COMMENTS OF THE ABA SECTION OF ANTITRUST LAW

HMG REVISION PROJECT – COMMENT
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The Section of Antitrust Law (the "Antitrust Section" or the "Section") of the American Bar Association (ABA)[1] is pleased to submit these comments to the proposed Horizontal Merger Guidelines ("Proposed Guidelines") issued by the U.S. Department of Justice ("DOJ") and the Federal Trade Commission ("FTC") (collectively referred to as the "Agencies") on April 20, 2010.[2] The views expressed herein are being presented on behalf of the Antitrust Section and have been approved by the Section's Council. They have not been approved by the House of Delegates or the Board of Governors of the ABA and, accordingly, should not be construed as representing the policy of the ABA.

The Section applauds the Agencies for their efforts during the past eight months to revisit and explore whether changes to the 1992 Merger Guidelines[3] are warranted. The Section noted in its 2008 Transition Report[4] that the Guidelines provide important guidance to the Agencies, the private sector and the courts. Thus, it is important that any guidelines issued by the Agencies accurately reflect actual practice at the Agencies, clearly explain the analysis conducted by the Agencies, and accurately reflect the accepted analytical framework that should be used. As stated in the Section's Comments submitted on November 9, 2009,[5] there are concerns that certain aspects of the 1992 Merger Guidelines no longer reflect current economic thinking while other parts do not accurately reflect the process used by the staffs of the Agencies. The Proposed Guidelines significantly address many of these concerns.

The Section agrees that the Proposed Guidelines must meet the Agencies' goals, including "assist[ing] the business community and antitrust practitioners by updating and increasing the transparency of the analytical process underlying the Agencies' enforcement decisions," as "[t]he Agencies seek to identify and challenge competitively harmful mergers

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1 The Section assembled a working group led by Joseph G. Krauss to draft these comments. The working group included Thomas Barnett, Matthew Bellinger, Jeffrey Brennan, Timothy Daniel, Gail Levine, Bilal Sayyed, Robert Schlossberg, Christine Wilson, and Mark Whitener .

2 U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES FOR PUBLIC COMMENT; RELEASED APRIL 20, 2010, *available* at http://ftc.gov/os/2010/04/100420hmg.pdf. [hereinafter "PROPOSED GUIDELINES']

3 U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES (1992) (with Apr. 8, 1997 revisions to §4 on efficiencies), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶13,104 [hereinafter "1992 MERGER GUIDELINES"].

4 AMERICAN BAR ASSOCIATION SECTION OF ANTITRUST LAW, 2008 TRANSITION REPORT (2008), *available at* http://www.abanet.org/antitrust/at-comments/2008/11-08/comments-obamabiden.pdf.

5 AMERICAN BAR ASSOCIATION SECTION OF ANTITRUST LAW, REGARDING THE FEDERAL TRADE COMMISSION AND DEPARTMENT OF JUSTICE HORIZONTAL MERGER REVIEW PROJECT, PROJECT NO. P092900, (November 9, 2009), *available* at http://ftc.gov/os/comments/horizontalmergerguides/545095-00010.pdf [hereinafter ABA SECTION COMMENTS].

while avoiding unnecessary interference with mergers that are either competitively beneficial or neutral."[6] The Section believes that these goals are best served by guidelines that:

- Describe the analytical frameworks that the Agencies use in a balanced, burden-neutral manner – setting out both the conditions that may indicate the potential for competitive concerns, as well as the conditions that may mitigate such concerns. As statements of enforcement policy, the Guidelines should articulate factors that could lead the Agencies to challenge a transaction. At the same time, most transactions, even those that combine competitors, ultimately are not challenged, and often are not even extensively investigated. For guidelines to fully reflect Agency policy and practice, the factors that lead to a merger being challenged should be described as fully as are the factors that lead to a merger being cleared. A balanced, burden-neutral approach is consistent with the Agencies' goals of increasing the transparency of the Agencies' enforcement decisions, and of "challenging competitively harmful mergers while avoiding unnecessary interference with mergers that are either competitively neutral or beneficial."

- Reflect a broad analytical consensus, while avoiding choosing sides on issues that remain the subject of meaningful debate. Awaiting consensus before incorporating controversial concepts into enforcement guidelines can have several positive consequences. It can increase the likelihood that policies are analytically sound and that potential problems with a given approach have been addressed; avoid subjecting the Guidelines to change whenever subsequent Agency leaders with different views take office; and ensure the Guidelines' continued role as a model of best practices for international enforcers.

- Provide a reliable indication of the analytical approaches that the Agencies are likely to apply, and of the actual enforcement outcomes that emerge from Agency investigations.

- Take into account the potential impact that U.S. policies can have abroad, and are consistent with policy statements that the Agencies have advocated abroad, including the International Competition Network's Recommended Practices for Merger Analysis.[7]

- Take into account the courts' role in merger enforcement. One of the proposed Guidelines' goals is to "assist the courts in developing an appropriate framework for interpreting and applying the antitrust laws in the horizontal merger context." Here,

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6 U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, Request for Views on Proposed Horizontal Guidelines, at 1 (Apr. 20, 2010), *available at* http://www.ftc.gov/os/2010/04/100420hmg-requestviews.pdf..

7 *See* Press Release, Fed. Trade Comm'n, International Competition Network Adopts Recommended Practices to Improve Merger Analysis, Creates New Virtual University, and Addresses Complex Unilateral Conduct Issues (Apr. 29, 2010), *available at* http://www.ftc.gov/opa/2010/04/icn.shtm; Press Release, U.S. Dep't of Justice, International Competition Network Adopts Recommended Practices to Improve Merger Analysis and Presents Report on Unilateral Conduct Issues (Apr. 29, 2010), *available at* http://www.justice.gov/atr/public/press_releases/2010/258303.htm.

too, the Section believes a balanced approach is appropriate to reflect accurately and clearly all of the considerations that are used in a merger analysis.

The Section notes that the Proposed Guidelines make several significant changes that were suggested by the Section in its comments to the questions posed by the Agencies in September. At the same time, the Section believes that the Proposed Guidelines can be improved further by (i) clarifying several statements that may lead to unduly narrow interpretations of Agency practice and (ii) increasing transparency by explaining more fully how Agency staff might use the analytical framework found in the Proposed Guidelines. The Section believes that these changes will result in a more balanced set of guidelines that accurately reflect Agency practice and will provide greater guidance to Agency staff, merging parties, and the Courts .

The Section appreciates the fact that the Proposed Guidelines were released in draft for public comments, consistent with international best practices.[8] The openness and transparency that the Agencies have demonstrated in the beginning of this process should continue through the final adoption of any revisions. Although the Agencies have not sought public comment before the issuance of previous merger guidelines, the experience in other jurisdictions has shown that an open process can yield valuable input from practitioners and business persons and result in more effective and more complete guidelines. The Section applauds the Agencies for taking these very important steps to ensure continued openness and transparency in this process.

For ease of reference, the Section has organized its comments below by the sections of the Proposed Guidelines (the Section has no comments on sections 11-13). First, though, the Section believes it is useful to highlight a number of its primary points:

- Use of price-cost margins: In a number of places, the Proposed Guidelines suggest presumptions that can be drawn from a firm's margins. The Section believes it is very important that at a minimum such discussions be expanded to clarify that any inferences to be drawn from margins (whether relating to elasticity of demand, possible coordination, etc.) depend on the circumstances of the particular firms and market conditions at issue, and require an appropriate calculation of margins, i.e., use of an appropriate measure of cost.

- Use of market definition: The Section agrees that market definition is not an end in itself. Nonetheless, the Proposed Guidelines unduly downplay the role of market definition. The Section believes it would be more consistent with judicial precedent, and internationally recommended practices, to make clear that market definition remains a necessary element of merger analysis under Clayton Act Section 7.

