Comments of
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To the Federal Trade Commission and Department of Justice
For the Horizontal Merger Guidelines Review Project

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We thank the Federal Trade Commission and the Department of Justice for this opportunity to comment on possible revisions to the Horizontal Merger Guidelines ("Guidelines").[1] As antitrust practitioners who work for a global company that has long been active in the area of mergers and acquisitions, we have a strong interest in ensuring that any changes to the Guidelines promote the goals that the agencies described in their request for public comments: to more accurately and clearly describe agency practice; and to incorporate learning and experience gained since the Guidelines were last significantly revised in 1992, thereby promoting a more accurate and efficient merger review process.[2]

While we have observations on some of the specific questions the agencies have posed, our comments at this stage of the Guidelines review process focus on a few broader themes:

- The Guidelines have been successful and influential, both at home and abroad, because they set out an economically sound framework for analyzing mergers that generally reflects a broad and deep consensus. Any revisions to the Guidelines should avoid attempting to advance a particular agenda or attempting to influence the course of merger policy development, but should focus on areas where a clear consensus has developed since the last Guidelines revisions.

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[2] Fed. Trade Comm'n & U.S. Dep't of Justice, Horizontal Merger Guidelines: Questions for Public Comment (Sept. 22, 2009), at 1, *available at* http://www.ftc.gov/bc/workshops/hmg/hmg-questions.pdf.

- The Guidelines have been the most successful in articulating a largely burden-neutral analytical framework for assessing mergers, and in establishing safe harbors for transactions that clearly do not require extensive analysis. The Guidelines have been much less successful when they sought to establish presumptions that particular mergers raise competitive concerns, especially presumptions that are based on factors such as HHI market concentration levels or market share thresholds that lacked a strong empirical foundation and did not reflect consensus. There are some areas where the Guidelines' analytical approach could be updated and improved, notably in the area of unilateral effects. This can and should be done in a way that avoids the use of unsubstantiated presumptions, particularly those that do not have a strong empirical and experiential basis and that do not reflect widespread consensus in the antitrust community.

- The U.S. agencies have played an important and constructive role in promoting sound merger enforcement policies internationally, leading by example when they articulate sensible U.S. policies – such as the Guidelines – that become models for other jurisdictions, and promoting international consensus through vehicles such as the International Competition Network's Recommended Practices for Merger Analysis.[3] Any revisions to the Guidelines should take into account the policy messages that will be sent abroad from changes to a document that has served as a template for merger analysis globally, and should be consistent with the policies the agencies have espoused abroad, including the recently adopted ICN Recommended Practices.

1. Guidelines revisions should reflect consensus and avoid advancing policy agendas

The Guidelines have been remarkably successful policy statements. Few statutes require as much interpretation and case-specific analysis as the antitrust laws, including the merger control provisions. Over the past three decades, the U.S. antitrust agencies have done a great public service by issuing, and periodically refining, the Guidelines in order to help explain and guide how the agencies apply the antitrust laws in this area. The basic economic framework set out in DOJ's 1982 and 1984 guidelines, while still largely intact, was significantly updated in 1992 (and again in 1997, with respect to

[3] Int'l Competition Network, Recommended Practices for Merger Analysis (April 2008 and June 2009), *available at* http://www.internationalcompetitionnetwork.org/media/library/Cartels/Merger_WG_1.pdf. The U.S. agencies played a leading role in the development of the Recommended Practices, and the Department of Justice was the co-chair of the Working Group that developed them.

efficiencies) to reflect developments in antitrust analysis that had gained sufficiently widespread acceptance to make the revisions generally uncontroversial. This concept of revisions to the Guidelines being more of a “lagging” than a “leading” indicator of antitrust thinking – reflecting consensus rather than attempting to shape it – has helped the Guidelines continue to command respect and acceptance among agency staff, antitrust practitioners, courts, and business people.

This consensus-based approach has also contributed to the Guidelines’ success as a template for merger enforcement policy abroad. Key elements of the Guidelines’ approach to merger analysis underlie enforcement policies in numerous other jurisdictions, and in multilateral statements of best practices such as the ICN Recommended Practices. The Guidelines are widely regarded as an analytically sound template for merger analysis that does not reflect or promote any particular policy agenda and is not subject to the vagaries of changing administrations or agency leadership. It is for these reasons, we believe, that the Guidelines have been so well regarded abroad.

