COMMENTS OF THE ABA SECTION OF ANTITRUST LAW
REGARDING THE
FEDERAL TRADE COMMISSION AND DEPARTMENT OF JUSTICE
HORIZONTAL MERGER REVIEW PROJECT
PROJECT NO. P092900

November 9, 2009

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 questions posed for comment by the U.S. Department of Justice ("DOJ") and the Federal Trade Commission ("FTC") (collectively referred to as the "Agencies") in anticipation of their joint public workshops to explore the possibility of updating the Horizontal Merger Guidelines.[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 beginning the process to explore the possibility of revising the Guidelines. The Section noted in its 2008 Transition Report[3] that the Guidelines provide important guidance to the agencies, the private sector and the courts. Nonetheless, concerns have been raised that certain aspects of the current Guidelines no longer reflect current economic thinking while other parts may no longer be followed by the Agencies in their review of mergers. The Agencies should use the learning gained from the application of the Guidelines over the past seventeen years since their last comprehensive review to ensure that the Guidelines remain current in their reflection of Agency practice and analysis.[4]

The Section provides below detailed comments to each of the questions posed for public comment. A few highlights of the key points discussed in the comments are:

- The Section believes that the HHI thresholds in the current Guidelines should be raised to reflect more accurately Agency practice. Publicly available data from the Agencies reveal that the current thresholds are too low, since the Agencies rarely challenge transactions where HHI levels are below 2500. The current Guidelines

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1 The Section assembled a working group led by Joseph G. Krauss to draft these comments. The working group included Rachel Brandenburger, Jeffrey Brennan, Mary Coleman, Kathryn Fenton, David Gelfand, Gorav Jindal, Peter Love, James Lowe, Mary Anne Mason, Henry McFarland, James O'Connell, David Scheffman, Sheridan Scott, Robert Schlossberg, Greg Sivinski, Eric Stock, Christine Wilson, Hiram Andrews, Diane Tuomala, and Justin Bernick.

2 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 GUIDELINES].

3 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.

4 The Section notes that the 1992 Guidelines were revised in part in 1997 with the revisions and modifications to the efficiencies section. That was the last time the agencies considered any revision to those 1992 Guidelines.

suggest an undue level of concern for transactions in markets with HHIs between 1800 and 2500 and provide inaccurate and incomplete guidance to companies, practitioners and the courts. The Guidelines should be revised and the HHI thresholds should be increased to reflect more accurately actual agency practice.

- The Section believes that the market concentration presumptions currently in Section 1.51 of the Guidelines should be removed. The presumptions are a remnant of prior guidelines and current enforcement statistics and the use of an integrated competitive effects analysis indicate that the presumptions are less relevant to modern merger analysis. Furthermore, eliminating the presumptions would reduce the risk of judicial outcomes that diverge from modern merger analysis and economic theory.

- The Agencies should consider revising the Guidelines in limited respects so that they accurately describe the process by which the Agencies analyze mergers. As discussed more fully in the responses below, there are discrete aspects of the Guidelines that may warrant clarification. More generally, it would be useful to incorporate the explanation in the 2006 *Commentary on the Horizontal Merger Guidelines*,[5] that the Guidelines are applied through an integrated analysis and not a rigid step-by-step approach. However, such a revision should make clear that each of the elements and concepts described in the Guidelines serves an important analytical purpose and each should be considered before a decision is made to challenge a particular transaction.

- The Section recommends against broad expansion of the Guidelines to address extensively the many types of information that, on a case-by-case basis, may support conclusions about competitive effects. Publications such as the Commentary, speeches, investigation closing statements, complaints, analyses to aid public comment, and competitive impact statements, are better-suited for elaboration on factual foundations for Agency decisions in individual merger cases. The Section believes, however, that a very limited and concise modification to the Guidelines, to acknowledge the Agencies' frequent use of information other than market shares and concentration, would benefit the public by aligning the text with actual practice.

- The Section believes that expansion of the unilateral effects discussion would be useful. These discussions should reflect the agency practice developed over the last 17 years as unilateral effects analyses have become more common and as economic thinking has advanced.

- The Section does not believe that the distinction between uncommitted and committed entry is a useful one in practice, largely because an analysis of uncommitted entrants as contemplated by the Guidelines is rarely, if ever, undertaken.

5 FED. TRADE COMM'N & U.S. DEP'T OF JUSTICE, COMMENTARY ON THE HORIZONTAL MERGER GUIDELINES (2006), *available at* http://www.ftc.gov/os/2006/03/CommentaryontheHorizontalMergerGuidelinesMarch2006.pdf [hereinafter COMMENTARY]

The Section believes that the Guidelines should be revised so that they more accurately describe Agency practice. The largely artificial and potentially confusing separation of the analysis between "uncommitted entrants" that are given market shares and "committed entrants" that are analyzed under the entry rubric is not helpful. Indeed, under the integrated analysis that the Agencies currently undertake, it makes more sense to consolidate the analysis of potential supply responses in a single section.

