Good News, Bad News, or No News? The U.S. Antitrust Enforcement Agencies' Commentary on the Horizontal Merger Guidelines

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The most common question merging companies ask their antitrust lawyers is: "Will the antitrust enforcement agencies care about our transaction?" For nearly 40 years, the agencies have sought to answer this question through merger guidelines and, to a lesser extent, through court filings in merger enforcement actions and speeches concerning those actions. In recent years, the agencies have also begun issuing statements explaining why they chose *not* to challenge certain mergers.[1]

Consistent with this trend, the Department of Justice ("DOJ") and Federal Trade Commission ("FTC") recently issued a joint 60-page Commentary[2] on the agencies' application of their merger guidelines since 1992. In short, the Commentary:

- Provides additional guidance on the agencies' approach to merger enforcement, but is not fully illuminating because it focuses far more on mergers the agencies successfully challenged than on those they chose not to challenge.
- Underscores the continuing tension between providing business with greater guidance and providing merging parties and courts with statements that could be used against the agencies in litigation. The agencies are reticent to provide greater predictability at the expense of enforcement flexibility.
- Breaks no new ground for those who regularly toil in the antitrust field, but provides confirmation of the agencies' current practice with respect to some important issues.

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Without question, the Commentary will soon become a *de facto* component of the agencies' merger guidelines, and the substantive elements of the Commentary will therefore become an important part of the agencies' antitrust review and enforcement process.

Purpose of the Commentary

The agencies' effort to provide business and counsel with insight into the exercise of its prosecutorial discretion in merger enforcement began with DOJ's 1968 Horizontal Merger Guidelines. Since that time, the agencies have revisited the merger guidelines every 10 to 14 years. In 1982, DOJ issued a radically different set of merger guidelines, and in 1992 the DOJ and FTC jointly issued yet another, more modest, revision.[3]

Although fourteen years have now passed since the agencies issued the 1992 Horizontal Merger Guidelines (the "Guidelines"), the agencies concluded there was no need for a significant revision of the Guidelines. The agencies conducted a three-day workshop in February 2004 to examine whether the current analytical framework for evaluating M&A transactions serves the dual purpose of (a) reaching the correct enforcement decisions, and (b) providing antitrust practitioners and interested parties will appropriately clear guidance regarding the substantive principles the agencies consider in making enforcement decisions. Workshop participants generally agreed that the analytical framework set out in the Guidelines is effective in yielding the right results in individual transactions and in providing advice to parties considering an M&A transaction.

While the agencies concluded that a substantive revamping of the Guidelines is neither necessary nor appropriate, they nonetheless took note of the perceived complexity of the Guidelines and concluded that the business community and antitrust practitioners would find useful and beneficial an explication of how the agencies apply the Guidelines in particular circumstances.

The agencies' Commentary is an attempt to provide practical guidance regarding the application of the Guidelines, without making any change in the substantive legal or economic principles set forth in the Guidelines. To accomplish this purpose, the agencies organized the Commentary as essentially an "annotation" to the principal sections of Guidelines, complete with a narrative explanation of the manner in which the agencies apply the respective sections of the Guidelines and reference to outcomes of previous FTC and DOJ merger investigations.

What's New in the Commentary

Bad News. The Commentary is largely devoted to explaining why the agencies rejected arguments in favor of mergers. Of the 77 cases discussed, 52 involved transactions that the agencies opposed (or approved subject to a consent decree). While the points discussed in the Commentary are familiar to experienced antitrust counsel, the agencies emphasized the following:

- **Less Focus on Market Definition.** The Commentary may begin an effort by the agencies to deemphasize incrementally the significance of "market definition" in the application of the antitrust laws to a proposed merger. The Guidelines suggest a linear analytical process, where definition of the affected product and geographic markets is a critical first step with enormous impact on all other areas of merger analysis. In antitrust litigation, the definition of the market is often outcome determinative, as market definition will determine to a significant degree how many competitors exist within the affected market, the shares of the competitors, and the likelihood of new entry. Market definition has often been the agencies' Achilles heel in merger cases the agencies have litigated and lost.[4]

  In the Commentary, the agencies appear to step away from the Guidelines' emphasis on market definition analysis:

  > *First,* the agencies say that market boundaries often are not precise or rigid, and assert that imprecise markets can be sufficient for determining whether a transaction may lessen competition.
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  > *Second,* the agencies explain that market definition may play a lesser role in transactions where the competitive effects are clear in the absence of a traditional market analysis. In this context, the agencies suggest that market definition may be less critical in transactions where empirical data can be used to show clear competitive effects.
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  > *Third,* the agencies suggest that they may treat individual bidding situations as distinct relevant markets when analyzing the competitive effects of transactions involving certain types of complex and customized products that are purchased through an auction or bidding process. Although the agencies have not relied on this theory in any litigated merger challenge, the Commentary describes a number of transactions in which the agencies sought and obtained consent decrees based upon a theory that the transaction at issue would substantially lessen competition in individual bid markets.[5]

- **Continued Skepticism of Entry and Repositioning.** Like market definition, entry plays a key role in antitrust litigation, including merger litigation. After a series of litigation losses in the 1980s, the agencies raised the bar in the 1992 Guidelines, requiring merging parties to make more detailed showings to support an argument that entry would deter or defeat a merger's anticompetitive effects.

  The Commentary suggests that the agencies still harbor a high degree of skepticism with respect to entry arguments, and the Commentary appears to suggest that entry often will not, in the agencies' view, be sufficient to prevent anticompetitive effects in mergers involving consumer products. In particular, the Commentary states that "[t]he agencies commonly find that proposed mergers involving highly differentiated consumer products would not attract the entry of new brands because entry would not be profitable at pre-merger prices."[6]

  The Commentary also strongly suggests that the agencies do not generally consider repositioning by non-merging

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firms to be a sufficient mitigating factor in transactions involving differentiated consumer products. The Commentary states that the agencies "rarely find evidence that repositioning would be sufficient to prevent or reverse what otherwise would be significant anticompetitive unilateral effects from a differentiated products merger."[7]

- **No 35% Safe Harbor.** Although the Guidelines do not contain an express "safe harbor" provision for transactions between firms with a combined market share of less than 35%, the agencies stated in the Guidelines that they generally do not consider unilateral anticompetitive effects to be likely unless the merging firms' combined share exceeds 35%. The agencies use the Commentary to deemphasize the significance of the 35% market share threshold and expressly state that the Guidelines do "not establish a special safe harbor applicable to the Agencies' consideration of possible unilateral effects."[8] In particular, the Commentary states that "[c]ombined shares less than 35% may be sufficiently high to produce a substantial unilateral anticompetitive effect if the products are differentiated and the merging products are especially close substitutes or if the product is undifferentiated and the non-merging firms are capacity constrained."[9]

Good News. The Commentary also contains some good news for merging parties. Specifically, the agencies confirmed the following principles:

- **"Four to Three" is Often Acceptable.** The agencies have previously suggested that they are generally quite concerned about coordinated anticompetitive effects resulting from mergers that reduce the number of competitors in a market from four to three. The Commentary is more equivocal, stating that "when the evidence does not show that the merger will change of the likelihood of coordinate among the market participants or of other anticompetitive effects, the Agencies regularly close merger investigations, including those involving markets that would have fewer than four firms."[10]

- **Unilateral Effects Analysis is Tailored to the Market.** The 1992 revision to the Merger Guidelines introduced to the agencies' merger analysis the concept of unilateral anticompetitive effects, and unilateral effects theories have played a significant role in a majority of merger investigations since that time. Although the Guidelines describe the general unilateral effects analysis, the agencies have not provided significant information concerning the methods they use to analyze possible unilateral effects in particular cases. The Commentary provides significant additional and sophisticated insight into this issue and describes in detail the agencies' approach to analyzing possible unilateral anticompetitive effects in a number of specific industries and market conditions, including consumer products industries, markets characterized by homogenous goods, markets characterized by auction sales, and bidding markets involving highly specialized or custom products.

- **Efficiencies Have a Greater Role.** Although the Guidelines recognize that pro-competitive efficiencies should be an important part of an integrated merger analysis, the agencies have said and done little in the past to suggest that they take efficiency claims seriously. As a result, parties to M&A transactions often have opted not to make rigorous efficiency presentations. The Commentary, however, references specific investigations in which the agencies credited efficiency claims and may therefore encourage parties going forward to devote the resources necessary to develop and document appropriate efficiency arguments. Finally, the Commentary makes clear that the agencies' consideration of efficiency claims is broader than the Guidelines suggest; the agencies acknowledge for the first time that "out-of-market" efficiencies and fixed cost savings are potentially significant to the overall analysis.[11]

No News. Finally, the Commentary reaffirms the following long-standing guideposts of the agencies' merger analysis:

