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Revised Horizontal Merger Guidelines: Acknowledging Current Agency Practice

Yesterday the Department of Justice (DOJ) and Federal Trade Commission (FTC) released and sought public comment on proposed, revised Horizontal Merger Guidelines (guidelines) that reflect how the agencies evaluate the potential competitive effects of mergers and acquisitions between firms at the same level of product distribution. The guideline's last significant revisions came in 1992. For the past 18 years, the fundamental framework of the 1992 guidelines remained unchanged despite the continuing evolution of theories and tools to determine which mergers are likely to harm competition.[1] During that time, there has been a growing divergence between the analytical framework laid out in the 1992 guidelines and the actual practices at the DOJ and the FTC. These proposed guidelines attempt to codify those practices already in place at the agencies.[2]

The proposed guidelines provide the government with far more flexibility in its integrated approach to merger investigations to determine whether a transaction may lead to a substantial lessening of competition and thus violate U.S. antitrust law. The 1992 guidelines incorporated a linear five-step approach that began with defining the relevant product and geographic market(s). The proposed revisions to the guidelines de-emphasize the importance of market definition and expressly state the "agencies' analysis need not start with market definition."[3] Notwithstanding the language of Section 7 of the Clayton Act that the adverse competitive effects occur within a "line of commerce," the guidelines appear to lessen the importance of actually defining a market to analyze competitive harm. The DOJ and the FTC suggest that market definition is only one of the many analytical tools available that may be informative regarding competitive effects.

Another significant difference between the 1992 guidelines and the newly proposed version is the presumption of harm for mergers resulting in certain concentration levels. Although the 1992 guidelines state that transactions resulting in post-merger Herfindahl-Hirschman Index (HHI) thresholds between

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1 While this is the first significant revision to the guidelines since 1992, the agencies have acknowledged their evolving analytical framework. In 1997 the DOJ and the FTC issued a minor change to the guidelines to clarify the agencies' treatment of efficiencies during the merger review process and, in 2006, issued a commentary on the 1992 guidelines that shed greater light on the tools the agencies use in merger investigations.

2 FTC Press Release, "Federal Trade Commission Seeks Views on Proposed Update of the Horizontal Merger Guidelines," April 20, 2010 (stating "the proposed Guidelines put out for comment… reflect the current state of merger analysis at the FTC and DOJ").

3 Horizontal Merger Guidelines, released for public comment on April 20, 2010 at 7.

1,000 and 1,800 with increases of more than 100 points may raise "significant competitive concerns," in reality, the agencies rarely challenged mergers with concentration levels below 1,800.[4] The proposed guidelines label markets with HHIs below 1,500 as unconcentrated. Even those mergers that result in concentrated markets (*i.e.*, HHI between 1,500 and 2,500) only "potentially raise significant competitive concerns" when there is a post-merger increase in the HHI of more than 100. Only those mergers in highly concentrated markets (*i.e.*, HHI above 2,500) with a post-merger increase of more than 200 will create a presumption that the transaction is likely to enhance market power. Despite the higher targeted concentration levels, the proposed guidelines likely are still conservative. For example, a transaction in a concentrated market involving two equally sized firms each with 10 percent market share may raise concerns under the proposed guidelines, although experience would suggest that such a transaction is unlikely to be challenged.

The framework and analytical tools available to evaluate unilateral effects is substantially different in the proposed guidelines. The extent of direct competition between the products sold by the merging parties is fundamental to measuring the risk of competitive harm through unilateral price increases. If customers view the merging parties' products as close substitutes, the proposed guidelines posit that competitive harm can result when the combination of the two parties has the incentive to raise the price of one of the products because a sufficient number of customers will simply purchase the substitute product from the merged entity. Unilateral effects received cursory treatment in the 1992 guidelines and targeted transactions that resulted in a combined market share of at least 35 percent. The proposed revisions to the guidelines do not mention the 35 percent safe harbor and suggest neither defining markets nor calculating market shares and concentration are necessary for the analysis.[5] Instead, the proposed guidelines describe numerous other tools available to measure the risk of competitive harm through unilateral behavior including diversion ratios, upward pricing pressure, customer switching patterns, price/cost margins and merger simulations.

How the agencies consider potential entry during a merger review also has changed with the proposed revisions to the guidelines. The 1992 version indicated that firms with the ability to enter within one year in response to a small but significant and nontransitory increase in price (SSNIP) would be deemed a market participant. In the proposed guidelines, firms that are not current producers, but that would be very likely to provide "rapid supply responses with direct competitive impact in the event of a SSNIP," are considered market participants. As in the 1992 guidelines, later entry that is timely, likely and sufficient may be used as evidence to counteract competitive concerns. Whereas the 1992 guidelines defined "timely" as within two years, the proposed guidelines state that "entry must be rapid enough to make unprofitable" those actions that are the source of competitive concern. The vagueness within the proposed guidelines, as compared to the definable time periods in the 1992 guidelines, allows the agencies more flexibility to interpret whether entry is meaningful.

The proposed guidelines also describe other areas of the agencies' merger review including efficiencies, innovation, coordinated effects and monopsony power. Unlike the 1992 guidelines, the proposed revisions also provide a framework for determining whether partial acquisitions and

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4 *See*, *e.g.*, "Fed. Trade Comm'n & U.S. Dep't of Justice, Merger Challenges Data, Fiscal Years 1999-2003," at tbl.1 (2003) (demonstrating that markets resulting in HHI levels below 1,800 constituted only 4.5 percent of the agencies' challenges from 1999 through 2003).

5 *Id*. at 21.

minority interests may harm competition even if such minority positions do not necessarily or completely eliminate competition between the parties to the transaction. The proposed guidelines also address anticompetitive effects in already consummated mergers, an area that has been an increasing focus of the regulators. Given the number of areas covered in these proposed guidelines and the differences between the previous version, it becomes apparent that, over the past 18 years, there have been significant developments in theories and tools to measure competitive harm.

Importantly, these guidelines do not set forth a standard of law but merely a paradigm under which the DOJ and the FTC review transactions. While the proposed revisions to the guidelines provide fertile ground for debate over how best to perform a competitive analysis, in reality they are not that surprising. The differences between the 1992 guidelines and the revised version should not be viewed as a significant change in policy at the FTC and the DOJ, but rather as an effort to codify the actual analytical tools and framework currently used by the agencies. As new theories and tools evolve in the coming years, expect the guidelines to once again fall out of step with actual agency practice. For now, the new guidelines fairly accurately reflect current DOJ and FTC thinking. Despite this announcement receiving significant attention, the proposed guidelines indicate the DOJ and the FTC continue to apply the same tools to review mergers as they have for some time.

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