- The Section recommends that the Guidelines be revised (1) to acknowledge (in accordance with the Commentary) that fixed cost savings may result in lower prices in the short term; and (2) to state that the Agencies will consider as cognizable those fixed cost savings that are likely to result in long term benefits to consumers, with the weight accorded to projections or claims of fixed cost savings dependent on, among other things, the relative level of certainty that those savings will be achieved, and the timeframe within which those savings are projected to be achieved.

The Agencies have not asked a question directly related to coordinated effects analysis (other than a question about the role of past coordination). The Section believes that if the Merger Guidelines are revised, further discussion and clarification of how the agencies assess whether coordinated effects are likely would be useful. The current Merger Guidelines provide a checklist of issues to assess when considering coordinated effects but provide only limited guidance as to the approach taken by the Agencies and in particular how they assess whether a merger is likely to change the potential for coordination. Several recent articles have discussed the analysis of coordinated effects and the Section believes the Agencies should consider updating the coordinated effects section to incorporate this learning.[6]

The Section looks forward to working with the Agencies to develop Guidelines that are synchronized with existing agency standards and practice. The Section encourages the Agencies to make this process a regularly occurring event to ensure that the Guidelines remain current and up to date.

If the Agencies conclude that revisions to the Guidelines are warranted at this time, the Section also encourages the Agencies to seek comment on those revisions before issuing them in final form. 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,

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6 *See, e.g.*, MARC IVALDI ET AL., THE ECONOMICS OF TACIT COLLUSION: FINAL REPORT FOR DG COMPETITION, EUROPEAN COMMISSION (2003), *available at* http://ec.europa.eu/competition/mergers/studies_reports/the_economics_of_tacit_collusion_en.pdf; David T. Scheffman & Mary Coleman, *Quantitative Analyses of Potential Competitive Effects from a Merger*, 12 GEO. MASON L. REV. 319 (2003); William E. Kovacic, Robert C. Marshall, Leslie M. Marx, & Steven P. Schulenberg, Quantitative Analysis of Coordinated Effects (September 2005, revised June 2006) (unpublished, *available at* http://www.ftc.gov/be/seminardocs/Marx_CoordinatedEffects.pdf); Andrew Dick, *Coordinated Interaction: Pre-Merger Constraints and Post-Merger Effects*, 12 GEO. MASON L. REV. 319 (2003); Janusz A. Ordover, *Coordinated Effects*, *in* II ABA SECTION OF ANTITRUST LAW, ISSUES IN COMPETITION LAW AND POLICY 1359-83 (2008).

the experience in other jurisdictions has shown that an open process can solicit valuable input from practitioners and business persons and result in more effective and more complete guidelines. The Section hopes that the Agencies will follow the lead of other jurisdictions and seek input before any revisions are finalized.

Finally, although the Section applauds the Agencies for beginning a process of revising horizontal merger guidelines that have been substantially in place for seventeen years, the Section also notes that there are other guidelines of even older vintage that are "still on the books" and despite their age may be used by the inexperienced practitioner or the inexperienced business person for guidance on certain transactions. The Non-Horizontal Merger Guidelines were issued in 1984 by DOJ[7] and have not been revisited or revised since that time, despite the significant evolution of economic theory dealing with vertical mergers. The Agencies still investigate and from time to time challenge vertical mergers, but practitioners and businesses do not have any current guidance on how the Agencies will analyze such mergers. The Section encourages the Agencies to articulate their analytical approach to vertical mergers, potentially leading toward updated guidance, that reflects current economic theory and agency practice with respect to vertical mergers.

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7 NON-HORIZONTAL MERGER GUIDELINES, *available at* http://www.usdoj.gov/atr/public/guidelines/2614.htm (originally issued as part of U.S. DEP'T OF JUSTICE, MERGER GUIDELINES (1984)) .

1. *The Guidelines (§0.2) specify a five-step analytical process to determine whether to challenge a horizontal merger. Should the Guidelines be revised to indicate that the Agency's assessment of whether the merger is likely to reduce competition may not entail following the five steps in the order listed and that not all five steps are needed in all cases? If so, what can be said about when such departures are and are not appropriate?*

Comment:

The Agencies should consider revising the Guidelines in limited respects so that they accurately describe the process by which the Agencies analyze mergers. As discussed more fully in the responses below, there are discrete aspects of the Guidelines that may warrant clarification. More generally, it would be useful to incorporate the explanation in the Commentary that the Guidelines are applied through an integrated analysis and not a rigid step-by-step approach. However, such a revision should make clear that each of the elements and concepts described in the Guidelines serves an important analytical purpose and each should be considered before a decision is made to challenge a particular transaction.