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8 For example, in the United Kingdom , "[b]etween April and September 2009, the Competition Commission (CC) and the Office of Fair Trading (OFT) (together, the Authorities) conducted a public consultation on their joint Merger Assessment Guidelines. Responses to the consultation were published …: a summary of those submissions and the Authorities' response to the major points raised are now published as a single document. The Authorities have revised the draft Merger Assessment Guidelines to reflect many of the detailed drafting points contained in the submissions and in the light of substantive comments on aspects of the previous draft." http://www.oft.gov.uk/OFTwork/mergers/publications/guidelines/substantive/

- Concentration-based presumptions of illegality: As it did in its initial comments, the Section urges the Agencies to remove the presumption of illegality keyed to the level and increase in the HHI. The presumption does not reflect how the Agencies conduct investigations, is not theoretically warranted, and could be misinterpreted by other countries thereby undercutting international efforts to promulgate solid merger analysis principles.

- Unilateral effects analysis: Although new section 6 is an improvement over the 1992 Merger Guidelines, it would benefit from giving greater credit to the role of efficiencies and repositioning in the ultimate assessment of competitive effects, and from noting potential limitations on the applicability of the analysis. The Section is also concerned with the new articulation of a theory of competitive harm due solely to a reduction in the number or variety of products offered. The concept is difficult to evaluate and very difficult to define and quantify; and the theoretical possibility that a merger could thus harm competition in ways not otherwise subject to challenge based on a theory of price increase or reduction in output is outweighed by the possibility that including this theory will promote ultimately unwarranted investigations here and abroad.

- Coordinated effects analysis: Section 7 suggests an unduly low bar for the Agencies in articulating a theory of adverse competitive effects that is inconsistent with Agency practice and Court precedents, and the section overall could be improved by adding factors that balance the analysis.

- Efficiencies: Section 10 seems to downplay the often procompetitive contributions to consumer welfare that reducing fixed costs can make.

SECTION 2: EVIDENCE OF ADVERSE COMPETITIVE EFFECTS

As a general matter, the Section commends the Agencies for adding this new section that provides the bar and business community with useful, practical guidance as to the types of evidence the Agencies will consider in their merger review. Nonetheless, as discussed below, in a number of places, the Section believes that the Proposed Guidelines could be more even-handed in its presentation and that the Proposed Guidelines unnecessarily establishes a presumption or presumes the likely result of an inquiry rather than simply articulating the relevant inquiry and the required evidence.

Title – The title of this section is misleadingly narrow. It could more accurately read, for instance, "Evidence Relevant To The Competitive Effects Analysis."

Section 2.1.2 – In the last sentence "substantial" seems to limit unnecessarily (and somewhat vaguely describe) the possible inquiry. The Section suggests that the word be deleted and replaced by the words "and significance" so it accurately reflects that agency staff considers all competitors as appropriate in their analysis.

Section 2.1.3 – As discussed in more detail under section 5, the Agencies should eliminate language that suggests that any presumption is attached to market shares or concentration. The Section believes the Guidelines would more accurately reflect actual practice if the Guidelines stated that higher concentration will lead to greater scrutiny of the evidence presented by the merging parties to show that the merger will not lead to a lessening of competition. This also would be more consistent with positions taken by the Agencies in the international context encouraging foreign jurisdictions to remove any market share presumptions from their analyses. The last sentence could then read: “Mergers that cause a significant increase in concentration and result in highly concentrated markets can indicate a greater likelihood that the merger will enhance market power, requiring closer scrutiny of the merger’s likely competitive effects.”

Section 2.1.5 – Although the Section has no specific comments on this paragraph, which addresses the concept of a “maverick” firm, it does note that the concept is not specifically addressed in Section 7, the coordinated effects section. It would seem appropriate to do so, as the elimination of a “maverick” firm is one of the stronger coordinated effects theories. The Agencies could consider moving this paragraph to section 7 or discussing the concept with an appropriate cross-reference.

Section 2.2.1 – The last sentence in the first paragraph should be deleted. First, the example does not add anything material to the point of the section, which is “sources of evidence.” To address inferences that can be drawn from price-cost margins does not provide useful additional guidance in this context. Second, the assumption in the example at a minimum needs amplification and clarification so as not to be misinterpreted. For instance, it has been noted that in many industries the price-cost margin may reflect far more on the need to obtain a return on fixed costs such as research and development than it is informative about competitor coordination or own elasticity. These concepts can be developed in section 4 where the issue is also addressed. If not deleted, the sentence should be modified to clarify that an appropriate measure of costs should be used, not suggesting that short-run marginal cost is always appropriate. Consistent with that approach, the Section suggests that the now penultimate sentence be revised to read: “The business decisions taken by the merging firms and other market participants also can be informative about industry conditions, including the firms’ decisions relating to their pricing and output.”

In addition, the discussion of “intent” evidence should be explicitly limited to intent that is “merger-specific”; and it seems unnecessary and potentially misleading to label such evidence as “highly informative” rather than simply “informative” as many other factors will bear on its persuasiveness. The list of putatively anticompetitive actions here is potentially problematic, especially by including a reduction in "product variety." A reduction in the mere number of product types offered by a merged firm, absent evidence of likely price increases/output reductions as a result of lost competition, is ambiguous at best and may often reflect efficiencies, e.g. by introducing an improved product that combines the merged parties' capabilities in a way that competes more effectively with other products. Therefore, the Section suggests deleting references to product variety here and elsewhere in the Proposed Guidelines.

Finally, the last two sentences of this section seem unnecessary and should be deleted. Whether and to what extent the financial terms of the transaction are probative on the competitive effects question is an issue on which there is a lack of consensus and insufficient experience and precedent. The sentences also do not provide additional meaningful guidance in the context of the thrust of the section, which is "sources of evidence."

SECTION 3: TARGETED CUSTOMERS AND PRICE DISCRIMINATION

This section explains that adverse competitive effects from mergers may be limited to a subset of customers who cannot avoid post-merger price increases. Because competitive concerns based on differential pricing have long been recognized, inclusion of this anticompetitive effect from mergers is a sensible addition to the Guidelines.

The Section offers the following suggestions that it believe will clarify this section.

First, given general agreement on the economic conditions that permit price discrimination, the Section recommends that the sentence in the fourth paragraph, "This may involve identification of individual customers to which different prices are offered, or offering different prices to different types of customers based on observable characteristics" be modified to read: "This normally requires identification of individual customers to which different prices are offered, or offering different prices to different types of customers based on observable characteristics." Similarly, the final sentence in Example 3 potentially is confusing, especially read in conjunction with the first sentence; the Section therefore recommends that this sentence be deleted.

Second, the Section suggests that the phrase "post merger" be added to the end of the final sentence in section 3 to make more explicit that the competitive concern here is that a merger can increase the likelihood that prices might increase to some, but not all, of the merging firms' customers. As currently drafted, the sentence could be read to imply that differential pricing itself is a competitive concern. Price discrimination can improve consumer welfare by reducing prices and increasing output to certain customers, and the dangers of condemning all price discrimination as anticompetitive are well known and widely recognized. The Proposed Guidelines should make clear that the competitive concern is a post-merger price increase to targeted customers rather than differential pricing in and of itself.

SECTION 4: MARKET DEFINITION

The Role of Market Definition

The Proposed Guidelines retain a discussion of relevant markets, but contain language that could be read to suggest that market definition may play a lesser role. The Proposed Guidelines suggest that the Agencies may not rely on a relevant market analysis in cases where there are numerous other tools that "more directly predict the competitive effects of a merger, reducing the role of inferences from market definition and market shares." A reduction in the role of market definition in merger analysis would be wrong as a matter of policy, as a matter of law, and as a matter of international competition norms that the Agencies and others have espoused. Accordingly, the Section recommends for several reasons that the Agencies clarify and reaffirm in these Guidelines that market definition is an indispensable element of any decision to challenge a merger.

First, requiring the Agencies to define a relevant market in challenging a merger is good policy. It helps to ensure that the Agencies focus on and address key issues affecting the determination whether a particular transaction is likely substantially to lessen competition and thereby to make better, more predictable enforcement decisions. As the Proposed Guidelines acknowledge, an "evaluation of competitive alternatives available to customers is always necessary at some point in the analysis." Properly understood, defining a relevant market is an exercise in determining the competitive alternatives available to customers and how meaningful those alternatives are, both individually and collectively. Put another way, "[m]arket definition identifies an arena of competition." [9] If they were to reduce the role of market definition, the Agencies would risk moving toward a less rigorous assessment of those issues.

