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FTC and DOJ Publish Revised Horizontal Merger Guidelines

On August 19, 2010, the Federal Trade Commission and the U.S. Department of Justice (collectively "the Agencies") released the final version of the revised Horizontal Merger Guidelines (the "2010 Merger Guidelines"). The 2010 Merger Guidelines update and replace the 1992 Merger Guidelines.

Since the issuance of the first Horizontal Merger Guidelines in 1968, the Agencies have sought to provide a guide to how the Agencies review mergers between companies that compete for the same customers (so-called "horizontal" competitors). However, commentators had noted that the 1992 Merger Guidelines no longer reflected the Agencies' enforcement policy. The 2010 Merger Guidelines in many respects more accurately reflect the Agencies' current practices in reviewing horizontal mergers.

The 2010 Merger Guidelines substantially change the text of the 1992 Merger Guidelines. In most respects, however, the changes appear to embody existing Agency practice rather than significantly altering merger review policy. Notably, the 2010 Merger Guidelines:

- raise the concentration thresholds at which mergers are considered likely to create anticompetitive effects, to more closely track actual Agency practice;
- de-emphasize market definition, and provide more guidance on the fact-specific analyses and theoretical concepts the Agencies actually use in merger review;
- provide details on the types of evidence the Agencies consider in merger review;
- add concepts not previously covered or given much attention in the 1992 Merger Guidelines, but which have developed in enforcement practice over time, such as mergers' effects on innovation, and the analysis of mergers between buyers; and
- implement some new concepts, such as using merger review to enforce Section 2 of the Sherman Act's prohibition on the unlawful acquisition or maintenance of monopoly power.

The 2010 Merger Guidelines are substantially longer and more complex than the 1992 Merger Guidelines. They also adopt a tone that is slightly less favorable to mergers than the 1992 Merger Guidelines, notably with respect to firms with high margins (such as many technology companies). Whether these changes will have any significance for merger enforcement remains to be seen.

A more detailed description follows, tracking the structure of the 2010 Merger Guidelines.

Section 1: Overview

The 2010 Merger Guidelines begin with an overview outlining the philosophy behind the Guidelines. The revisions do not dramatically change the Guidelines' substance, but do adopt a somewhat more skeptical tone toward mergers. For example, the overview notes that mergers should not be permitted to "entrench" market power (an addition to the prior "create or enhance" language); it adds "diminish[ing] innovation" and "reduced product variety" to the taxonomy of anticompetitive effects of mergers; and it asserts that "[e]nhanced market power may also make it more likely that the merged entity can profitably and effectively engage in exclusionary conduct."

A major theme of the 2010 Merger Guidelines, starting with the overview, is that Agency staff do not mechanically follow the five-step approach outlined in the 1992 Merger Guidelines, but instead engage in a more amorphous, fact-specific inquiry using a variety of analytical tools. It has long been the case that Agency staff focus their analysis on the issues of most importance in each merger review, as opposed to proceeding rigorously through the 1992 Merger Guidelines' steps as if they were a checklist. Thus, this change in language largely reflects long-standing practice, though it also seems to be an attempt to grant even more discretion to the Agencies. It will be interesting, however, to see whether this change, combined with the de-emphasis on market definition described below, has any influence on the courts in litigated merger cases.

Section 2: Evidence of Adverse Competitive Effects

The 2010 Merger Guidelines include a new section entitled "Evidence of Adverse Competitive Effects," which outlines the type of evidence Agency staff typically take into account, and the weight they accord that evidence.

The Agencies explain that they consider "any reasonably available and reliable evidence" in determining whether a merger under consideration is likely to cause anticompetitive effects, but this new section "discusses several categories and sources of evidence that the Agencies, in their experience, have found most informative…." The enumerated types of evidence include:

- for consummated mergers, evidence of actual competitive effects;
- evidence that the parties currently set their prices above incremental cost;
- natural experiments or "direct comparisons based on experience";
- market share and concentration in one or more relevant market(s);
- the closeness of competition among the parties (e.g., whether they are or are likely to become "head-to-head" competitors); and
- whether the transaction would eliminate a "maverick" player in the market.

The Agencies also explain that the potential sources of these types of information include the merging parties themselves, customers and other industry participants and observers. These types of evidence from this variety of sources are all widely used in practice by both the Agencies and counsel to merging parties, and many were discussed in the Commentary to the Merger Guidelines issued by the Agencies in 2006. Thus, the addition of this new section should not significantly change the Agencies' approach, and may be helpful to parties and counsel by enhancing transparency.

Section 3: Targeted Customers and Price Discrimination

The 2010 Merger Guidelines include an expanded discussion of price discrimination — the ability of merging firms to identify particular customers or types of customers who will tolerate higher prices. This reflects current Agency practice, which has long considered price discrimination in both market definition and the assessment of competitive effects.