- **Customer Testimony is Critically Important.** The Commentary identifies the types of evidence most likely to be useful in a merger investigation and discusses the specific uses of such evidence. For example, the agencies use the Commentary to reaffirm the heavy reliance they place on information provided by customers and state that "[c]ustomers typically are the best source, and in some cases may be the only source, of critical information on the factors that govern their ability and willingness to substitute in the event of a price increase."[12] This emphasis is notable in light of two recent losses in merger challenges by the FTC and DOJ in which federal courts questioned the probative value of customer testimony.[13]

- **Empirical Data is Increasingly Important.** The Commentary acknowledges and provides numerous examples of the agencies' ever-increasing use of empirical data and econometric analysis in merger investigations. The Commentary makes notable reference to retail scanner data and so-called "natural experiments" involving previous market disruptions as the types of empirical evidence that the agencies generally consider to be particularly significant in analyzing the likely competitive effects of a transaction.

- **HHI Thresholds Generally are Not Meaningful.** The Guidelines set out general market concentration thresholds based upon the Herfindahl-Hirschman Index ("HHI"), that the agencies use to determine whether a proposed transaction requires detailed investigation. In practice, it has become increasingly clear that the agencies generally do not place meaningful weight on the HHI thresholds. The agencies confirmed this in 2003 and 2004 by releasing merger challenge data that documents the fact the agencies have often not challenged transactions that fall well outside the HHI zones set forth in the Guidelines.[14] The agencies confirm in the Commentary that the HHI thresholds are "but a 'starting point' for the analysis."[15]

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Greater Transparency in Antitrust Enforcement: The Next Step

The Commentary is notable for the agencies' willingness to further explain the Guidelines and provide specific examples from recent enforcement activities involving application of discrete principles from the Guidelines. This approach is consistent with the agencies' objective of providing greater transparency and predictability in merger enforcement, and reflects a positive trend in agency practice. As such, the Commentary will provide affirmative, albeit modest, assistance to companies and their counsel in evaluating antitrust risk and navigating the antitrust approval process.

The agencies next step in improving the transparency of the merger review process should be to consistently issue statements explaining why they chose not to oppose those transactions that were subject to detailed investigation and review. This would provide merging parties and their counsel with a new, and more informative, commentary on the agencies' application of the Merger Guidelines.

Notes

1. *E.g.*, Department of Justice Antitrust Division Statement on the Closing of Its Investigation of Whirlpool's Acquisition of Maytag (March 29, 2006) (available online at http://www.usdoj.gov/atr/public/press_releases/2006/215326.pdf); Statement of the Commission Concerning Federated Department Stores, Inc./The May Department Stores Company (August 30, 2005) (available online at http://www.ftc.gov/os/caselist/0510001/050830stmt0510001.pdf).
2. A copy of the agencies' joint Commentary is available online at http://www.usdoj.gov/atr/public/guidelines/215247.pdf.
3. The agencies also issued some focused amendments to the Merger Guidelines in 1984 and 1997.
4. *See*, *e.g.*, *FTC v. Tenet Health Care Corp.*, 186 F.3d 1045, 1053-54 (8th Cir. 1999); *Oracle Corp.*, 331 F. Supp. 2d at 1158-60; *United States v. Sungard Data Systems, Inc.*, 172 F. Supp. 2d 172, 182-83 (D.D.C. 2001); *FTC v. Tenet Health Care Corp.*, 186 F.3d 1045, 1053-54 (8th Cir. 1999).
5. Commentary at 8, 32, 33, 35.
6. Commentary at 38.
7. Commentary at 31.
8. Commentary at 26.
9. Commentary at 26.
10. Commentary at 20.
11. Commentary at 56.
12. Commentary at 9.
13. *See*, *e.g.*, *United States v. Oracle Corp.*, 331 F. Supp. 2d 1098, 1167-68 (N.D. Cal. 2004); *FTC v. Arch Coal, Inc.* 329 F. Supp. 2d 109, 145-46 (D.D.C. 2004).
14. *See* Department of Justice and Federal Trade Commission, Merger Challenge Data for Fiscal Years 1999-2003 (Dec. 18, 2003) (available online at http://www.usdoj.gov/atr/public/201898.htm); Federal Trade Commission, Horizontal Merger Investigation Data, Fiscal Years 1996-2003 (issued Feb. 2, 2004 and amended Aug. 31, 2004) (available online at http://www.ftc.gov/os/2004/08/040831horizmergersdata96-03.pdf).
15. Commentary at 15.

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