Indeed, the Proposed Guidelines suggest that the Agencies might seek to avoid addressing hard questions sometimes presented by the process of defining a relevant market in particular cases. For example, the Proposed Guidelines states that "[r]elevant antitrust markets defined according to the hypothetical monopolist test are not always intuitive and may not align with how industry members use the term 'market.'" This suggests that more direct measures of competitive effects may be preferred in such instances. The counterintuitive nature of the market implicated by the more direct evidence, however, likely raises questions about the reliability of such alternative evidence. In such cases, the Agencies should justify their deviation from common sense intuition identified through a relevant market analysis.

The Proposed Guidelines may be interpreted to reduce the role of relevant market analysis most significantly in cases involving unilateral effects analysis. For example, the Proposed Guidelines suggests that the Agencies might base a merger challenge on a determination that certain differentiated products that are substitutable with those of the merging parties do not adequately discipline competition. Contrary to the suggestion in the Proposed Guidelines, defining a relevant market is as important in the unilateral effects context as it is in coordinated effects analysis. The analytical tools used by the Agencies to evaluate unilateral effects require numerous judgments and estimates, such as the selection of the competitive model, estimation of variables, and assessments of issues such as entry and repositioning. The Agencies can significantly enhance the reliability of its use of these tools if it integrates its assessment into the contours of a relevant market.

To illustrate the importance of market definition in providing context for a unilateral effects analysis under the Proposed Guidelines, the Section offers the following hypothetical example:

> The industry consists of ten producers of differentiated widgets with each firm having an equal market share, or 10 percent. Further, the diversion ratio between each product is the same non-zero number – that is, diversion is proportional to market shares, with no greater diversion between the merging parties' products than between any products in the market. A hypothetical monopolist analysis would indicate that the smallest relevant market would include all 10 producers. Two of the firms propose

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[9] PROPOSED GUIDELINES § 4.0.

to merge to form a combined entity with a 20 percent share of that relevant market.

The Proposed Guidelines could be read as permitting the Agencies potentially to infer anticompetitive effects merely by applying one of its unilateral effects models to the proposed transaction. All of them would predict some "upward pricing pressure." The Agency could point to the Proposed Guidelines as indicating that this "more direct" evidence of harm reduces the need to confront the relevant market analysis and thereby shift to the parties the burden to disprove the existence of harm to competition. The Section respectfully submits that such an approach would present too low a threshold for shifting the burden to the parties to defend the transaction. The Proposed Guidelines should make clear that the Agencies will continue to adhere to defining a relevant market and will not make enforcement decisions based solely on the results of a unilateral effects model.

Second, if the Agencies were intending to reduce the role of market definition analysis, it would be more difficult for merging parties and practitioners to accurately assess the Agencies' potential analysis of transactions. Thus, elimination of the requirement to engage in product market definition would reduce transparency, lead to less reliable outcomes, and diminish the utility of the Guidelines for practitioners and parties to potential transactions.

Any suggestion that the Agencies were intending to reduce the role of relevant market definition to merely one of many tools for merger analysis would move the Agencies away from the international norms in this area. In particular, the International Competition Network ("ICN") recently adopted two new Recommended Practices for Merger Analysis. The first of the new practices states that "[a]gencies generally should address the competitive effects of a merger within economically meaningful markets."[10] Any attempt by the U.S. Agencies to move away from the use of relevant markets as a fundamental component of merger review would move the United States away from this consensus recommendation by the global competition community.

Moreover, in evaluating mergers under Section 7 of the Clayton Act, the courts require the government (or any plaintiff) to define the relevant market. Deemphasizing market definition is inconsistent with decades of well-established case law.

To assist the Agencies in addressing these concerns, the following language changes could help ensure that market definition remains a fundamental aspect of any decision to challenge a transaction, whether or not it is the first issue that the Agencies examine in a given investigation:

- In section 4, Market Definition, first paragraph: Describe market definition as an "important tool" rather than merely "one of the tools."

- Revise the last sentence of the same paragraph to read as follows: "Some of the analytical tools used by the Agencies to assess competitive effects do not rely on

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10 Press Release, Fed. Trade Comm'n, *supra* note 7; Press Release, U.S. Dep't of Justice, *supra* note 7 These Recommended Practices were issued in 2010; the DOJ chaired the merger review working group that formulated the Recommended Practices.

market definition, although evaluation of competitive alternatives available to customers and the contours of the relevant market are always necessary at some point in the analysis."

- In the next paragraph, to reflect better the integrated analysis described in the Commentary, change the second and last sentences of the paragraph to read as follows: "For example, evidence that a reduction in the number of significant rivals offering a group of products causes prices for those products to rise significantly can indicate that those products form a relevant market. Such evidence also may more directly predict the competitive effects of a merger and should be considered along with all other available evidence as well as any inferences from market definition and market shares."

- In the sixth paragraph of section 4, in order ensure a more balanced discussion of some of the issues relating to market definition, revise the paragraph to read as follows: "Defining a market broadly to include relatively distant product or geographic substitutes can lead to misleading market shares. This is because the competitive significance of distant substitutes is unlikely to be commensurate with their shares in a broad market. Similarly, defining a market too narrowly can understate the competitive significance of substitutes that are outside the narrowly defined market. Accordingly, the Agencies seek to define a market that, based on the totality of the evidence available, provides the most accurate context in which to assess the competitive effects of the merger."

- Also to help ensure a balanced discussion of the issues relating to relevant market definition, add a new Example 4A that would read as set forth below and delete the first sentence of the next paragraph:

> "Example 4A: With regard to the same proposed merger between Firms A and B, if Brand A motorcycle prices were to rise, not only would some buyers substitute to Brand B and other buyers to cars, but still other buyers would substitute to Brand C or Brand D motorcycles. Far more buyers see Brand C and Brand D motorcycles as much more similar to Brand A motorcycles than are Brand B motorcycles, and far more Brand C and Brand D motorcycles are sold than Brand B motorcycles. Evaluating shares in a market that excludes Brand C and Brand D motorcycles would greatly overestimate the competitive significance of Brand B motorcycles in constraining Brand A's prices and greatly underestimate the significance of Brand C and Brand D motorcycles.

- In the next paragraph, clarify that the hypothetical monopolist test may or may not lead to a single relevant market. The current language could be read to suggest that it never leads to a single relevant market.

Other Aspects of Market Definition

Section 4 (at page 7) provides that where analysis suggests alternative plausible markets resulting in market shares that lead to different inferences regarding competitive effects, "it is particularly valuable to examine more direct forms of evidence concerning those effects." This text may be read to imply that "more direct forms of evidence" exist in every merger investigation, when, to the contrary, it is often the case that the data or economic tools required to analyze such data reliably are not available to serve this evidentiary purpose. The Section recommends that the Agencies acknowledge this point and clarify that their examination of "more direct forms of evidence" is limited by the availability and reliability of such evidence in particular cases.

Section 4 (at page 8) appropriately points out that a market defined too broadly can lead to misleading market shares; Example 4 is an illustration of that problem. The Section recommends that the Proposed Guidelines further explain, and provide an example to illustrate, that a market defined too narrowly can also result in misleading market shares.

Section 4.1.1 (page 9 last paragraph) states that "the Agencies will *normally* also include a third product [in the market] if that third product is a closer substitute for the first product than is the second product [that is already included in the market]" (emphasis added). The paragraph explains that the third product is a closer substitute for the first product if, in response to a SSNIP on the first product, more revenues are diverted to the third than to the second product. By using the term "normally," and by referring to a third product that is a "closer substitute" for the first product than is the second product, the Agencies signal that a relevant market might exclude a product that is an as close or closer substitute to an in-market product than is the only other in-market product. Because, on its face, this would appear to be a highly questionable or anomalous result, the Section recommends that the Agencies modify this discussion to clarify that a third product that is a comparably close substitute for the first product will be included in the market. To this end, the fourth paragraph of Section 4.1.1 could be revised to read as follows: "When applying the hypothetical monopolist test to define a market around a product offered by one of the merging firms, if the market includes a second product, the Agencies will also include a third product if that third product and the second product are comparably close substitutes for the first product. This would be the case if, in response to a SSNIP on the first product, similar revenues are diverted to the third product as to the second product."