Section 4: Market Definition

The 2010 Merger Guidelines downplay the importance of market definition. However, the final version of the 2010 Merger Guidelines downplays market definition to a lesser extent than originally proposed when the Federal Trade Commission released the proposed revisions to the 1992 Merger Guidelines for public comment in April 2010. The final 2010 Merger Guidelines explain that the market definition exercise is "not an end in itself, but is useful to the extent it illuminates the merger's likely competitive effects." The 2010 Merger Guidelines note that

market definition serves two primary purposes. First, it "helps specify the line of commerce and section of the country in which the competitive concern arises." Second, it "allows the Agencies to identify market participants and measure market shares and market concentration," a necessary step for market concentration analysis. The 2010 Merger Guidelines emphasize that "competitive effects can inform market definition," suggesting that in some instances the impact that a reduction in the number of rivals offering a product or group of products has on price may support finding that those products constitute a relevant market. The revisions suggest that this type of analysis is most likely to be used when there are multiple "alternative and reasonably plausible candidate markets [whose] market shares lead to very different inferences regarding competitive effects." In other words, the Agencies are most likely to apply this type of analysis in cases in which defining the relevant market(s) is difficult.

The reduced emphasis on market definition reflects current Agency practice in which market definition clearly matters, but competitive effects theories are often viewed as more important. This downplaying of market definition may also be an attempt to address some of the recent difficulties the Agencies have faced in litigation, since — in some tension with Agency views — courts have generally considered market definition to be an indispensable requirement for a merger challenge, and resisted efforts to define narrow markets.

The 2010 Merger Guidelines also address the "hypothetical monopolist" test, which is used to determine the appropriate relevant antitrust product market. The 1992 Merger Guidelines explained that a relevant product market is "a product or group of products such that a hypothetical profit-maximizing firm that was the only present and future seller of those products ('monopolist') likely would impose at least a 'small but significant and nontransitory' increase in price" ("SSNIP"). The 2010 Merger Guidelines expand and update this definition, stating that the test is used "to identify a set of products that are reasonably interchangeable with a product sold by one of the merging firms." The 2010 Merger Guidelines also provide specific examples of the test's application and of factual variations that might affect how it is applied.

The 2010 Merger Guidelines reinforce the importance of the hypothetical monopolist test in merger analysis. The final version of the 2010 Merger Guidelines expands on the proposed 2010 Merger Guidelines revisions by giving the agencies added flexibility in the amount of price increase that constitutes a SSNIP and giving pre-merger margins a role in the hypothetical monopolist test. Traditionally, the Agencies considered a SSNIP to be a price increase of approximately 5%. Under the 2010 Merger Guidelines, the percentage used for the SSNIP will vary based on the characteristics of the industry and may be higher or lower than 5%. This variation on the SSNIP percentages reflects current Agency practice. For example, the FTC has publicly advocated for a 1% SSNIP to apply in certain transactions in the petroleum and supermarket industries. In addition, the pre-merger margins of the parties will be a key factor in what amount of SSNIP to use, "[t]he higher the pre-merger margin, the smaller the recapture percentage necessary for the candidate market to satisfy the hypothetical monopolist test."

Section 5: Market Participants, Market Shares and Market Concentration

One of the most anticipated changes was the Agencies' upward revision of the concentration thresholds used in assessing whether a proposed transaction would likely result in anticompetitive effects. The Agencies use the Herfindahl-Hirschman Index ("HHI") to calculate market concentration. The HHI is calculated by summing the squared market shares of all participants in a relevant market.

As a practical matter, the 1992 HHI levels did not comport with the Agencies' actual enforcement actions, as the Agencies generally challenge only mergers that significantly exceeded these thresholds. For example, a joint study by the Agencies on the levels of concentration in challenged mergers between 1999 and 2003 revealed that more than 87% of mergers challenged by the Agencies would have resulted in post-merger market concentration above 2,400 and almost all of the challenges at concentration levels below 2,400 were in three specific industries: petroleum, supermarkets and banking.

The 2010 Merger Guidelines update these thresholds to more closely reflect the Agencies' actual enforcement practice.

Also consistent with actual practice, the Agencies noted that in some cases the change in the number of competitors is more significant than

Market Description	1992 Merger Guidelines HHI Thresholds	2010 Merger Guidelines HHI Thresholds
Unconcentrated Market — A merger that results in an unconcentrated market is considered unlikely to result in adverse competitive effects.	Under 1,000	Under 1,500
Moderately Concentrated Market — A merger in a moderately concentrated market that results in a change in the HHI of more than 100 points potentially raises significant antitrust concerns.	1,000 to 1,800	1,500 to 2,500
Highly Concentrated Market	Above 1,800 with an HHI increase of: 50–100 points: potentially raises significant anticompetitive concerns; More than 100 points: creates a *presumption* that the merger will result in anticompetitive effects.	Above 2,500 with an HHI increase of: 100–200 points: potentially raises significant anticompetitive concerns; More than 200 points: will be *presumed* to be likely to enhance market power.

changes in the HHI, changes in concentration are only one factor to be considered, and such changes in concentration may be more or less significant in particular contexts.