The organizational structure of the Guidelines—five sequential sections that address market definition and concentration, competitive effects, entry, efficiencies, and failing and exiting assets—can be read to suggest that the Agencies analyze mergers according to a formal, step-by-step process. This view is arguably supported by the language found in portions of the Guidelines, *e.g.*:

> *First*, the Agency assesses whether the merger would significantly increase concentration and result in a concentrated market . . . . *Second*, the Agency assesses whether the merger, in light of market concentration and other factors that characterize the market, raises concern about potential adverse competitive effects. *Third*, the Agency assesses whether entry would be timely, likely and sufficient either to deter or to counteract the competitive effects of concern. *Fourth*, the Agency assesses any efficiency gains that reasonably cannot be achieved by the parties through other means. *Finally* the Agency assesses whether, but for the merger, either party to the transaction would be likely to fail, causing its assets to exit the market.[8]

This language suggests that a merger review under the Guidelines is a mechanical, sequential analysis—*i.e.*, that the Agency first defines the relevant market and measures concentration, then conducts an assessment of likely adverse competitive effects within that defined market, and then if anticompetitive effects are considered likely proceeds to examine the other "steps" of the Guidelines.[9]

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8 Guidelines § 0.2 (emphasis added).

9 Such a linear, "step-by-step" approach is arguably a relic of the formalistic approach followed in older decisions such as *Philadelphia National Bank*. *See* 374 U.S. 321, 355-72 (1963).

The Agencies have been aware of such perceptions for some time and have attempted in recent years to clarify how they utilize the Guidelines' five-part analytical structure in practice. For example, in the Introduction to the Commentary, the Agencies explained:

> Each of the Guidelines' sections identifies a distinct analytical element that the Agencies apply to an integrated approach to merger review. The ordering of these elements in the Guidelines, however, is not itself analytically significant, because the Agencies do not apply the Guidelines as a linear, step-by-step progression that invariably starts with market definition and ends with efficiencies or failing assets. Analysis of efficiencies, for example, does not occur "after" competitive effects or market definition . . . , but rather is part of an integrated approach. If the conditions necessary for an anticompetitive effect are not present—for example, because entry would reverse that effect before significant time elapsed—the Agencies terminate their review because it would be unnecessary to address all of the analytical elements.[10]

More recently, FTC Chairman Jon Leibowitz, in his remarks announcing the "Joint FTC/DOJ Project to Modernize the Horizontal Merger Guidelines," noted that "the Guidelines clearly exaggerate the extent to which the Agencies follow a single, rigid, step-by-step approach . . . ."[11]

It could be argued that by making such statements the Agencies have already provided sufficient explanation and that revising the Guidelines to make this point is unnecessary. However, the Guidelines should stand alone as a unified statement of enforcement policy, and the fact that the Agencies feel it necessary to clarify the Guidelines through statements in other policy documents and in speeches is in the view of the Section an argument in favor of revising the Guidelines so that they more accurately "describe the analytical framework and specific standards normally used by the Agenc[ies] in analyzing mergers."[12]

In this regard, the Section specifically recommends that the formulaic "step-by-step" language of Section 0.2 be revised to reflect the fact that the merger review process is an integrated whole, as described in the Commentary. If the Guidelines' approach is so revised, the "integrated" nature of merger analysis should be clearly defined so that the analytical rigor currently imposed by the Guidelines is not lost and that potentially critical elements are not neglected in particular cases. Thus, the Section recommends that the Agencies ensure that the Guidelines indicate that each element of a Guidelines analysis is important and must be addressed before the Agency concludes that a transaction is anticompetitive.

For example, some have argued that the Agencies' understandable and well-known focus on competitive effects should be extended—*i.e.*, that there is no need for a separate market definition element in an integrated competitive effects analysis. The Section does not endorse

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10 COMMENTARY at 2.

11 FTC Chairman Jon Leibowitz, Remarks before the Third Annual Georgetown Law Global Antitrust Enforcement Symposium, September 22, 2009, *available at* http://www.ftc.gov/speeches/leibowitz/090922mergerguideleibowitzremarks.pdf.

12 GUIDELINES § 0.

this view. Specifically, any revised Guidelines should reiterate that relevant market definition (whether through competitive effects or otherwise) is an important part of merger review, that it lends rigor to the Agency's analysis and has a beneficial disciplining effect on enforcement decisions, and that neglecting any elements of the Guidelines analysis—for example, failing to define clear relevant market boundaries—can lead to Agency challenges that will not succeed in court.[13]

Finally, the Section recommends that the Agencies consider making express in the Guidelines that, where the Agency can focus on a potentially dispositive issue to enable it to close an investigation quickly, it will do so. Although each element of the Guidelines analysis is important, especially when deciding whether to challenge a transaction, it may be possible to determine relatively quickly that a particular element of the analysis precludes the likelihood of finding harm to competition. For example, if the evidence regarding market definition indicates that there are many competitors, then the Agency may be able to close its investigation without further analysis. Similarly, in cases where there is evidence of substantial and on-going entry, or where there is strong evidence that significant entry is likely to occur, the Agency may appropriately terminate its review of the transaction without further burden or delay.