Moreover, the third product is appropriately included in the market not only if it is a "closer" substitute for the first product than is the second product, but also if the third and second products are comparably close substitutes for the first product. Such close substitution would be reflected by a similar diversion of revenues to the third and second products in response to a SSNIP on the first product. The Section recommends that the Agencies revise this paragraph to confirm this principle.

In Section 4.1.2, in the first paragraph, fourth sentence, change "might" to "are likely to" to clarify that the agencies do not rely on mere possibilities.

In Example 10, last sentence, change "will" to "may" or "is likely to" to reflect the fact that the Agencies will make a decision in each case based on the circumstances.

In Example 11, revised the language to clarify the key assumptions regarding targeted discrimination: "Example 11: Glass containers have many uses. In response to a price increase for glass containers, some users would substitute substantially to plastic or metal containers, but baby food manufacturers would not. If a hypothetical monopolist of glass containers was aware that baby food manufacturers would not switch, could price separately, and could limit arbitrage, baby food manufacturers would be vulnerable to a targeted increase in the price of glass containers. The Agencies could define a distinct market for glass containers used to package baby food."

In Example 14, add the phrase "and high transportation costs prevent arbitrage between customers in City X and City Y" to the end of the fifth sentence to ensure that this assumption is expressly stated.

Section 4.1.3, like section 2.2.1, discusses pre-merger margins and the inferences to be drawn from them – here (page 12) in the context of critical loss analysis. Section 4.1.3 states that absent coordinated interaction "[h]igh pre-merger margins normally indicate that each firm's product individually faces demand that is not highly sensitive to price." The Section recommends that any reference in the Proposed Guidelines to the evidentiary significance of margin evidence to market definition clarify that the Agencies will evaluate such evidence only in light of the entire factual record. For example, in a particular market, within the context of all evidence of competitive conditions, relatively high margins may indicate that each firm's product faces demand that is not highly sensitive to price. This evidence may tend to indicate a smaller predicted loss and make it more likely that the predicted loss is less than the critical loss, such that the candidate market satisfies the hypothetical monopolist test. In different circumstances, however, relatively high pre-merger margins could be observed along with evidence that, as a whole, shows that demand for each firm's product is relatively elastic, such that the pre-merger margins are consistent with a higher predicted loss.

The Section also recommends that the Proposed Guidelines expressly confirm the Agencies' recognition that the determination of the appropriate margin is an important element of this analysis. It would be beneficial for the Proposed Guidelines further to explain that firms in competitive industries may set prices well above their short run marginal costs – for example, to recover fixed costs from research and development or from capital-intensive manufacturing operations.

SECTION 5: MARKET PARTICIPANTS, MARKET SHARES, AND MARKET CONCENTRATION

The Section applauds the Agencies for removing the largely artificial and potentially confusing separation of the analysis between "uncommitted entrants" and "committed entrants" that was present in the 1992 Merger Guidelines and instead use a more practical concept of "rapid entrants." [11] *See* Proposed Guidelines, § 5.1. The 1992 Merger Guidelines had included a one year timeline as to how quickly the supply response must occur. Although removing this one-year guide will provide the agency with more flexibility to consider a range of supply responses, the Proposed Guidelines would benefit from a statement that the Agencies may consider entry of either a shorter or longer duration than the historical one-year guide according to particular industry characteristics.

The Section also applauds the Agencies for recognizing that the HHI levels in the 1992 Merger Guidelines largely had fallen into disuse, and for the significant step they have taken through the increases suggested in the Proposed Guidelines toward bringing the HHI levels more in line with current practices at the Agencies. [12]

Although the HHI thresholds have been increased to reflect more accurately actual practice, the Proposed Guidelines continue to invoke presumptions based on market shares and concentration. The Section has previously recommended that market concentration presumptions should be removed from the Merger Guidelines. [13]

The Proposed Guidelines acknowledge that market shares and market concentration are to be used "in conjunction with" and as a "part of" the competitive effects analysis. [14] They further state that the market concentration thresholds are 'not to provide a rigid screen" and provide "one way to identify those mergers for which it is particularly important to examine whether other competitive factors confirm, reinforce, or would counteract" potential anticompetitive concerns." [15] And yet, despite these statements, the Proposed Guidelines nevertheless retreat to the historical rigidity of a presumption.

The Section urges the Agencies to reconsider and correct the inherent inconsistency by removing the presumption language and clearly stating that market concentration should remain but one part of the analysis. The Section believes that it is appropriate that the Guidelines acknowledge that high levels of market concentration can require closer scrutiny of other factors bearing on the likelihood of anticompetitive effects. This approach is consistent with recent legal jurisprudence adopting a "sliding scale" approach.[16] Therefore, the Section recommends that this sentence be modified to state:

> Mergers resulting in highly concentrated markets that involve an increase in the HHI of more than 200 points can indicate a greater likelihood that that the merger will create or enhance market power and will be scrutinized more closely. The higher the concentration and the greater the increase in the HHI, the greater the need to closely scrutinize evidence of whether the merger is unlikely to enhance market power.

In addition, in the third paragraph of Section 5.3, which describes situations where the Agencies will consider the number of significant competitors where calculating market concentration, the

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[11] *See* PROPOSED GUIDELINES § 5.1.
[12] *See* PROPOSED GUIDELINES § 5.3.
[13] *See, e.g.*, ABA SECTION COMMENTS, *supra* note 5, at 2, 18-19.
[14] *See* PROPOSED GUIDELINES § 5.
[15] *See* PROPOSED GUIDELINES § 5.3.
[16] *See, e.g.*, FTC v. H. J. Heinz Co., 246 F.3d 708 (D.C. Cir. 2001).

Section believes that readers will find one sentence of this paragraph confusing and vague: "If a firm has retained its market share even after its price has increased relative to those of its rivals, that firm already faces limited competitive constraints, making it less likely that its remaining rivals will replace the competition lost if one of that firm's important rivals is eliminated due to a merger." This sentence seems to address a situation where the firm may retain its market share after its price has increased due to product quality or some other differentiation, which is an important issue. But the sentence is potentially conflicting by at first concluding that the firm "already faces limited competitive constraints" but then stating that the elimination of "an important rival" may reduce competition. The Agencies should consider clarifying this sentence to address more clearly the relevant point or deleting it entirely and modifying the remainder of the paragraph to read:

> The Agencies may measure market concentration using the number of significant competitors in the market. This measure is most useful when there is a significant gap in market share between significant competitors and smaller rivals when it is difficult to measure revenues in the relevant market, or when each competitor has a similar capability of winning future sales in markets characterized by competitive bidding.

SECTION 6: UNILATERAL EFFECTS

Unilateral effects analysis plays an increasingly prominent role in the Agencies' merger enforcement efforts, and the revisions to that analysis in Section 6 are some of the most significant and comprehensive aspects of the Proposed Guidelines. In several respects, Section 6 describes potential approaches to assessing unilateral effects that reflect analytical consensus and provide valuable guidance. Section 6 helpfully distinguishes among different settings in which unilateral effects may be analyzed, including markets characterized by differentiated products, markets where prices are determined in negotiations or bidding, and markets in which products are relatively homogeneous. Some of the underlying economic premises are not particularly controversial, and most are stated clearly. In several respects, however, Section 6 could be significantly clarified and, in some instances, made more consistent with sound analytical principles and with actual enforcement outcomes.

