HMG Review Project – Comment, Project No. P092900

HHI Screening Thresholds and the U.S. Department of Justice and Federal Trade Commission Horizontal Merger Guidelines

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Question 9: Do the HHI thresholds in the Guidelines accurately reflect current Agency practice? Should they be adjusted? If so, to what values?

Response Summary and Conclusion

The HHI-based screening thresholds in the Horizontal Merger Guidelines ("Guidelines") should be increased. Based on the merger challenge data published by the Federal Trade Commission, the cut-off for a moderately concentrated market should be increased to at least 2,000. The presumption that all mergers in highly concentrated markets with HHI increases over 100 are likely to create or enhance market power or facilitate its exercise should be dropped and instead these mergers should be described as potentially raising significant competitive concerns, depending on the factors set forth in Sections 2 – 5 of the Guidelines. If a presumption of likely competitive harm is retained, it should be subject to a substantially higher post-merger HHI threshold than is presently the case.

Economic Analysis

The DOJ and FTC jointly published merger challenge data for the years 1999 – 2003[2] and the FTC separately published data covering the years 1996 – 2007[3] (the "FTC Merger Challenge Report"). The FTC Merger Challenge Report includes data on investigations that were closed in addition to those that led to enforcement actions. In particular, it provides data on whether FTC investigations were closed or led to an enforcement action broken down by the level of the post-merger HHI and the change in the HHI. A total of 1,150 markets are summarized in the FTC Merger Challenge Report.[4]

The data in the FTC Merger Challenge Report suggests that the thresholds in the Guidelines are too low. For instance, consider the moderately-concentrated merger screening threshold. The Guidelines presently state, "Mergers producing an increase in the HHI of less than 100 points in

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[2] "Merger Challenges Data, Fiscal Years 1999–2003", issued by the Federal Trade Commission and the U.S. Department of Justice, December 18, 2003, http://www.justice.gov/atr/public/201898.pdf.

[3] Horizontal Merger Investigation Data, Fiscal Years 1996-2007", issued by the Federal Trade Commission, December 1, 2008, http://www.ftc.gov/os/2008/12/081201hsrmergerdata.pdf.

[4] Table 3.1 provides data on 280 closed investigations and 870 that led to an enforcement action.

moderately concentrated markets post-merger are unlikely to have adverse competitive consequences and ordinarily require no further analysis."[5] If the 100-point HHI increase is retained as a cut-off, the data in the FTC Merger Challenge Report indicates that the post-merger HHI range for moderately concentrated markets can be increased from 1,800 to 2,000. The FTC Merger Challenge Report Table 3.1 shows no challenges and a number of investigation closures when the post-merger HHI is below 1,999 and the HHI increase is below 100.

Actual enforcement experience as summarized by Table 3.1 in the FTC Merger Challenge Report raises another substantial concern regarding the screening thresholds currently used in the Guidelines. The language regarding the interpretation of HHI information in the highly concentrated region is:

> Mergers producing an increase in the HHI of more than 50 points in highly concentrated markets post-merger potentially raise significant competitive concerns, depending on the factors set forth in Sections 2-5 of the Guidelines. Where the post-merger HHI exceeds 1800, it will be presumed that mergers producing an increase in the HHI of more than 100 points are likely to create or enhance market power or facilitate its exercise. The presumption may be overcome by a showing that factors set forth in Sections 2-5 of the Guidelines make it unlikely that the merger will create or enhance market power or facilitate its exercise, in light of market concentration and market shares.[6]

Table 3.1 of the FTC Merger Challenge Report shows that between FY 1996 and FY 2007, enforcement action was taken in 99 markets and investigations were closed in 57 markets where the post-merger HHI was in the range 1,800 – 2,399 and the HHI increase was greater than 100. (A copy of Table 3.1 is provided as an attachment.) Thus, investigations were closed for 37% of the markets in this range. This percentage is too high to support the Guidelines' statement that mergers in this range are "presumed … likely to create or enhance market power or facilitate its exercise". Mergers in this range should be subject to the same language used for smaller HHI increases between 50 and 100, namely, that these mergers "potentially raise significant competitive concerns, depending on the factors set forth in Sections 2-5 of the Guidelines." If a presumption of likely competitive harm is retained, the thresholds for mergers subject to this presumption should be set higher. Consider, for example, mergers with a post-merger HHI equal to or above 5,000. Table 3.1 of the FTC Merger Challenge Report indicates that 408 investigations lead to enforcement actions in this range and 30 were closed. These 30 markets represent only 7% of the total investigations in this range. The presumption language, if used at all, should be reserved for much higher levels of concentration than is presently the case.