2. Should the Guidelines be revised to address more fully how the Agencies use evidence about likely competitive effects that is not based on inferences drawn from increases in market concentration? If such revisions are undertaken, what types of direct evidence are pertinent? How should the following categories of evidence be used?

Comment:

Although the Guidelines in general do not elaborate on the factual and other information upon which the Agencies draw inferences and base conclusions in individual cases about competitive effects, some guidance is contained in Section 0.1. That section provides that "the Guidelines set forth a methodology for analyzing issues once the necessary facts are available" and that "[t]he necessary facts may be derived from the documents and statements of both the merging firms and other sources." In addition, Section 1.5 addresses market concentration and provides that such information "is a useful indicator of the likely potential competitive effect of a merger."

Most observers of federal merger enforcement generally understand that the Agencies assess competitive effects in a more nuanced and comprehensive way than by looking primarily at concentration and HHIs despite possible inferences that could be made from certain language in the Guidelines to the contrary. The Agencies confirmed this in the Commentary, which states that "the ultimate decision of whether a merger likely will be anticompetitive is based heavily on evidence of potential anticompetitive effects," and that although shares and concentration levels

13 *See, e.g.*, U.S. v. Oracle Corp., 331 F. Supp. 2d 1098, 1158 (N.D. Cal. 2004) (rejecting Antitrust Division challenge to Oracle's proposed acquisition of rival PeopleSoft and holding that government had failed to define sufficiently "articulable and distinct product market").

"have some predictive value" and are used as "at least a starting point during the initial [HSR] waiting period," the requisite inquiry is "intensively fact-driven."[14]

The Section recommends against broad expansion of the Guidelines to address extensively the many types of information that, on a case-by-case basis, may support conclusions about competitive effects. Publications such as the Commentary, speeches, investigation closing statements, complaints, analyses to aid public comment, and competitive impact statements, are better-suited for elaboration on factual foundations for Agency decisions in individual merger cases. The Section believes, however, that a very limited and concise modification to the Guidelines, to acknowledge the Agencies' frequent use of information other than market shares and concentration, would benefit the public by aligning the text with actual practice.

Should the Agencies modify the Guidelines in this manner, they should note that all such evidence is not always available or applicable in all cases. To avoid being misconstrued as a rote "checklist" of evidence used in every case, the new text should explain that when such evidence is available, the Agencies evaluate it for reliability, interpret it within the context of potentially inconsistent facts elsewhere in the record, and accord it weight appropriate under the circumstances.[15] The text should also clarify that by identifying sources and categories of information that are frequently relevant to competitive effects, the Agencies do not intend to negate or diminish the potential importance of other types of information that are not identified.

Any revision to the Guidelines pertaining to how the Agencies use evidence about likely competitive effects should invoke the integrated approach that the Agencies articulate in the Commentary. "What matters is not the label applied to a competitive effects analysis, but rather whether the analysis is grounded in both sound economics and the facts of the particular case."[16] Further, "[t]he type of evidence that is most telling varies from one merger to the next, as do the most productive tools of economics."[17] The Agencies should emphasize that they challenge a merger only after concluding that the weight of *all* record evidence—as derived from reliable documents, statements, and economic methods that are appropriate to the particular case—establishes a likelihood of anticompetitive harm.

a. For an already consummated merger, evidence of actual, adverse competitive effects

Comment:

Consummated mergers are the most obvious cases for using "direct" evidence of competitive effects, because market performance after the merger can often be observed. The Guidelines do not distinguish between proposed and consummated mergers or state a distinct

14 COMMENTARY at 2-3.

15 As an example, the Agencies might look to the Commentary, which, in regard to natural experiments, states: "To be probative, of course, such data analyses must be based on accepted economic principles, valid statistical techniques, and reliable data. Moreover, the Agencies accord weight to such analyses only within the context of the full investigatory record." COMMENTARY at 10.

16 *Id.* at 17.

17 *Id.*

framework for evaluating the competitive significance of post-transaction changes in price, output, or other dimensions of rivalry. The Section recommends that the Agencies expressly address consummated mergers in the Guidelines.

The Guidelines could usefully state that the Agencies view a post-merger, non-transitory quality-adjusted price increase (or other demonstrated consumer harm) as an "actual adverse competitive effect" only after reasonably drawing such a conclusion from a rigorous investigation into the causes of the price increase. The ultimate inquiry in such an investigation is whether the price increase resulted from market power that is sustainable and that the merger created or enhanced—and not from independent events unrelated to competition or the merger.