We encourage the agencies to continue to follow this approach. Any revisions to the Guidelines should focus on areas where a broad and deep consensus has developed since the Guidelines were issued in their current form, rather than attempting to advance a particular economic, legal or policy agenda or to influence the course of merger policy development. The Guidelines are less likely to serve the goal of promoting a more accurate and efficient merger review process if, for example, revisions are driven by an effort to counteract the outcomes in particular litigated cases; or to support a particular economic theory that is still subject to debate; or to take a broadly pro- (or anti-)

enforcement stance that departs from the tradition of continuity on core antitrust doctrine from one administration to the next.

This does not mean that the agencies should refrain from playing their appropriate role as leaders in merger policy development. But there are other, better ways for the agencies to engage in policy formation than by incorporating debatable concepts into the Guidelines. These include speeches, workshops, and other forums where policies and analytical approaches can be discussed without prematurely embodying them into enforcement guidelines.

2. **The Guidelines should generally be burden-neutral and should avoid the use of unsubstantiated presumptions**

The Guidelines have been the most successful, and durable, to the extent that they set out an economics-based analytical framework for assessing whether a merger is likely to be anticompetitive – a framework that outlines the purpose and underlying assumptions of merger review, and describes the analytical process for doing the competitive assessment. Mainly as a result of the 1992 revisions, the Guidelines contain a fairly detailed discussion of the conditions in which mergers may lead to coordinated or unilateral anticompetitive effects. They expressly do this without assigning burdens of proof or, for the most part, burdens of coming forward with evidence.[4] We believe the Guidelines' overall analytical process – including market definition and measurement,

[4] One exception to this principle occurs in the efficiencies section of the Guidelines, where, in the 1997 revisions, the agencies stated that "in part because much of the information relating to efficiencies is uniquely in the possession of the merging firms … the merging firms must substantiate efficiency claims to that the Agency can verify by reasonable means the likelihood and magnitude of each asserted efficiency …." Guidelines, Section 4.

distinct analytical frameworks for assessing coordinated and unilateral competitive effects, entry, and efficiencies – has been successful and should largely be retained.[5]

The Guidelines have been considerably less successful when they attempted to establish presumptions that mergers are likely to be anticompetitive where particular thresholds are met. Notable examples are the presumptions in the coordinated effects section based on Herfindahl-Hirschman Index ("HHI") measurements of market concentration, and the presumptions in the unilateral effects section based on HHIs and the 35 percent share threshold.[6] There was no sound empirical basis for these presumptions when they were established; they did not reflect a consensus among antitrust analysts; and they have never closely tracked the agencies' actual analysis. As a result, these presumptions have been widely criticized in theory, have been largely ignored in practice, and are among the aspects of the Guidelines that are generally viewed as in need of revision because they can provide inaccurate guidance to companies and counsel who are not familiar with the agencies' actual practice.

The agencies should examine how the Guidelines' discussion of unilateral competitive effects analysis could be updated to reflect developments since the 1992 revisions and to more closely describe the modes of analysis that the agencies apply in practice to different types of transactions. In doing so, we believe it is important that the

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[5] Some adjustments in the sequence of steps laid out in the Guidelines' analytical process, or in how some of those steps are described, may turn out be warranted. The agencies identified several such issues in the questions they posed for public comment. Overall, however, we believe the Guidelines' essential approach has held up well over time. For example, we would not advocate abandoning or significantly downplaying the Guidelines' emphasis on market definition and measurement as initial steps in the analysis. These steps impose a useful discipline and transparency on the process, even though they are more relevant to some theories of anticompetitive effects than to others. We also think the distinct analysis of coordinated and unilateral effects, which was introduced in the 1992 revisions and has been endorsed by numerous other jurisdictions and in the ICN Recommended Practices, has brought greater coherence and rigor to the merger review process and should be retained.

[6] Guidelines, Sections 1.51 and 2.211.

agencies avoid the use of presumptions as a general matter. In particular, we believe the agencies should refrain from replacing one set of unsubstantiated presumptions – such as the HHIs and market share thresholds in the current Guidelines' coordinated and unilateral effects sections – with other, equally unsubstantiated presumptions.

One method of assessing potential unilateral effects cases that has been advanced by the chief economists at the agencies, the "upward pricing pressure" or "UPP" approach, would attempt to identify transactions that potentially raise competitive concerns based on an analysis of pre-merger diversion ratios between the merging firms' products, and those products' variable margins.[7] As the UPP approach has been described, it could also incorporate assumptions about efficiencies. Other factors – such as post-merger responses to the merger by competitors (e.g. repositioning and expansion) or customers (e.g. substitution to other suppliers, shifting preferences) – would be deferred to later stages of the investigation, after a transaction has been flagged as potentially raising concerns.