A relatively static approach to unilateral effects analysis. Taken as a whole, Section 6 would appear to indicate that significantly more mergers are likely to lead to unilateral anticompetitive effects than is actually the case, either in terms of economic reality or observed agency practice. In its current form, Section 6 is open to the criticism that it places excessive reliance on the generalization that every horizontal merger involving differentiated products creates the potential for anticompetitive effects – without adequately explaining the variety of factors that, in reality and in practice, often negate such effects. Section 6 appears to place excessive emphasis on some potentially relevant, but fundamentally static and typically non-decisive, factors (such as win/loss data or other backward-looking information reflecting the existence of pre-merger competition between the parties), while generally downplaying forward-looking factors that may be decisive in many cases (such as competitor repositioning, and efficiencies), in reaching the predictive judgment that typically is required in merger cases. To the extent this is the case, the Proposed Guidelines appear to deviate from the prevailing analytical consensus, and from actual agency enforcement practice. Many transactions that would appear to raise concerns under section 6 as proposed would not, and should not, be challenged or necessarily even investigated extensively today.

The strong emphasis on largely static factors is evident at several points in section 6. A central feature of section 6.1 is Example 18, which provides a quantitative example for assessing unilateral effects in differentiated product markets. Example 18, which incorporates assumed facts from Examples 5 and 6, concludes that as a result of the hypothetical merger of firms producing products A and B, the merged entity "would raise prices 10%." There are many assumptions that appear to have been made in this example, some arguably necessary and appropriate for purposes of simplification, others more controversial. What is clear is that the example postulates a significant price increase without discussing the basis on which post-merger diversion ratios may reliably be determined or how costs and margins are defined, and without taking into account critical factors such as potential repositioning or efficiencies.

Section 6.1 (including Example 18) relies heavily on "diversion ratios" as a measurement of the extent of competition between the merging firms' products, noting that diversion ratios "can be very informative" in assessing unilateral effects, "with higher diversion ratios indicating a greater likelihood of such effects." There is little or no discussion of what types of information would constitute reliable evidence of "diversion ratios," or of the need to consider whether backward-looking information (such as win/loss data from prior transactions) is necessarily a reliable predictor of future diversion of sales from one party to another. The examples postulate that certain proportions of sales "are diverted" from one product to another, with no discussion of the evidentiary basis on which this conclusion might be reached, particularly on a forward-looking basis, which is the critical question for examining competitive effects.

This issue is further highlighted by the statement in section 6.1 that "[d]iversion ratios between products sold by merging firms and those sold by non-merging firms have at most secondary predictive value." The basis for this assertion is not provided, and is not evident. Examining the competitive proximity of other suppliers' products to those of the merging firms is likely to be a – perhaps the – critical factor in many unilateral effects cases involving differentiated products. The closer other parties' products are to the merging parties' products, the less reliable any prediction of anticompetitive effects would be, and the more likely that the other parties can readily make minor "repositioning"-type adjustments to eliminate any such effects. The issue arises again later in section 6.1, with the assertion that "[a] merger is unlikely to generate *substantial* unilateral price increases if non-merging parties offer *very close* substitutes for the products offered by the merging firms" (emphasis added). Even leaving aside how other suppliers/products might be repositioned in response to the merger (see below), the Proposed Guidelines appear to downplay the potential significance of competitors' products in assessing unilateral effects, without apparent basis in theory or practice.

Similarly, section 6.2, which deals with unilateral effects in markets where prices are determined through negotiations or auctions, posits that in such markets, a merger between competing sellers prevents buyers from playing sellers off against each other, and that "[t]his alone can significantly enhance the ability and incentive of the merged entity to obtain a result more favorable to it, and less favorable to the buyer …." This appears to suggest that any horizontal merger in this type of market is likely to have some anticompetitive effects, or, at a minimum, to indicate a situation in which competitive concerns are theoretically possible, without adequate discussion of the factors that could mitigate or eliminate this concern. Section 6.2 goes on to say that anticompetitive effects "are likely in proportion to the frequency or probability with which, prior to the merger, one of the merging sellers had been the runner-up when the other won the business." This language appears unduly to suggest a sliding scale in which some competitive harm is viewed as likely whenever (as would be the case in any horizontal merger) the merging firms compete with each other, with the only question being the degree of harm. This is probably not what the Agencies intended, and should be clarified.[17]

Section 6.2 also states that "when the merging sellers are likely to know which buyers they are best and second best placed to serve, any anticompetitive unilateral effects are apt to be targeted at those buyers; when sellers are less well informed, such effects are more apt to be spread over a broader class of buyers." This is an example of where the Proposed Guidelines could be drafted in a more balanced manner. The first part of this sentence may not be controversial in suggesting that sellers' ability to target specific customers whom the seller knows regard the merging firms' products as closest substitutes is relevant; but the second part seems to suggest that the absence of such ability is insignificant, or simply brings another theory of harm into play. This could be redrafted to more clearly distinguish between different competitive effects theories, and to provide more balanced descriptions of the conditions in which each theory is more, and less, likely to apply.

The Section believes that the issues identified above should be addressed by revising or deleting language which suggests an unduly static approach to that analysis consistent with the edits proposed in the attached redline.

Downplaying of dynamic, mitigating factors. As noted above, in addition to according significant prominence to largely static factors in identifying potentially anticompetitive mergers, section 6 appears to significantly downplay the role of dynamic factors, such as competitor repositioning and entry, in unilateral effects analysis.

Repositioning. The treatment of repositioning in the analysis of unilateral effects in differentiated product markets is one of the more noteworthy and significant features of the Proposed Guidelines. The differences among suppliers and their products that make them "differentiated" can take a wide variety of forms, and just as these differences came about as firms reacted to conditions in the marketplace, they are potentially subject to modification – "repositioning" – in response to a merger. These competitive responses can range from introducing new products to modifying existing ones, or simply marketing those features more effectively to particular customers. Customers can also bring about repositioning by adjusting their preferences or simply by communicating to existing suppliers how they can win the customer's business. "Repositioning" in its various forms is ubiquitous, especially in the types of markets to which differentiated products analysis applies. As noted above, competitor

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17 Section 6.2 does state that "these factors are likely to be small if there are *many* equally placed bidders" (emphasis added), but this appears to place too high a burden on the merging parties to rebut the apparent implication of anticompetitive effects whenever the merging parties have bid in competition with each other. It is not clear what constitutes "many" other such bidders; moreover, in many cases even a relatively small number of such bidders can, and in reality do, result in competitive markets, such that many mergers in such markets are neither challenged nor extensively investigated.

responses are important reasons why many mergers in such markets do not raise significant competitive concerns in the eyes of customers or, as a result, the agencies.

This is not to suggest that, as a matter of enforcement policy, repositioning should be assumed to prevent or counteract potential unilateral effects in any particular case, but the Proposed Guidelines appear to move considerably in the opposite direction. Repositioning is not mentioned until the end of section 6.1, and then only to say that it may occur "in some cases" – and that it will be evaluated under the entry analysis in section 9, to see whether it would be sufficient to deter or counteract "what otherwise would be significant anticompetitive unilateral effects from a differentiated products merger." The Proposed Guidelines cite with approval the Agencies' 2006 Commentary on the Horizontal Merger Guidelines, which contained the controversial statement that "[t]he 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."[18]

Whether intended or not, the Proposed Guidelines could be read to suggest that the Agencies' policy is to presume unilateral effects from a considerably wider range of mergers than currently is the case, based on an evaluation of largely static factors (pre-merger data suggesting diversion ratios, and pre-merger margins), and then to treat repositioning arguments with the kind of skepticism that typically is given to de novo entry arguments. It is widely understood by practitioners, and acknowledged by some in the Agencies, that entry arguments are rarely successful in defending a merger that otherwise has been deemed potentially anticompetitive.[19] Whether this tendency to reject arguments about de novo entry is typically justified or not, repositioning will often be much easier and more likely than new entry. By definition, "repositioning" applies to firms that already sell products that are similar to the merging firms' products, and that may in fact be within the same relevant product market applying the SSNIP test. Requiring the parties to demonstrate that such repositioning meets the requirements of de novo entry under section 10 appears unjustified.

The Section believes that the Proposed Guidelines would more accurately describe sound analysis, economic reality, and actual Agency outcomes, if repositioning were given a more prominent role in section 6.1; that the analysis of repositioning should be described in the unilateral effects section, separately from the entry analysis and in a way that recognizes the potentially important differences between repositioning and new entry; and that repositioning (and efficiencies) should be incorporated into the overall effects analysis, rather than treated in effect as a "defense" that is assessed after a transaction has been flagged as potentially problematic.