The Section encourages the Agencies to acknowledge that two complementary approaches to competitive effects analysis are available in consummated merger cases. The first approach is to ascertain what happened to price (or other dimension of rivalry) following the merger and determine why any variations from the pre-merger period occurred. The second approach is to apply traditional Guidelines analysis to ascertain whether they predict anticompetitive effects from the merger. Should the two approaches yield irreconcilable results in a particular case, it would alert the Agency that further analysis is likely required before reaching a conclusion whether the merger is anticompetitive because price increase may be transitory or unrelated to the merger.

b. Evidence based on so-called "natural experiments," such as variations across geographic markets, time periods, customer categories, or similar product markets showing how customers are affected by competitive conditions whose variation may be comparable to the change to be wrought by the merger

Comment:

Natural experiments can, in many circumstances, lead to significant quantitative information about likely competitive effects of a merger. Accordingly, in any revision to the Guidelines concerning information sources for competitive effects analysis, it would be appropriate to include this category. The term "natural experiment," however, is shorthand for a potentially limitless variety of prior marketplace events, and is not widely recognized outside a relatively small circle of specialists. Any reference to this type of information in the Guidelines should be articulated with the broader audience in mind.

Such a Guidelines revision should be consistent with current understanding about the appropriate uses and potential limitations of natural experiments. The event that sets the experiment must be a legitimate proxy for the change that would occur after the merger—i.e., the elimination of a particular firm as an independent competitor. Also, as in consummated merger analysis, when interpreting why, e.g., price was higher after the event than before, the Agencies must investigate whether factors unrelated to competition explain the price variation. Otherwise, the event is not informative about the merger and provides no predictive value for the competitive analysis. The Agencies also must assess whether future changes in the relevant market, such as entry or re-positioning, are likely, so as to negate or diminish the predictive value of the natural experiment.

c. Evidence of the merging firms' post-merger plans

Comment:

A statement made with knowledge about a firm's post-merger plans usually is relevant to competitive effects analysis, but rarely if ever is decisive on that ultimate issue. Market power is not a function of a firm's plans or intent, but of its *ability* to raise price by reducing output. Statements about plans may reflect a party's expectations and intentions, and as such can be useful information for the overall competitive analysis. But post-merger plans in and of themselves should not be a substitute for rigorous, integrated application of the Guidelines framework and the economic principles on which it is based—taking the entire investigatory record into account to understand how competition works in the relevant market. As the Commentary provides, "[i]f the *conditions necessary* for an anticompetitive effect are not present,"[18] then the Agencies will terminate their review of the merger. The Agencies should clarify that post-merger plans should be evaluated no differently. If, after a full Guidelines analysis, the investigatory record does not support a conclusion that the post-merger market conditions will create conditions conducive to the exercise of market power, then evidence about the merging parties' post-merger plans should not be a sufficient basis for challenging the merger.

d. Evidence from customers about how they will respond to, and be affected by, the merger

Comment:

The Agencies have long sought information from customers about expectations and supply alternatives following a merger and rightfully so. Credible, non-speculative, and fact-based observations by informed customers can be important to an overall analysis of likely competitive effects. For example, in bid markets, customer views of bidders may be an important indicator of the strength and credibility of current and future bidders, notwithstanding inferences that might be drawn from historical won/loss data.

Any Guidelines revision about information from customers should also acknowledge the potential limits of such evidence. The weight to be accorded to views of particular customers should reflect how representative they are among all customers in the relevant market. As the Commentary notes, decisions whether to challenge a merger are not appropriately based on a simple tally of how many customers oppose versus support the transaction.[19] In addition, "all customers in a relevant market are not necessarily situated similarly in terms of their incentives."[20] Such incentives must be taken into account when drawing inferences and assigning weight to customer statements. Customer views about competitive effects—like inferences drawn from the merging firms' post-merger plans—should be an element of an

18 *Id.* at 2 (emphasis added).

19 *Id.* at 10.

20 *Id.*

integrated analysis under the Guidelines rather than dispositive evidence that a merger is likely to create, or exacerbate, conditions conducive to the exercise of market power.[21]

e. Evidence that the merging firms have engaged in significant head-to-head competition leading to lower prices or other customer benefits

Comment:

Evidence that (i) the merging parties have engaged in head-to-head competition and (ii) lower prices or other customer benefits occurred at the same time has probative value as part of an integrated merger analysis but does not alone create a sufficient basis for predicting anticompetitive effects after the merger. The existence of such conditions can indicate a need for additional investigation to understand the competitive process in the relevant market and to ascertain whether timely competition from other incumbent firms, from firms repositioning, or from firms entering through customer sponsorship, likely would adequately replace the loss of this head-to-head competition.