We understand that the economics underlying the UPP approach are not controversial. But we question whether that approach justifies establishing presumptions in the Guidelines that particular transactions raise competitive concerns. For example, we understand that if the UPP approach were applied to a merger between two suppliers of differentiated products in an overall market that had as many as seven similarly sized competitors, with no evidence of particular competitive "closeness" between the merging firms so that diversion ratios among the firms were assumed to be proportional to market

[7] *See* Joseph Farrell and Carl Shapiro, "Antitrust Evaluation of Horizontal Mergers: An Economic Alternative to Market Definition," (Nov. 2008), *available at* http://faculty.haas.berkeley.edu/shapiro/alternative.pdf.

shares, then – assuming variable margins that are fairly typical in many differentiated product markets, and crediting the merger with a 10 percent "standard deduction" for assumed variable cost efficiencies – the result would be a presumption of anticompetitive price effects.[8] It is not clear how strong such a presumption would be, or how much further investigation would typically be required to rebut the presumption, or how open the agencies would be in practice to certain types of rebuttal evidence, such as competitor repositioning (as discussed further below). Yet such a merger would be unlikely to raise significant concerns under the agencies' current practice.[9] The UPP approach as it has been described arguably would create a presumption of anticompetitive effects that is least as overly inclusive, and as potentially misleading an indicator of the agencies' actual enforcement intentions, as the current Guidelines' HHI thresholds.[10] As the agencies consider how to address the discrepancy between the HHI thresholds and actual agency practice, we respectfully caution against adding a new set of presumptions that may suffer from similar problems.

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[8] For example, we understand that the following hypothetical transaction would trigger a presumption of unilateral effects under the UPP approach as it has been described: a merger between two among seven equally-sized firms, with diversion ratios assumed to be proportional to market shares (and with 20 percent diversion to firms outside the putative seven-firm "market"), variable margins of 43 percent, and efficiencies assumed to equal a 10 percent reduction in pre-merger marginal costs. The UPP's proponents have used a 10 percent efficiencies "standard deduction" for purposes of illustrating how the UPP analysis might work. There are many other possible variations; for example, if less diversion to firms outside the "market" were assumed, lower variable margins could still lead to a presumption of unilateral effects.

[9] FTC investigation data for the period 1996-2007 indicates that there were no FTC enforcement actions brought out of all investigations that examined more than 400 relevant markets outside the grocery, oil, chemical and pharmaceutical industries, where the transaction reduced the number of significant competitors in a relevant market from seven to six (or more). Federal Trade Commission, Horizontal Merger Investigation Data, Fiscal Years 1996-2007 (2008) ("FTC Investigation Data"), at 21, *available at* http://www.ftc.gov/os/2008/12/081201hsrmergerdata.pdf.

[10] The hypothetical seven-to-six transaction described above would lead to a post-merger HHI of approximately 1840, with an HHI increase of just over 400 points. The FTC Investigation Data indicate that from 1996-2007 there were no FTC enforcement actions in this HHI range (or lower) outside the grocery, oil, chemical and pharmaceutical industries. *Id.* at 15.

There are other reasons to be skeptical about incorporating such a presumption into the Guidelines. First, our experience suggests that reliable evidence of pre-merger diversion ratios between the merging firms' products often will not be available, either in the initial phase of a merger review (when it appears that the UPP-type screen would typically be applied) or later. Even if the firms maintain some bidding data or win/loss information, it may often reveal little or nothing about how close firms are to each other competitively, how or why they are close, or how distant other firms are. And even accurate information about pre-merger diversion is inherently static – it does not address how other firms or customers may react post-merger in order to render the merging firms' perceived pre-merger "closeness" ephemeral. Other questions may be raised about the applicability of a UPP-type analysis in a given case – such as whether the proper measure of "margins" is being used,[11] or whether the level of assumed efficiencies is appropriate for purposes of an initial enforcement screen.[12]

Finally, any competitive effects analysis – regardless of whether it begins with UPP-type presumptions – should take into account dynamic post-merger reactions by competitors and customers. In unilateral effects cases involving differentiated products,

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[11] We welcome the agencies' indication that they will examine whether fixed cost reductions should play a more significant role in the analysis of merger efficiencies. Questions for Public Comment, n.2 *supra,* No. 14. Our understanding is that the UPP approach would look to variable margins in establishing an initial presumption of anticompetitive pricing potential. It is not clear whether variable margins would always, or usually, be the most appropriate measurement of margins for purposes of examining potential competitive effects, particularly in technology-driven markets where firms make substantial (fixed) investments in research, development and innovation. The agencies and other commentators may wish to further consider this question.