Sections 6 and 7: Unilateral and Coordinated Effects

The 2010 Merger Guidelines also provide an expanded discussion of competitive effects (unilateral and coordinated), which reflects the considerable emphasis Agency staff and merging firms typically place on this issue during merger review. Notably, the revisions switch the order of effects theories, moving unilateral effects ahead of coordinated interaction, which appears to reflect the more robust role unilateral effects have played in merger enforcement since the issuance of the 1992 Merger Guidelines.

The 2010 Merger Guidelines reflect substantial changes to unilateral effects analysis, including an expanded discussion of bargaining and auction models and the elimination of market share screens. Additionally, the Agencies have added a new section that brings innovation analysis — previously found only in other guidance issued by the Agencies, such as the *Antitrust Guidelines for the Licensing of Intellectual Property* and the *Antitrust Guidelines for Collaborations Among Competitors* — into the Merger Guidelines themselves. The revisions also include a discussion of the effects of mergers on “product variety” — a relatively untested area of merger analysis that has the potential to introduce uncertainty and confusion, since it is unclear whether adequate legal and economic guidance exists for assessing optimal levels of product variety.

While the discussion of coordinated interaction (joint action by competing firms) in the 2010 Merger Guidelines does not appear to be greatly different from that contained in the 1992 Merger Guidelines, the final 2010 Merger Guidelines update the list of factors considered to increase the likelihood of coordination and therefore make the Agencies likely to challenge the merger.

Section 8: Powerful Buyers

The 2010 Merger Guidelines include a new section discussing powerful buyers and their potential ability to check anticompetitive conduct. However, consistent with current practice, the revisions note that arguments that “power buyers” may constrain post-merger price increases are subject to a number of limitations.

Section 9: Entry

The 2010 Merger Guidelines provide a simplified discussion of “ease of entry” and its role in merger analysis.

The Agencies explain that they will consider whether the prospect of entry into the relevant market will deter or counteract any competitive effects. In making this determination, the Agencies will consider the timeliness, likelihood and sufficiency of entry. In considering whether entry is "likely," the 2010 Merger Guidelines also eliminate the requirement from the 1992 Merger Guidelines that entry must occur within two years, in favor of a more amorphous approach, consistent with the tone and language of many of the other revisions. Importantly, the revisions note that the Agencies will give substantial weight to the actual history of entry into the relevant market. Lack of prior successful and effective entry may indicate that entry is slow or difficult.

Sections 10 and 11: Efficiencies and Failure and Exiting Assets

The 2010 Merger Guidelines do not substantially change the former Guidelines' discussion of efficiencies, or of the "failing firm" and exiting asset defenses.

Section 12: Mergers of Competing Buyers

The 2010 Merger Guidelines elevate the discussion of mergers of competing buyers from a small note in the 1992 Merger Guidelines to an entire section. In the revisions, the Agencies note that just as mergers of sellers can enhance market power on the selling side of the market, buyer mergers can lead to increased market power, sometimes labeled "monopsony power." In analyzing whether a merger will likely enhance buyer market power, the Agencies will follow a similar framework to analyzing mergers of competing sellers. The final version of the 2010 Merger Guidelines adds that the Agencies will even use the "hypothetical monopsonist" test in analyzing mergers of competing buyers. The Agencies will also consider the presence of other buyers and efficiencies such as reduced transaction costs and volume-based discounts. Also, consistent with the DOJ's recent interest in the agriculture industry, this new section includes an example of a merger involving agricultural buyers.

Section 13: Partial Acquisitions

Finally, the 2010 Merger Guidelines also reflect the Agencies' increased interest in recent years in partial acquisitions of competing firms. Here, the 2010 Merger Guidelines confirm that the Agencies will analyze partial acquisitions much as they do a traditional merger. Key factors will include whether the partial acquisition results in effective control of the target firm, the potential ability of the acquiring firm to influence the competitive conduct of the target firm, whether the acquisition will reduce the incentive of the acquiring firm to compete, and whether it will give the acquiring firm access to competitively sensitive information from the target firm. Through analysis of these factors, the Agencies weigh potential unilateral and coordinated effects against any likely efficiencies, though the 2010 Merger Guidelines note that partial acquisitions usually do not enable many of the types of efficiencies associated with mergers.

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The 2010 Merger Guidelines demonstrate that the Agencies currently engage in fact-specific, case-by-case analysis of each merger that comes before them, rather than the more rigid analytical process outlined in the 1992 Merger Guidelines. We would be pleased to discuss how the revisions to the Horizontal Merger Guidelines may affect your transactions or other transactions in your industry.

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