This view is consistent with the Commentary. After illustrating a hypothetical natural experiment in which one merging party reduced price in response to the other merging party's entry, but other incumbent sellers did not reduce price, the Agencies state that they would "accord weight to such analyses only within the context of the full investigatory record, including information and testimony received from customers and other industry participants and from business documents."[22] The Section agrees that evidence of the nature described in this question is appropriately interpreted as part of an overall competitive effects analysis, and not as meaningful "direct" evidence of anticompetitive effects.

f. Historical evidence of actual or attempted coordination in the industry

Comment:

The Section believes that the Commentary provides an effective description of the appropriate interpretation of historical evidence of actual or attempted coordination in the industry—acknowledging that it depends on the circumstances. "When investigating mergers in industries characterized by collusive behavior or coordinated interaction, the Agencies focus on how the mergers affect the likelihood of successful coordination in the future."[23] For example, if the industry is experiencing ongoing coordination, then the removal by merger of a coordinating firm or a potentially disruptive fringe firm may exacerbate the coordination.[24] On the other hand, for example, if the conduct preceded significant developments such as entry, product innovation,

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21 *See* Ken Heyer, "*Predicting the Competitive Effects of Mergers by Listening to Customers*," 74 ANTITRUST L.J. 87 (2007) ("Customer views are . . . best employed as a complement to, rather than as a substitute for, economic analysis").

22 COMMENTARY at 10.

23 *Id.* at 23.

24 *Id.* at 22.

or investments in efficiencies by incumbents, then incentives or the ability to coordinate in the future may be altered.[25] .

Modest revision of the Guidelines to clarify the role of prior coordination, consistent with the principles stated in the Commentary, would be appropriate.

3. *Should the Guidelines include a more detailed discussion of how the hypothetical-monopolist test for market definition (§1.11) is applied? This could include discussion of the following points.*

a. ***Why the hypothetical monopolist approach often leads to properly defined relevant antitrust markets that do not include the full range of functional substitutes from which customers choose.***

Comment:

The Section believes that it could be useful to revise the Guidelines to include a satisfactory answer to 3.a. Much has been written about why markets often exclude some functional substitutes, and the Agencies' briefs in litigated cases always seek to educate the judge as to why this is the case. Moreover, some litigated cases, such as *FTC v. Staples*,[26] make this point clear.

b. ***How to conduct "critical loss analysis," including the proper use of evidence regarding pre-merger price/cost margins.***

Comment:

The Section believes that the Guidelines should be revised to clarify the Agencies' views on the specifics of evidence used, and the weighing of that evidence, in applying the hypothetical monopolist test. Such an expansion of the discussion of how the hypothetical monopolist test is implemented would provide a lead-in to the topic addressed in 3.b.

To begin, it would be useful to explain what impacts the profitability of a price increase by a hypothetical monopolist. The Guidelines should explain that following a price increase the hypothetical monopolist will earn more profits on each unit sold. However, some customers will reduce their purchases of products in the candidate market, and the monopolist will lose the profits that it would have earned on those sales. Whether the price increase will be profitable depends on the volume of sales that shift and the current profits on those sales. Thus the hypothetical monopolist test requires an assessment of the amount of lost sales that would be needed to make a price increase unprofitable and an assessment of whether the sales that would likely be lost as a result of the price increase are larger or smaller than this amount.

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25 *Id*. at 24.

26 970 F. Supp. 1066 (D.D.C. 1997).

This approach fits what has been called "critical loss analysis." There is widespread agreement that this is the basic "arithmetic" of the hypothetical monopolist test, but there is not widespread agreement on how this arithmetic is to be applied in some circumstances or on the relevant evidence and weighing of the evidence in performing this analysis. Both Agencies have used critical loss analyses.[27]

The amount of lost sales needed to make a price increase unprofitable is the critical loss level. This level will depend on the size of the price increase and pre-merger price/cost margins.[28] The Section agrees that clarifying the proper estimation and use of price/cost margins would be helpful. This gets into the proper delineation of variable costs and the time period during which various categories of costs are variable. It would be helpful for the Agencies to clarify their views on this.

The critical loss level often can be estimated from actual data. The next steps are the estimation of the *actual loss* and then a comparison of the critical loss and the actual loss. To determine the actual loss, one must *estimate* the sales that would be lost in response to a hypothetical SSNIP. There is nothing unique about this type of estimation. It is common for a fact finder to make a determination regarding what would occur in circumstances different from those observed. Estimation of damages is just one important example.[29] However, the Guidelines do not provide guidance on agency views on the calculation of actual loss.

The Section believes that the most important thing for the Agencies to clarify with some detail is the relevant evidence and analysis for estimation of the actual loss. It would be very beneficial for the Agencies also to describe the various types of evidence that might be relevant to estimating actual loss, e.g., data from natural experiments, econometric estimates, simulation analyses, economic theory, customer surveys and other market research, documents, etc. The Section believes that it would be helpful to explain how critical loss analysis should be conducted in potentially complex situations such as those involving differentiated products.[30]

A particularly important issue to clarify is the role and weight of economic theory in the assessment of actual loss. The Section's view is that antitrust analysis of mergers is fundamentally empirical, but informed by economic theory. Thus, economic theory alone is

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27 *See, e.g.*, Ken Heyer & Nicholas Hill, *The Year in Review at the Antitrust Division 2007-2008*, 33 REV. INDUS. ORG. 247 (2008).