<u>Efficiencies</u>. Like repositioning, efficiencies are scarcely mentioned in section 6. It is uncontroversial, however, that efficiencies can have a direct and substantial impact on the

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18 Fed. Trade Comm'n & U.S. Dept of Justice, Commentary on the Horizontal Merger Guidelines, at 31, *available at* http://www.ftc.gov/os/2006/03/CommentaryontheHorizontalMergerGuidelinesMarch2006.pdf.

19 *See, e.g.*, Christine A. Varney, Assistant Attorney Gen., Antitrust Div., U.S. Dep't. of Justice, Remarks as Prepared for the American Bar Association/American Health Lawyers Association Antitrust in Healthcare Conference (May 24, 2010) ("entry defenses in the health insurance industry generally will be viewed with skepticism and will almost never justify an otherwise anticompetitive merger") *available at* http://www.justice.gov/atr/public/speeches/258898.htm

ultimate price effects from a merger involving differentiated products. As with repositioning, as a practical matter efficiencies are likely to be an important reason why many mergers that otherwise would (at least under the Proposed Guidelines' relatively static approach) lead to predictions of some unilateral price effects do not, in fact, have such effects. Evaluating and quantifying potential efficiencies from a proposed transaction can be difficult, although in many cases it may be no more difficult than predicting anticompetitive effects. The current chief economists at the Agencies, in articulating the "upward pricing pressure" approach to unilateral effects analysis that underlies section 6.1, acknowledged the potential significance of efficiencies and suggested the possibility of incorporating some assumed level of marginal cost reductions into that analysis. Any such assumption would be somewhat arbitrary, but at least it would mitigate the tendency of the "upward pricing pressure" approach to predict price increases from many mergers involving differentiated products. Rather than incorporating any sort of "standard deduction" for efficiencies, the Proposed Guidelines adopts what appears to be a version of the UPP analysis that contains no assumed level of efficiencies, but that instead appears to treat efficiencies (like repositioning) essentially as a "defense," to be proven by the parties after the merger has been flagged as potentially anticompetitive.

The efficiencies section of the Proposed Guidelines, section 10, makes clear that the burden is on the parties to demonstrate efficiencies under rigorous standards, and in practice efficiencies "defenses" very seldom prevail. Yet, as noted above, most mergers that would indicate some level of concern under section 6.1 are not likely to be anticompetitive, and are not challenged. As noted above, competitor responses such as repositioning are likely to be one important reason for this, and efficiencies are another. The Section believes that section 6 should take a more balanced view to unilateral effects analysis that fully reflects the significant role of efficiencies, consistent with the suggested changes in the attached redline.

Unjustified assumptions based on margins. As noted earlier in connection with sections 2.2.1 and 4.1.3, at several points the Proposed Guidelines appear to make fairly strong assumptions based on margins. [20]

These assumptions appear to be unjustified and they suggest an enforcement policy that would be inconsistent with good policy or actual enforcement outcomes. As the Assistant Attorney General for Economics at DOJ told the Antitrust Modernization Commission:

> Over the long run, the competitive price covers all costs, including a risk-adjusted cost of capital … In this sense, the long run competitive price equals average cost ….
>
> [I]t is error to infer genuine antitrust market power based on the gap between price and marginal cost. This error may be more common or more pronounced in innovative industries, but it is not confined to such industries. The gap between price and marginal cost provides a necessary return to cover various fixed costs, including R&D costs in innovative industries and the "first-copy"

[20] *See* PROPOSED GUIDELINES § 2.2.1 ("if a firm sets price well above marginal cost, that normally indicates either that the firm is coordinating with its rivals or that the firm believes its customers are not highly sensitive to price;" *see also* PROPOSED GUIDELINES § 4.1.3.

> costs in content-based markets. The key point to bear in mind here is that the competitive price can easily and significantly exceed marginal cost.[21]

As discussed above in connection with section 4.1.3, the assumptions in the Proposed Guidelines based on margins appear to be unjustified or, at a minimum, potentially misleading. Moreover, in view of the very prominent role that margins play in the Proposed Guidelines' unilateral effects analysis, there is the potential for that analysis to flag many more mergers as potentially anticompetitive than is actually the case. Any discussion of margins in the context of unilateral effects should, at a minimum, make clear that the relevant costs – and therefore margins – need to be determined in a manner that is appropriate in each particular case, focusing on the costs that are relevant to firms' pricing decisions, including a determination of the appropriate timeframe over which those costs are evaluated.

Reduced product "variety" as a theory of competitive harm. Section 6.4 suggests that a merger may lead to unilateral anticompetitive effects due to a "material reduction in variety" that "leads to a demonstrable loss of significant value to consumers over and above any price effects," such as where the merged firm ceases offering one of the products sold by the merging parties. The discussion notes that a reduction in product "variety" may not necessarily be anticompetitive and may in fact be efficient. The conditions in which such an efficiency effect might be found are not well articulated, however, nor are concepts like "demonstrable loss of significant value to consumers," apart from any price effects, explained.

As section 6.2 notes, a nominal reduction in the mere number of products offered by the merged firm is not an uncommon consequence of mergers, and can be competitively neutral or procompetitive. Moreover, it is not clear what if any transactions the Agencies would contemplate investigating or challenging under a theory of anticompetitive reductions in product "variety" that would not have been adequately addressed under another, accepted theory of unilateral effects. The Section believes the Agencies should consider whether such a theory is needed, and whether the Proposed Guidelines provide adequate guidance as to when and why such a theory would be applied. Application of the theory could result in unnecessary investigations prompted by otherwise routine, and competitively insignificant, facts – such as the fact that, presumably in every case, some customers purchased (and therefore ascribed "value" to) the product that ultimately was eliminated post-merger. In addition, on this and other issues, the Section believes the Agencies should consider the important impact that U.S. policy statements such as the Guidelines have had, and will likely continue to have, on the development of antitrust policy outside the United States. Adding language to the Guidelines that is ambiguous could weaken the constructive role that the Agencies' policies have had abroad, and could undermine the increasing international consensus toward economically rigorous and transparent standards for merger enforcement.

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21 Carl Shapiro, Antitrust, Innovation, and Intellectual Property, Testimony Before the Antitrust Modernization Commission, at 7 (Nov. 8, 2005, *available at* http://faculty.haas.berkeley.edu/shapiro/amcinnovation.pdf.

The foregoing comments on section 6 suggest the following specific revisions to the Proposed Guidelines:

In the second introductory paragraph of section 6, delete the reference to "reduced product variety."

Add a new paragraph at the end of the introductory portion of section 6:

"The Agencies will take into account potential efficiencies in assessing unilateral effects from a merger, bearing in mind that many mergers generate some level of cost reductions, and that cost reductions attributable to a merger directly affect whether, or to what degree, the merger is likely to have anticompetitive price effects. The greater the potential efficiencies, the lower the potential for unilateral price effects."

In section 6.1:

In the second paragraph, the Section recommends changing the second sentence to reflect more fully the factors that bear on the assessment of potential unilateral effects (changes emphasized in italics): "Some of the sales lost due to the price rise may merely be diverted to the product or the merger partner and, depending on factors including relative margins, efficiencies, and competitive responses such as repositioning, capturing such sales loss through merger may make the price increase profitable …."

In the third paragraph, second sentence, the section would add "potentially" before "greater, the more the buyers of products sold by one merging firm consider …"

In the fourth paragraph, in order to provide a more analytically balanced formulation, and to ensure that margin data is evaluated in the proper context, the section recommend changing the second sentence as follows: "If premerger margins between price and the costs that firms consider in setting prices are sufficiently high, that significant fraction need not approach a majority." Delete "many" from the next sentence.

Example 18 would better reflect the foregoing discussion if it were revised as follows (changes highlighted in italics_: "In Example 6, the merged entity controlling products A and B would "potentially have an incentive to raise prices 10%, absent efficiencies or competitive responses such as repositioning…."

