIVISION POLICY GUIDE TO MERGER REMEDIES (2004) and A STUDY OF THE COMMISSION'S DIVESTITURE PROCESS (1999)). Those documents provide useful guidance on the theory and application of different remedial approaches. The process of crafting a remedy that restores competition lost by the merger is informed by a number of general principles, but remedies are often fashioned to account for merger-specific factors. These include whether the remedy is designed to eliminate or reduce the ability or incentive to exercise market power post-merger, whether structural remedies are preferable over behavioral fixes in particular situations, whether intellectual property is the centerpiece of a remedy, whether intra-platform or inter-platform competition is the goal of the remedy, and how important it is for potential buyers of divested assets to display particular attributes. These considerations make a discussion of remedy in the context of the Guidelines of limited usefulness.

Question 19

Should the Guidelines include illustrative examples? If so, which aspects of the current or revised Guidelines would benefit from the inclusion of examples? Would real-world

examples or hypothetical examples be more valuable? Would the inclusion of examples risk undue reliance on them and, if so, what caveats should be provided?

See response to Question 20.

Question 20

Should the Guidelines be revised to reflect learning based on merger retrospective studies?

Providing illustrative examples and reflecting learning based on merger retrospectives would enhance the effectiveness of merger review, offer more transparency to merger applicants and outside observers, and strengthen the linkage between theory and applications. However, such examples and learning may be more appropriately placed in the Commentary, which would allow for greater flexibility in updating and periodically revising the information.

The rationale for including learning from merger retrospectives in the Guidelines or Commentary is compelling. Based on enforcement statistics, it is well known that antitrust enforcement has been lax over the last decade, particularly at DOJ. But many unchallenged mergers have failed to produce their predicted benefits and increasingly, attention is focused on the post-merger conduct of some merged firms. Together, these observations suggest that more research be devoted to retrospective merger studies. A number of possible issues would be useful to explore before the Agencies revise the Guidelines or Commentary to include material on illustrative examples and retrospective studies. The most obvious are whether unchallenged consummated mergers led to significant savings and/or price increases and whether the remedies adopted in mergers that were allowed to proceed on a restructured basis were effective.

Other areas worth probing as background to potential revisions to the Guidelines include the extent to which innovation concerns played a role in past enforcement decisions, and the extent to which merger enforcement and non-enforcement has affected various types of innovation. Also important is systematic analysis of how the courts have used or misused the Guidelines, and consideration of modifications that could enhance litigation outcomes, particularly in unilateral effects cases. Finally, an understanding of merger dynamics in network industries is also important, particularly in instances where predictions of merger-enhanced tipping effects deterred entry by potential competitors.

Care should be taken, however, to make any revisions based on illustrations and retrospectives taken from a representative sample of cases. These cases ideally would reflect merger review across a variety of industries and key issues and concepts. Retrospective studies should emphasize mergers that were allowed to proceed by the Agencies without challenge (e.g., Whirlpool/Maytag or XM/Sirius), and mergers challenged by the Agencies that were allowed to proceed by the courts (e.g., Oracle/PeopleSoft, and Western Refining/Giant).

IV. Additional Issues Involving Merger Review

A. Monopsony

The AAI believes the Guidelines should be more specific with regard to mergers of competing buyers to determine whether the combination is likely, without offsetting justification, to create or enhance classic monopsony power. Indeed, because the Agencies have historically challenged few mergers on this ground, they should be especially vigilant in the future to ensure that they do not allow acquisitions that subject small sellers to monopsonistic exploitation.

Market power encompasses the ability of a single buyer, or a coordinating group of buyers, to depress the price paid for a product to a level that is below the competitive price and thereby depress output. The exercise of market power by buyers ("monopsony power") has adverse effects comparable to those associated with the exercise of market power by sellers. In order to assess potential monopsony concerns, the Agencies apply an analytical framework analogous to the Guidelines' framework for horizontal mergers of sellers. Since a merger that achieves or enlarges classic monopsony power is likely, absent offsetting efficiencies, to harm both atomistic suppliers and consumers, such transactions ought to be investigated carefully.

The AAI believes, however, that the Guidelines do not go far enough. They refer only to mergers that create monopsony power and "thereby depress output." But monopsony can cause competitive harm even when it does not reduce output. In evaluating mergers of buyers, therefore, the Agencies should consider whether the transaction is likely to cause adverse effects beyond an immediate reduction in output, such as a transfer of wealth from suppliers to the merged firm. Some recent investigations suggest that the Agencies may not recognize, or at least not emphasize, this possibility (e.g., Wal-Mart's acquisition of the largest supermarket chain in Puerto Rico, and in an investigation of the merger of two of the largest providers of prescription benefit management services). For example, a merged firm may exercise monopsony power by engaging in all-or-nothing contracting or other forms of discrimination among its suppliers, and such conduct may transfer wealth from the suppliers to the monopsonist without depressing output. Alternatively, the merged firm may use its enhanced power to exploit suppliers that have made sunk investments in the industry.