28 If the merger reduces costs, then these margins should be calculated using post-merger costs.

29 For a discussion of the law and economic principles applied to the calculation of damages *see* ABA SECTION OF ANTITRUST LAW, PROVING ANTITRUST DAMAGES (2d ed. forthcoming 2010).

30 *See, e.g.*, Joseph Farrell & Carl Shapiro, *Improving Critical Loss Analysis*, 7 ANTITRUST SOURCE (February 2008); Michael Katz & Carl Shapiro, FURTHER THOUGHTS ON CRITICAL LOSS, 3 ANTITRUST SOURCE (March 2004); Daniel P. O'Brien & Abraham L. Wickelgren, *The State of Critical Loss Analysis: Reply to Scheffman and Simons*, 3 ANTITRUST SOURCE (March 2004); David T. Scheffman & Joseph J. Simons, *The State of Critical Loss Analysis: Let's Make Sure We Understand the Whole Story*, 3 ANTITRUST SOURCE 1 (November 2003); Michael Katz & Carl Shapiro, CRITICAL LOSS: LET'S TELL THE WHOLE STORY, 17 ANTITRUST 49 (Spring 2003); Daniel P. O'Brien & Abraham L. Wickelgren, *A Critical Analysis of Critical Loss Analysis*, 71 ANTITRUST L.J. 161 (2003); Michael G. Baumann & Paul E. Godek, *A new look at critical elasticity*, 51 ANTITRUST BULL. 325 (Summer 2006); Barry C. Harris & Joseph J. Simons, *Focusing Market Definition: How Much Substitution is Necessary?*, 12 RES. L. & ECON. 207 (1989).

insufficient to determine actual loss. (The Section has the same opinion with respect to the role of economic theory in competitive effects analyses.)

There is another issue that would benefit from clarification. In most applications, the hypothetical monopolist test posits a SSNIP for all products in the candidate product market. Some have argued that this is not the only reasonable approach to market definition, since it may be profitable for a hypothetical monopolist to raise the prices of only a subset of products in a candidate market. However, the Section believes that it is generally most sensible to assume a uniform SSNIP for all products in the candidate market. The goal of market definition is not to identify what pricing approach would be most profitable for the parties to the merger, but rather to identify the most significant competitive constraints on the prices of the products of the merging parties and thus provide a starting point with which to assess the potential competitive effects of the transaction. A common SSNIP is easier to apply and more likely to identify the specific competitive constraints on the prices of the merging firms' products. Competitive effects analyses can then identify the specific constraints and the impact of changes in those constraints on post-merger prices. Thus, we suggest that the Guidelines state that the normal practice will be to apply an across-the-board SSNIP for all products (but not for all customers when price discrimination is likely). The potential reasons for any deviations from this normal practice should be spelled out in the Guidelines.

4. *Should the hypothetical monopolist test in the Guidelines (§1.11) be simplified so that any collection of substitute products constitutes a relevant product market if a hypothetical monopolist over that group of products would find it profitable to impose at least a small but significant and non-transitory increase in price (SSNIP), including the price of a product of one of the merging firms? This would involve dropping the requirement that products be added in the order of "next best substitutes" and the use of the "smallest market" principle.*

Comment:

The Section believes that this change should not be made. This change in fact would not be a simplification because much guidance would need to be given as to how the group of products would be chosen. Such an approach might create the potential in some situations for a judge to believe that the Agencies may be putting forward a "contrived" market definition.

The Agencies may wish to consider to what extent problems in defining the market using "next best substitutes" and the "smallest market" principle can be addressed by the analysis of competitive effects.

5. *The Guidelines state (§1.11) that the size of the SSNIP will "in most contexts" be five percent. All else equal, the larger the SSNIP, the broader the market. Should the size of the SSNIP "in most contexts" be increased to ten percent? Should the Guidelines provide further explanation of the base price from which the SSNIP is calculated? Should the Guidelines provide further explanation of the conditions under which the Agencies will use a SSNIP other than the standard SSNIP?*

Comment:

As discussed above, the goal of market definition is to identify the most significant competitive constraints on the merging parties as a starting point to assess the competitive effects of the transaction. The hypothetical monopolist approach defines the market as the set of products that must be controlled by the monopolist in order for a price increase of at least a SSNIP to be profitable. The question is what size SSNIP will normally raise competitive concern. A requirement of too high a predicted price increase is likely to result in a broad market within parts of which there could still be substantial scope for competitive harm from a merger. Too small a price increase will make it too hard to determine whether the predicted increase is likely to be profitable because attempting to identify consumer reactions to small price increases is likely to be difficult.