In the fifth paragraph, the Section recommends adding a new sentence before the last sentence: "Information relating to pre-merger conditions is potentially relevant if there is evidence that such information is indicative of likely post-merger diversion ratios." We believe the next sentence unduly casts doubt on the relevance of diversion ratios between products sold by the merging firms and products sold by other firms by stating that they "have at most secondary predictive value." The Section recommends replacing that language with "are also relevant to the inquiry into potential unilateral effects."

In the sixth paragraph, the Section believes it is important to include a discussion of the main conditions and assumptions that underlie the Proposed Guidelines' unilateral effects analysis. One condition that the Section believes is important, but that is not articulated in the

Proposed Guidelines, should be added here, after the first sentence: "This analysis requires that the products previously sold by both of the merging firms continue to be sold post-merger." Then the Section believe the next sentence should be clarified to state: "In the absence of efficiencies or competitive responses such as repositioning, that boost to profits is equal to the value to the merged firm of the sales diverted to those products." The next sentence should reflect the margins point noted above, by adding a reference to "the costs that firms consider in setting prices." And, in line with the above comments on the role of market definition, the Section recommends deleting the next sentence: "Diagnosing unilateral price effects based on the value of diverted sales need not rely on market definition or the calculation of market shares and concentration."

In the seventh paragraph, the Section recommends adding a reference to efficiencies at the end of the second sentence: " .. as well as potential efficiencies from the transaction."

In the last paragraph of section 6.1, the Section recommends changing the first sentence to state: "A merger is unlikely to generate substantial unilateral price increases if non-merging parties offer sufficiently close substitutes for the products offered by the merging firms; or if non-merging firms are able to reposition their products to offer sufficiently close substitutes for the products of the merging firms." After the reference to the entry analysis in section 9, the Section believes it is important to note the potential differences between repositioning and new entry, by adding: " … although repositioning may in some cases be more readily accomplished than is new entry."

In section 6.2:

In the second paragraph, the Section recommends changing the second sentence as follows: "This is a starting ;point in assessing whether the merger enhances the ability and incentive of the merged entity …." Then, the Section recommends adding a new sentence: "Unilateral effects are not likely if either of the merging firms would be replaced by the buyer with an equally competitive seller not previously considered."

The Section recommends that the third paragraph be revised as follows, to provide a more analytically neutral formulation: "Anticompetitive effects in these settings many be assessed based on a number of factors, including the frequency or probability with which, prior to the merger, one of the merging sellers had been the runner-up when the other won the business; the advantage the runner-up merging firm has over other suppliers in meeting customers' needs; and the degree of profitability of the pre-merger winning bids. All of these factors are likely to be small if there are sufficient, similarly-situated bidders."

In the third paragraph, the last sentence appears to unduly imply that anticompetitive effects are equally likely regardless of whether the merging sellers are aware of which buyers they are best positioned to serve, so the Section recommends deleting this sentence.

In section 6.3, Example 19, last sentence, the Section recommends adding "has the potential to" harm customers, and adding at the end of that sentence: "… depending on a further assessment of factors including efficiencies and competitors' likely supply responses."

In section 6.4, in accordance with the above discussion of the Section's concerns over introducing a theory of competitive harm based on a reduction in "product variety" apart from other output or price effects, the Section recommend deleting the references to "product variety" in the title of the section, and deleting the last two paragraphs of the section in their entirety.

In the first paragraph of section 6.4, the Section recommends adding at the end of the first paragraph: " …. To the ultimate harm of consumers." In thee second paragraph, second sentence, the Section recommends changing "capabilities" to "specialized assets or characteristics." The Section would add at the end of the last sentence: " … that is likely to enhance competition;."

SECTION 7: COORDINATED EFFECTS

The Agencies' proposed revisions to the 1992 Guidelines suggest a substantial lessening of the hurdles the Agencies need surmount before concluding a transaction increases the likelihood of (or makes for more durable) coordinated interaction. In addition to lowering the burden, the Proposed Guidelines are substantially "one-sided"; they fail to recognize the possibility that a transaction will make coordination less likely (or less sustainable).[22]

The Proposed Guidelines directly foreswear any significant burden on the Agencies to have transaction-specific evidence supporting a theory of post-merger coordination. The second paragraph of proposed section 7.1 reads as follows:

> "Pursuant to the Clayton Act's incipiency standard, the Agencies may challenge mergers that in their judgment pose a real danger of harm through coordinated effects, *even without specific evidence* showing precisely how this will happen. The Agencies are likely to challenge a merger that would significantly increase concentration and lead to a moderately or highly concentrated market if that market shows signs of vulnerability to coordinated conduct and the Agencies have a theory they deem plausible of how the merger may cause adverse coordinated effects." (Emphasis added).

The Section believes there is insufficient support for setting the Agencies' burden so low (or to suggest it is so low). In addition, as drafted, the Section believes it will have substantial repercussions in the development of merger law in those competition agencies with only limited experience in analyzing transactions for anticompetitive effects. The Section suggests the Agencies add a materiality component to their analysis, more directly indicate they will take account of countervailing evidence and not rely simply on concentration statistics, and strengthen the requirement that the Agencies have a theory supporting a determination that a merger may better support a coordinated outcome, post-merger. The Section suggests the following language replace the paragraph discussed above:

22 To address this later point, we suggest any revised Guidelines include the following sentence, just after the initial discussion of the way in which a merger may strengthen the conditions for coordination: "Conversely, a merger may disrupt existing coordination (whether explicit or tacit), and/or strengthen the incentive for the merged entity to deviate from a coordinated (explicit or tacit) outcome."

> Pursuant to the Clayton Act's incipiency standard, the Agencies are likely to challenge a merger that would significantly increase concentration and lead to a moderately or highly concentrated market if that market shows significant signs of vulnerability to coordinated conduct, absent countervailing evidence or conditions, and the Agencies have a credible theory of how the merger is likely to cause adverse coordinated effects.

Consistent with the belief that the Proposed Guidelines suggest too low a burden on the Agencies, the Section encourages further development of the materiality requirement[23], and recognition that whether a merger is likely to lead to more coordination requires inquiry into both the remaining firms (or a subset of the remaining firms) incentives to engage in post-merger coordination, and their ability to do so. The Section suggests that the Proposed Guidelines include the following language:

> The Agencies will seek to identify whether the merger brings about a material change in market conditions sufficient to make the incentives toward, or the ability to engage in, coordination more likely, more strong, or more durable.

The Proposed Guidelines should better recognize the distinction between "incentive" and "ability" to engage in coordinated interaction; the incentive, absent the ability, is not sufficient to lead to a coordinated outcome. Consistent with this, the Proposed Guidelines should recognize that while historical efforts at failed collusion may suggest the firms operating in the industry have an incentive to engage in a coordinated outcome, such failures do not support (and in fact counter) a finding that, pre-merger, the industry participants had the ability to coordinate. Thus, where the Proposed Guidelines suggest evidence of actual or failed collusion may be evidence of conditions supporting post-merger coordination, any new Guidelines should make clear that these conditions may simply support a finding of an incentive towards a coordinated outcome, not the ability to coordinate an outcome.

The Proposed Guidelines' abbreviation (or perhaps elimination) of the current Guidelines' discussion of Stigler's framework analyzing conditions conducive to coordination suggests the Agencies are downplaying (or eliminating) the necessity of identifying each factor in what the Guidelines currently suggest is required for a proper coordinated interaction case. The 1992 Guidelines are clear: "Successful coordinated interaction entails reaching terms of coordination that are profitable to the firms involved <u>and</u> an ability to detect <u>and</u> punish deviations that would undermine the coordinated interaction." (Emphasis added). The Proposed Guidelines are less clear: "The ability of rival firms to engage in coordinated conduct depends on the strength and predictability of rivals' responses to a price change or other competitive initiative." It is not only unclear if "strong" and "predictability" replace "punish" and "detect" (the concepts seem dissimilar), but also whether each of the two requirements (however measured) are necessary to allege coordinated effects, or are simply weighed against one another, with the presence of only

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[23] Further explication of the materiality requirement will help counter the current draft's suggestion that the analysis of various factors supporting coordination will not devolve into a simple reliance on counting, rather than analyzing the interplay, of factors supportive of coordination.

one factor (strength or predictability) being sufficient to support a coordination story. Put another way, it is unclear whether a strong but unpredictable response will be treated differently than a weak but predictable response.