[12] The current Guidelines assume that efficiencies typically result from horizontal mergers, but they do not attempt explicitly to quantify this. One possible concern from assuming a particular level of efficiencies for purposes of a UPP-type presumption is that the purported "credit' could in effect become a cap on the role of efficiencies in the agencies' analysis – that is, it could become even more difficult in practice for the parties to persuade the agencies to credit them with efficiencies that exceed the "standard deduction" that the agencies will already have stipulated for analytical purposes.

the relevant competitor response is typically described as "repositioning." Repositioning is a factor in the unilateral effects analysis in the current Guidelines, and it would be a factor in the post-presumption phase of the UPP analysis. Repositioning should be a key element in any analytical approach to unilateral effects. Yet, as various commentators have observed, the agencies have at times seemed unjustifiably skeptical of repositioning arguments.[13] The agencies' 2006 Commentaries on the Guidelines express this skepticism.[14]

Our experience suggests that this skepticism of repositioning is unfounded. Unilateral effects theories typically are applied to mergers in the very types of differentiated products industries where competitive dynamics require firms continually to adjust, whether by introducing new products, adding product features or modifying existing product characteristics, addressing customer needs in new ways, or simply marketing or bidding more effectively to particular types of customers. Firms must constantly do these things to remain competitive, even without the stimulus of a merger between two of their rivals. Customers can also take steps to "reposition" by, for example, turning to additional bidders or inducing current suppliers to meet their needs in different ways. The Guidelines, and agency practice, should fully recognize the role of dynamic competitor and customer responses to mergers, including all types of

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[13] *See, e.g.,* Comments of the ABA Section of Antitrust Law on the Federal Trade Commission and Department of Justice Horizontal Merger Review Project (Nov. 9, 2009) at 29 and n.67, *available at* http://www.abanet.org/antitrust/at-comments/2009/11-09/comments-P092900.pdf; Joint Submission of the Financial Services Roundtable, Microsoft Corporation, the National Association of Manufacturers, and Verizon Communications Inc. to the U.S. Department of Justice and Federal Trade Commission for the Horizontal Merger Guidelines Review Project (Nov. 9, 2009) at Section III.

[14] Fed. Trade Comm'n & U.S. Dep't of Justice, Commentary on the Horizontal Merger Guidelines, at 31 ("The Agencies rarely find evidence that repositioning would be sufficient to prevent or reverse what otherwise would be significant anticompetitive unilateral effects from a differentiated products merger"), *available at* http://www.ftc.gov/os/2006/03/CommentaryontheHorizontalMergerGuidelinesMarch2006.pdf.

repositioning, and should avoid making any express or implicit assumptions that such repositioning – which in fact is ubiquitous in many industries – is unlikely to occur.

3. Guidelines revisions should take into account the message they send abroad, and should be consistent with policies the agencies have advocated internationally

The Guidelines are not the agencies' only statements of merger policy. The U.S. agencies are both primary drafters of and signatories to the recently adopted ICN Recommended Practices for Merger Analysis, which are an important component of the ICN's growing body of recommended practices that serve as models for competition law regimes around the world. The Recommended Practices for Merger Analysis note that merger policies should avoid the mechanistic application of standards that apply "rigid presumptions, structural criteria, or formulaic concentration numbers." [15] A consistent theme in the Recommended Practices is that, while numeric indicators such as market share and concentration thresholds can be useful ways to distinguish between mergers that do not raise significant competitive concerns from those warranting further inquiry, generally such factors are not conclusive indicators that a merger is likely to harm competition, and agencies should ensure that any presumptions that are used may be overcome by the evidence in a detailed review of market conditions.[16]

We do not mean to suggest that the agencies would expressly depart from the principles in the ICN Recommended Practices in revising their own Guidelines. But we think it is useful for the agencies to bear in mind how changes in U.S. enforcement policies, such as the Guidelines, may be interpreted abroad. Guidelines revisions that create new presumptions, flag more mergers as potentially problematic, create greater

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[15] ICN Recommended Practices, n.3 *supra,* Section I (c), Comment 1.

[16] *Id.,* Section II (c).

uncertainty for merging firms, and require them to expend time and resources defending transactions that previously may have been routinely cleared, could have adverse consequences beyond the direct impact the revisions would have on U.S. policy. Such revisions could implicitly encourage other jurisdictions to depart from the increasing global consensus, embodied in the ICN Recommended Practices, that merger review should be based on a flexible assessment of relevant market conditions. The agencies should seek to update their Guidelines in ways that encourage this positive international consensus.