I recommend that all mergers falling outside the safe harbor screening thresholds be described in any Guidelines revision as potentially raising significant competitive concerns, depending on the factors set forth in Sections 2 – 5 of the Guidelines. If a presumption of harm is retained, it is more

[5] Guidelines at §1.51.

[6] Guidelines at §1.51.

appropriately used when the percentage of investigations closed is small, and any presumption should be subject to a substantially higher post-merger HHI threshold than is presently the case.[7] This will result in Guidelines that more closely reflect Agency practice.

[7] I have not recommended a cut-off for this threshold. Any new threshold should be based on a review of more recent enforcement action data from both the DOJ and FTC. The FTC Merger Challenges Report does not break down results by year, so FTC decisions from more recent years cannot be segregated from older years. Furthermore, the FTC Merger Challenges Report does not include information on enforcement actions and investigation closures from the Department of Justice.

Attachment

Table 3.1 from "Horizontal Merger Investigation Data, Fiscal Years 1996 – 2007", issued by the Federal Trade Commission on December 1, 2008

Table 3.1

FTC Horizontal Merger Investigations
Post Merger HHI and Change in HHI (Delta)
All Markets
FY 1996 through FY 2007

Enforced/Closed

		Change in HHI (Delta)								
		0 - 99	**100 - 199**	**200 - 299**	**300 - 499**	**500 - 799**	**800 - 1,199**	**1,200 - 2,499**	**2,500 +**	***TOTAL***
Post Merger HHI	**0 - 1,799**	0/14	17/30	19/20	17/11	3/6	0/1	0/0	0/0	56/82
	1,800 - 1,999	0/4	5/4	5/5	12/4	12/4	0/0	0/0	0/0	34/21
	2,000 - 2,399	1/2	1/5	7/7	25/16	31/10	1/2	0/0	0/0	66/42
	2,400 - 2,999	1/2	4/1	6/5	18/5	44/13	26/9	0/0	0/0	99/35
	3,000 - 3,999	0/2	2/2	4/2	6/5	19/12	66/18	31/14	0/0	128/55
	4,000 - 4,999	0/0	1/2	1/1	3/1	8/4	12/4	54/3	0/0	79/15
	5,000 - 6,999	0/0	4/0	4/2	4/1	12/0	11/2	110/18	36/4	181/27
	7,000 +	0/0	0/0	1/0	1/0	2/0	8/0	17/1	198/2	227/3
	TOTAL	2/24	34/44	47/42	86/43	131/49	124/36	212/36	234/6	870/280

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Merger Remedies and the U.S. Department of Justice and Federal Trade Commission Horizontal Merger Guidelines

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> **Question 18**: Should the Guidelines be revised to include a discussion of how the Agencies approach merger remedies? Such a discussion could include the following topics:
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> 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.

Response Summary and Conclusion

The U.S. Department of Justice ("DOJ") and Federal Trade Commission ("FTC") have issued joint "Horizontal Merger Guidelines" ("Guidelines") and several other joint antitrust enforcement policy statements, such as the "Commentary on the Horizontal Merger Guidelines"[2] ("Commentary"), "Statements of Antitrust Enforcement Policy in Health Care,"[3] and "Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition."[4] Policy statements regarding remedies are a notable exception to this Agency history of providing common guidance documents to industry, however. The DOJ released its "Antitrust Division Policy Guide to Merger Remedies"[5] in October 2004 (the "DOJ Policy Guide"). The DOJ Policy Guide was not issued in conjunction with the FTC. Instead, the FTC's guidance regarding remedies is detailed in a Merger Best Practices Statement from the Bureau of Competition issued in April 2003 (the "FTC Best Practices Statement").[6] In addition, the Bureau of Competition issued a second Merger Best Practices Statement that discusses 45 frequently asked questions about merger remedies[7] (the "FTC FAQs"). Neither of these documents is a

[1] Prior to my present position as a Director with LECG, LLC, I was an economist with the Economic Analysis Group of the Antitrust Division of the U.S. Department of Justice. The comments in this note represent the views of the author and do not represent the views of LECG or other experts at LECG.