Even if the suppliers continue to produce the same quantity, their profits have fallen and that may cause them to curtail product quality, cut back capital expenditures, or take steps that impose external costs on society. Further, an increase in concentration at one level of the distribution system may induce increases in concentration upstream and downstream. While the replacement of an atomistic distribution channel with one that is concentrated at each stage may increase efficiency and benefit consumers, it may also result in a series of oligopolies that engage in imperfect bargaining with each other, causing adverse effects on output and prices. Finally, the exploitation of suppliers by the merged firm may ultimately drive some of them out of business, diminishing long-run diversity and choice.

A comprehensive approach to mergers of buyers must also recognize that some combinations of significant buyers may be pro-competitive. One reason, already reflected in the Guidelines, is that the merger would yield cognizable, transaction-specific efficiencies of such character and magnitude that even though the transaction would create monopsony power, its net impact on the welfare of suppliers, consumers, and society would be positive. Another possibility is that the merger would generate countervailing power and the exercise of such power would benefit consumers. It may be difficult, however, to identify cases in which the creation of countervailing power would enhance rather than reduce competition. For this reason and others, the AAI is not advocating a countervailing power defense to an otherwise illegal merger. To the contrary, if a merger is likely to result in the monopsonistic exploitation of small suppliers, the merging parties should not be allowed to excuse this anticompetitive result on the ground that consumers may benefit, any more than such a defense would be permitted for buyer cartels. To put a finer point on this, consumer welfare is not the only proper objective of the merger control laws; the larger purpose is to assure to all the benefits of competitive markets.

B. Potential Competition

The AAI believes that the Guidelines should be updated to specifically address mergers that eliminate a potential competitor. A merger between an incumbent firm and a potential entrant into its market can relax the competitive constraint on incumbent firm pricing in the same manner as a merger between two incumbents. This fact has long been recognized in economics. The doctrine of potential competition was formulated in a series of Supreme Court merger opinions in the 1960s. Concern over mergers that "eliminate[d] specific potential entrants" was made explicit in the 1982 and 1984 Merger Guidelines, but this language was omitted starting with the 1992 revision of the Guidelines. While the accompanying commentary stated that there was "no change in policy toward non-horizontal mergers" (a category that included potential competition), the effect of the omission was to demote the importance of potential competition concerns.

Such demotion was never warranted by either economic theory or empirical evidence. Economic theory makes clear that a firm poised to enter the market can affect pricing decisions by incumbent firms. Most simply, a firm's efforts to raise price can be defeated by an output increase in its market, and it does not matter whether that output increase comes from another incumbent or from an entirely new entrant. For that reason the elimination of a potential entrant by merger, much like a merger between incumbents, can relax the competitive constraint and result in a price increase or other harms to consumers.

Both past and more recent empirical evidence casts light on the question of the size of the price increase permitted by a merger that eliminates a potential competitor. Much of the evidence takes the form of studies of prices in markets with and without potential competitors, or with varying numbers of potential competitors. Studies of airline, pharmaceutical, cable television, and railroad pricing all show that the presence of potential competitors results in significantly lower prices. Those studies underestimate merger effects since they do not examine a merger that purposefully targets a constraining outside firm for elimination. More recent evidence from one study of a particular airline merger corroborates this finding. It has established that in city-pair markets where one party was a potential competitor, the merger permitted price increases and consumer welfare losses more than half as large as the effects in markets where the merging carriers had been direct incumbents. Such evidence further establishes the competitive harm from merging a potential competitor out of existence.[18]

This effect, of course, is not a universal phenomenon. It depends on the state of competition in the premerger market, the number of potential competitors, the relative costs of all competitors (actual and potential), and product differentiation, among other factors.[19] But most of these considerations are identical to those used in evaluating mergers between incumbents, and pose no greater difficulties in implementation. There are, of course, some added complexities. Notably, issues of market definition and the applicability of the unilateral effects model will require attention, but these issues are not intractable and simply need the same attention that has been paid to mergers between incumbent firms.

The AAI believes that this is the appropriate opportunity for an explicit restatement of the doctrine of potential competition and for a description of the analytical framework to be used by the agencies for evaluating such mergers. This need is underscored by the frequency with which merger investigations and cases arise involving potential competition concerns. Among recent examples are the FTC's investigations of Google/DoubleClick and of Hospira/Mayne Pharma, and the DOJ's investigations of Delta/Northwest and of various telecommunications mergers.[20] Many

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[18] This evidence is reviewed in John Kwoka, "Mergers That Eliminate Potential Competition," forthcoming in Research Handbook on the Economics of Antitrust Laws, Einer Elhauge, ed.

[19] See id.

[20] Further examples may be found in John E. Kwoka, "Non-Incumbent Competition: Mergers Involving Constraining and Prospective Competitors," 52 Case W. Res. L. Rev.

of these have involved industries undergoing transitions, such as a due to regulatory reform (when traditional industry boundaries are blurred) or in high tech sectors (where transformational technologies permit invading other markets). More such mergers can be anticipated. Hence there is an urgent need to restate concern over such mergers and to provide guidance about the agencies' analytical process for reviewing them.

173 (2001); Darren Bush & Salvatore Massa, "Rethinking the Potential Competition Doctrine," 2004 Wisc. L. Rev. 1035 (2004).