Finally, the Section believes the distinction between "a common understanding that is not explicitly negotiated" and "parallel accommodating conduct not pursuant to a prior understanding" is unclear. This could be read to codify a distinction between tacit collusion and conscious parallelism, but that is unclear. In any event, it should be clarified under what circumstances the agencies will pursue each theory. The 1992 Guidelines recognize that coordinated interaction subject to section 7 challenge need not otherwise be illegal - without identifying a distinction between tacit collusion and conscious parallelism, by stating "[Coordinated interaction] includes tacit or express collusion, and may or may not be lawful in and of itself."

SECTION 8: POWERFUL BUYERS

In the Section's comments to the Guidelines Review Project submitted on November 6, 2009, the Section noted the ample amount of precedent – before the Agencies, in court and in foreign jurisdictions – where the presence of powerful buyers had an impact on the assessment of a merger's impact on competition. [24] The Section, therefore, recommended that the Agencies provide additional guidance on their view as to the significance of large buyers in assessing mergers. While the Section applauds the addition of the language in Section 8 of the Proposed Guidelines on Powerful Buyers, the Section is of the view that additional guidance is still needed.

Section 8 in the proposed revisions to the Guidelines provides limited guidance by explaining that "powerful buyers may constrain the ability of the merging parties to raise prices." It also refers to two instances where buyer power would not be relevant – when the powerful buyers cannot protect themselves and when other buyers in the market are still harmed by the merger's effects. The Section believes that further guidance on when powerful buyers would be relevant is necessary. In particular, the Section recommends amending the second paragraph of the section to read:

> "The Agencies consider the possibility that powerful buyers may constrain the ability of the merging parties to raise prices. This may occur, for example, where powerful buyers have the ability to sponsor entry, or where the presence of large buyers may reduce coordinated effects by creating an incentive for suppliers to deviate from the terms of coordination. The Agencies do not presume, however, that the presence of powerful buyers alone forestalls adverse competitive effects flowing from the merger. Even buyers that can negotiate favorable terms may be harmed by an increase in market power. The Agencies examine the choices available to powerful buyers and how those choices likely would change due to the merger. "

24 ABA SECTION COMMENTS, *supra* note 5, at 30-32.

SECTION 9: ENTRY

Sufficiency

Both the 1992 Merger Guidelines and the Proposed Guidelines use the same language to articulate the effects-based standard for assessing the sufficiency of entry: it must "deter or counteract the competitive effects of concern."[25] When it comes to price effects, both versions explain that sufficient entry renders the price increase unprofitable, returning prices to their premerger levels.[26] Unlike the 1992 Merger Guidelines, however, the Proposed Guidelines add the following sentence: "The Agencies normally look for reliable evidence that entry will be sufficient to replicate at least the scale and strength of one of the merging firms."[27] Because entry may often fall short of replicating the scale and strength of one of the merging firms and still be sufficient to deter or counteract the competitive effects of concern, the Section recommends deleting that sentence.

Two common examples illustrate the problem with measuring entry sufficiency based on whether it replicates the scale or strength of one of the merging parties. First, as explained in section 6.3 of the Proposed Guidelines, the typical competition concern in mergers with relatively undifferentiated products is that the merged firm will find it profitable to unilaterally suppress output and thereby raise market prices. In most circumstances where this concern exists, the merged firm need not cut output equal to the full production of one of the merging parties for this strategy to succeed. Thus, entry in the market sufficient to at least replace the amount of the output reduction should be sufficient to counteract the merger's anticompetitive effect. Replicating one of the merging parties' output would not be necessary under these circumstances.

The second example involves mergers that raise potential coordinated effects concerns. As explained in section 7 of the Proposed Guidelines, removing a competitor from the market may diminish competition by enabling or encouraging coordinated interaction among the remaining competitors. Whether coordinated effects will occur depends in large part on the "strength and predictability of rivals' responses" to competitive moves in the market.[28] Accordingly, entry by a "maverick" firm with the incentive to cut price and otherwise disrupt industry tendencies to cooperate on the terms of competition may be sufficient to counteract a merger's coordinated effects concerns.[29] Moreover, because a maverick's impact on the market in this situation is usually greater than the impact of a comparably-sized (or even larger), non-

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25 1992 MERGER GUIDELINES §§ 3.0, 3.4; PROPOSED GUIDELINES §§ 9.0, 9.3.

26 *See* 1992 MERGER GUIDELINES § 3.0 ("Entry that is sufficient to counteract the competitive effects of concern will cause prices to fall to their premerger levels or lower."); PROPOSED GUIDELINES § 9.0 ("A merger is not likely to enhance market power if entry into the market is so easy that the merged firm and its remaining rivals in the market, either unilaterally or collectively, could not profitable raise the price or otherwise reduce competition to the level that would prevail in the absence of the merger.")

27 Proposed Guidelines, § 9.3.

28 Proposed Guidelines, § 7.

29 The effects flowing from entry by a maverick firm are informed by the impact of removing a maverick firm through a merger. While the removal of maverick in certain circumstances can lessen competition, as explained in Section 2.1.5 of the Proposed Guidelines, the entry of a maverick firm can have unique benefits to competition.

maverick firm, entry by the maverick may be sufficient to counteract the competitive concerns of a merger without replicating the scale and strength of one of the merging parties.

SECTION 10 : EFFICIENCIES

The Section believes that the Proposed Guidelines are unduly skeptical of the significance of reductions in fixed costs. Since the 1997 revisions to the Current Guidelines, a consensus has been forming that a broader view of valuable, merger-specific efficiencies is appropriate, including as reflected in the Commentary. Thus the Section proposes that existing footnote 12 be moved to the body of the text and amplified by language contained in the Commentary so that the body of the text following what was footnote 12 would read:

> "The Agencies normally give significant weight to the results of this analysis over the short term. The Agencies also may consider the effects of cognizable efficiencies with no short-term, direct effect on prices in the relevant market. The Agencies consider merger-specific, cognizable reductions in fixed costs, even if they cannot be expected to result in direct, short-term, procompetitive price effects because consumers may benefit from them over the longer term even if not immediately. Efficiencies relating to costs that are fixed in the short term are unlikely to benefit customers in the short term, but can benefit customers in the longer run, e.g., if they make new product introduction more likely or less expensive. As with any other type of efficiency, reductions in fixed costs must be substantiated by the parties and verified by reasonable means. Delayed benefits from efficiencies (due to delay in the achievement of, or the realization of customer benefits from, the efficiencies) may be given less weight to the extent they are less proximate and more difficult to predict."

The Section also believes that some aspects of the efficiencies section unduly downplay the role of efficiencies in merger analysis. The Section believes that the following edits would result in a more balanced discussion. In addition, as discussed in the Section's comments on the Proposed Guidelines' unilateral effects analysis, it is important that efficiencies be fully taken into account to the extent that they may directly affect the effects analysis, rather than being viewed skeptically as a "defense" to an otherwise anticompetitive merger.

In the first paragraph, delete "Competition usually spurs firms to achieve efficiencies internally. Nevertheless," In the second paragraph, add a new first sentence: "As noted above, cost reductions attributable to the merger may directly affect the assessment of unilateral and coordinated effects." Change the next sentence to state: "More generally, the Agencies give the greatest weight to those efficiencies likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects." In the eighth paragraph, last sentence, delete "or variety." In the ninth paragraph, change the last two sentences to state: "Other efficiencies, such as those relating to research and development, are potentially substantial to the extent they can be reasonably verified and are not the result of anticompetitive output reductions. Yet others, such as those relating to procurement, management, or capital cost will be taken into account to the extent they are merger-specific or substantial." In the tenth paragraph, delete the last sentence relating to R&D efficiencies, which the Section believes are not uncommon in merger transactions and should be analyzed under the same standards as other efficiencies.