[2] http://www.justice.gov/atr/public/guidelines/215247.htm.

[3] http://www.justice.gov/atr/public/guidelines/0000.htm.

[4] http://www.justice.gov/atr/public/hearings/ip/222655.pdf.

[5] http://www.justice.gov/atr/public/guidelines/205108.pdf.

[6] Statement of the Federal Trade Commission's Bureau of Competition on Negotiating Merger Remedies," available at http://www.ftc.gov/bc/bestpractices/bestpractices030401.shtm.

[7] "Frequently Asked Questions About Merger Consent Order Provisions," available at http://www.ftc.gov/bc/mergerfaq.shtm.

policy statement from the Commission, and both include a disclaimer that the views expressed therein are those of the staff and not of the Commission or any individual Commissioner.[8]

The Guidelines do not contain any description of the approach taken by the Agencies to assess the adequacy of proposed remedies, and the DOJ Policy Guide, FTC Best Practices Statement, and FTC FAQs provide high-level statements but little detail regarding how the Agencies assess remedies. Even so, remedies are an important part of merger analysis and are evaluated often; the number of merger cases that are settled with remedies is large relative to the number of merger cases that are litigated by the Agencies. One goal of an update of the Guidelines is to "more accurately and clearly describe current Agency practice." Due to the limited guidance publicly available on the analytical framework used by the Agencies to evaluate remedies, and with the frequency with which the Agencies evaluate remedies, remedies should be part of any Guidelines update.

I have been working on merger analyses for over 18 years, both as an Economist with the Department of Justice and as an economic consultant to private parties. Based on this experience, my view is that adding a discussion of the evaluation of potential merger remedies to the Guidelines is one of the most important areas where a revision can enhance the efficiency of the U.S. merger review process. Businesses contemplating a remedy to a merger under investigation, and also contemplating whether to propose a merger that ultimately may require remedies, will gain by having additional guidance and understanding of how the Agencies will evaluate their remedy proposals. In addition to adding a discussion of the evaluation of remedies to the Guidelines, the Agencies should consider amending the Commentary to discuss examples of actual remedies evaluated. Consistent with the overall approach taken by the Commentary, these examples would highlight specific issues analyzed during the review of the remedy, such as considerations of financial viability and whether the divestiture of less than the full business of one of the merging firms is sufficient to restore lost competition. Though confidentiality concerns may prevent the Agencies from describing publicly examples of remedies that have been rejected, they should be able to provide meaningful guidance based on examples of remedies that have been accepted.

Economic Analysis

Horizontal merger enforcement policy is designed to prevent mergers that are likely to harm competition and lead to increased prices for customers. The basic economic framework for analyzing whether competitive effects are likely to result from a merger is well-known. Though the Agencies are seeking comment on aspects of horizontal merger enforcement policy, the basic principles of that policy, such as the use of the "hypothetical monopolist" test to define markets, the HHI to measure market

[8] For example, see FTC Best Practices Statement at endnote 1.

concentration, and the "timeliness, likelihood, sufficiency" approach to entry analysis, are not in question.[9]

Suppose that an economic analysis of the definition of the relevant market, competitive effects, entry, and efficiencies results in the conclusion that a merger is likely to harm competition and that neither merging party is at risk of failing. Under the Guidelines, this merger would be subject to challenge by the reviewing Agency. If a merger remedy were proposed that would fully negate the likely competitive harm, however, then the merger and remedy, as a package, would not harm competition, and there would no longer be any economic basis for the Agency to challenge the transaction with the remedy. Hence, the economic evaluation of the sufficiency of proposed remedies is a fundamental part of horizontal merger analysis, and the basic structure of that economic analysis should be outlined in the Guidelines.

The structure of the economic analysis of remedies centers on point (b) from the Agencies' Question 18: the relationship between the remedy and adverse competitive effects. The other two points raised by the Agencies in Question 18 are (a) the goal of protecting customers by preserving pre-merger levels of competition and (c) the shortcoming of behavioral remedies. With regard to item (a), markets change over time, and a merger review can take a long time to complete, especially if the review continues through to a trial on the merits. For this reason, the goal is better stated simply as preserving the level of competition that would have prevailed in the absence of the merger, not preserving pre-merger levels of competition. This point, however, relates not only to the analysis of merger remedies, but also to all other parts of horizontal merger review. As such, this should be discussed in a manner that relates to the entirety of the Guidelines, not only in a potential section on remedies. Indeed, the "Purpose, Underlying Policy Assumptions and Overview" section of the current Guidelines states, "The unifying theme of the Guidelines is that mergers should not be permitted to create or enhance market power or to facilitate its exercise." Given this statement up-front, all that needs to be stated in a new remedies section is that if, with a remedy, a merger would not likely create or enhance market power or facilitate its exercise, then the package of the merger and the remedy will be approved by the Agencies. The remainder of these comments focuses on items (b) and (c): competitive effects and the use of structural vs. behavioral remedies.

The Relationship between the Remedy and Adverse Competitive Effects

The relationship between the remedy and the potential adverse competitive effects is central. According to the DOJ Policy Guide, "carefully tailoring the remedy to the theory of the violation" and having a "close, logical nexus between the recommended remedy and the alleged violation" are "guiding principles" of the evaluation of remedies.[10] I agree. The FTC FAQs offer similar, though less direct, guidance. The FTC FAQs state, "An acceptable divestiture package is one that maintains or

[9] "Horizontal Merger Guidelines: Questions for Public Comment," Federal Trade Commission and U.S. Department of Justice, September 22, 2009, pp. 1-2.

[10] DOJ Policy Guide, pp. 2-3.

restores competition in the relevant market."[11] Any revision to the Guidelines should state that, if a remedy maintains or restores competition in the relevant market, the merger and remedy will be approved by the Agency.

These DOJ and FTC statements suggest a clear policy that remedies unrelated to the competitive effect of concern are unnecessary when trying to "fix" a merger. The FTC FAQs, however, appear to suggest otherwise. In particular, the FTC FAQs state that the Commission has sought divestitures of assets outside the relevant market when necessary. In particular, the FAQs state:

> There have been instances in which the divestiture of one firm's entire business in a relevant market was not sufficient to maintain or restore competition in that relevant market and thus was not an acceptable divestiture package. To assure effective relief, the Commission may thus order the inclusion of additional assets beyond those operating in the relevant market." For example, in *Guinness/Grand Met*, Dkt. No. C-3801, the Commission required divestiture of foreign assets even though the relevant geographic market was limited to the United States.[12]

This language from the FTC FAQs is broad and leaves an impression that remedies may expand beyond the actual competitive effects concern.

A brief review of the facts in Guinness/Grand Met does not suggest a remedy beyond the alleged competitive effects. The relevant product markets in *Guinness/Grand Met* were defined to be premium Scotch and premium gin. Guinness and Grand Met both produced their premium Scotches in Scotland and their premium gins in England. The relevant geographic market was defined to be the United States.[13] Though the divested assets may not have been physically located within the relevant geographic market as defined in the Complaint, the divested assets were used to supply the relevant market. Thus, the assets divested as part of the Guinness/Grand Met remedy were closely related to the competitive effects alleged.[14] This suggests that the impression created by the FTC FAQs is unintentional. I recommend that any new remedy section added to the Guidelines make clear that remedy proposals need not include, and the Agencies will not seek, the divestiture of assets that are unrelated to the Agencies' competitive effects concerns.[15] In Guinness/Grand Met, the geographic market may have been limited to the U.S. (perhaps due to a price discrimination analysis), and the

[11] Frequently Asked Question 15.

[12] Frequently Asked Question 15.

[13] The Guinness/Grand Met Complaint's discussion of the geographic market definition is only one sentence long and provides no description of why the U.S. is a relevant geographic market. Defining a U.S. market in this matter may have been reasonable, for example, due to the widespread regulation of spirit sales in the U.S.

[14] If it is ultimately decided to exclude a remedies discussion in the Guidelines, it may be appropriate to include several specific case discussions that detail and explain remedies in a future revision to the Commentary.

[15] Of course, a broader package of assets may be required if a more narrow package would not be financially viable. A financially unviable divestiture package is not likely to resolve competitive effect concerns.

divested assets may have been "beyond" the relevant market, but the assets were serving the U.S. and hence were directly related to competitive effects analysis.

My experience discussing remedy proposals, both with clients and Agency staff, is that asset divestiture packages are not always directly related or tied to competitive effect allegations. The inclusion of language in the Guidelines that ties remedies directly to the alleged competitive effects would improve clarity for merging parties, make settlements easier to achieve, and improve the efficiency of the Agencies' merger enforcement program.

Structural and Behavioral Remedies

The Agencies ask whether the Guidelines should include a discussion of the shortcomings of behavioral remedies in merger cases. The DOJ Policy Statement, the FTC Best Practices Statement, and the FTC FAQs share a preference for structural remedies. The DOJ Policy Statement states, "Structural remedies are preferred to conduct remedies in merger cases because they are relatively clean and certain, and generally avoid costly government entanglement in the market."[16] Consistent with this, the FTC Best Practices Statement and the FTC FAQs assume the remedy is a divestiture. FAQ 1, for example, states that "most orders relating to a horizontal merger will require a divestiture." The issue of whether structural or behavioral remedies are more appropriate in merger cases is not controversial but may be useful to businesses considering mergers and potential remedies. Thus, the inclusion of a very brief discussion of the preference for structural over behavioral remedies, which need not be longer than the DOJ Policy Statement quotation above, may be useful.

Analytical Questions

Many economic questions might be relevant when considering generally whether a proposed merger remedy is suitable, but answering only a few questions may be necessary in a specific case. Merger remedies are fact-specific, and an outline of all of the potential questions that may need to be considered in a merger remedy analysis is likely beyond the scope of the Guidelines, much in the same way that a full, detailed discussion of all potential unilateral effects theories may be beyond the scope of the Guidelines. Nevertheless, there are many economic questions that are commonly considered as part of remedy review, and these and others can be summarized in the Guidelines. I recommend that a high-level summary of pertinent remedy analysis questions be added to any Guideline remedy section. A list of these questions includes:

1. Is the set of assets being divested sufficient to create the competition necessary to replace what has been or will be lost due to the merger?[17]

[16] DOJ Policy Statement, p. 7.

[17] The analysis of this question will vary with the competitive effects analysis. If the competitive effects analysis is a bidding model, for example, will the competitor be able to bid as effectively as the competitor lost due to the merger? Given the discussion of competitive effects analysis in the Guidelines, the inclusion of more detailed questions should not be necessary.

2. If the divested assets amount to less than the full business of one of the previous competitors, will the new competitor have scale greater than minimum viable scale?

3. Will the new competitor's marginal cost be comparable to that of the competitor lost due to the merger?

4. Will the new competitor be financially viable?

5. Will the new competitor have access to raw materials comparable to that of the competitor lost due to the merger? Access to personnel? Access to intellectual property?

6. If reduced innovation is a competitive effects concern, will the new competitor have access to sufficient R&D capabilities?

Note that it may be useful to elaborate on the types of analyses conducted and the conclusions reached by the Agencies with regard to these and other remedies-related questions in a comparable section on remedies added to the Commentary. This may be particularly helpful with regard to the analysis of divestiture packages comprised of less than the full business of one of the merging parties, and of divestiture packages that "mix-and-match" assets from the merging parties (e.g., a manufacturing facility from one firm and a distribution facility from the other).

Conclusion

With the same data and analytical framework, parties proposing a transaction should expect similar results, independent of which Agency reviews their transaction. This is true both of the decision on whether to challenge a transaction as likely being anticompetitive and on whether to accept a remedy proposal. In particular, if a set of assets, such as manufacturing facilities, intellectual property, and customer contracts, is sufficient to resolve the competitive concerns arising from a merger when reviewed by one Agency, it should be sufficient to resolve any concerns that would arise if the other Agency were to perform the merger review instead. Though the Agencies might need separate documents that describe remedy <u>procedures</u> because they may utilize different enforcement mechanisms, they should share the same basic <u>evaluation framework</u> for considering remedies. This evaluation framework should be detailed in the Guidelines and possibly also explained further via examples in the Commentary. This will provide merging firms with improved clarity regarding the sufficiency of potential merger remedy proposals. It will also make it easier to develop such proposals and to present and support them to the Agencies, improving the efficiency of the U.S. merger review process.