Thus, one reason for using 5% is that it is a level that in most circumstances would be sufficiently reliable to identify when a hypothetical monopolist could impose a SSNIP. A 10% standard may in some cases make it easier to assess customer substitution patterns and markets that are most appropriate for assessing potential competitive effects—but in how many cases this will occur is unclear. Moreover, in those cases, we believe that staff will frequently use a 10% standard as an alternative if 5% is too small to be useful.

There can be situations in which a 5% price increase would be unprofitable for a hypothetical monopolist in a candidate market but a larger price increase would be profitable. Thus, the Guidelines should recognize this possibility and note that if a 5% price increase will be unprofitable, a market may still be defined if a larger price increase would be profitable. (Of course, factors such as entry or buyer power might defeat the larger price increase.) Thus, the Section believes that rather than move to the use of a 10% standard, a description of the circumstances under which the Agencies will use a 5% or 10% standard would be more useful.

Moreover, it would also be useful for the Agencies to explain further the conditions under which they use a SSNIP other than the standard SSNIP. The Section believes that even though at times the FTC will use a standard lower than 5% (such as a 1% standard for supermarkets as argued in the recent Whole Foods matter), the Guidelines should state that a smaller standard should only be employed if a small SSNIP can, in fact, be estimated with sufficient reliability. For instance, with a SSNIP of 1%, it is generally going to be difficult to prove that the SSNIP is not zero or at least *de minimis*. If a smaller SSNIP is used by the Agencies, the Guidelines should note that a smaller SSNIP may lead to the detection of smaller potential anticompetitive effects. Smaller potential anticompetitive effects of the merger are more likely to be offset by credible evidence of efficiencies.

6. *In defining the geographic market, the Guidelines refer (§1.21) to the locations at which the relevant product is produced. The locations of customers who are likely to be affected by the merger may be quite different from the locations of the suppliers. Should the Guidelines be revised to state that the geographic market may be defined based on the locations of customers rather than, or in addition to, the locations of suppliers, depending upon circumstances? Should other indicia employed in geographic market definition be discussed, such as legal and regulatory constraints?*

Comment:

The Section agrees that Section 1.21 of the Guidelines should be revised. As currently drafted, Section 1.21 does not fully capture the myriad product (and service) markets that can arise or sufficiently acknowledge the interplay between locations of suppliers and customers. The Guidelines could usefully clarify that in most instances, as a matter of practice, the Agencies ask the basic question of where customers would turn if their current supplier increased prices. In some circumstances, therefore, the evidence may support a geographic market definition based on the location of customers. It would be helpful for the Agencies to address the utility of other indicia employed in geographic market definition, such as legal and regulatory constraints.

The Guidelines should broaden the current exclusive focus on locations of producers.

As currently drafted, the Guidelines begin the geographic market analysis by asking whether a "hypothetical monopolist that was the only present or future producer of the relevant product at locations in that region would profitably impose at least a 'small but significant and nontransitory' increase in price, holding constant the terms of sale for products produced elsewhere. That is, assuming that buyers likely would respond to a price increase on products produced within the tentatively identified region only by shifting to products produced at locations of production outside the region, what would happen?"

First, the location where a product is produced is not always dispositive in determining the geographic market. For instance, consider a merger of producers of a raw material that is mined only in one country (Country X) but shipped all over the world. Would we say that the geographic market is Country X, because customers cannot source the product "outside the region" or would we say the geographic market is worldwide? In an effort to make the geographic market definition analogous to how one defines the product market, the current Guidelines create some degree of confusion when they refer to a "present or future producer of the relevant product market *at locations in that region* . . . ." Thereafter, the Guidelines refer to "buyers," but do not address the location of buyers although there can be an important interplay between the location of the customer and the location of the supplier. The Agencies should clarify the full range of evidence that can be taken into account to define a relevant geographic market.

Second, Section 1.21 does not fully take into account the influence of resellers/retailers and service providers on market dynamics. In analyzing a merger among resellers, the Agencies' practice is to identify the parties' locations and the locations of their customers; rather than the locations where products being resold were originally produced. Similarly, service providers by definition do not produce a tangible good and therefore there is no production location. The courts and the Agencies have routinely looked at actual sales patterns and where customers are located in defining geographic markets.[31] Although it is not possible for the Guidelines to cover every possible situation, the Agencies should clarify the language in Section 1.21 to address how the Agencies define the geographic market in transactions involving resellers, suppliers, or service providers.

Third, the Section believes the Guidelines should be revised to acknowledge the weight that the Agencies give to customer feedback in defining the relevant geographic market, albeit in seeking to implement the hypothetical monopolist test. Indeed, this would reflect Supreme Court precedent, which has described the relevant geographic market as "the area of effective competition . . . in which the seller operates, and to which the purchaser can practicably turn for supplies."[32] Moreover, the Agencies have already discussed this issue in the Commentary, which states "[c]ustomers are the best source, and in some cases they 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."[33]

Other jurisdictions also recognize the importance of customer perspectives in defining the geographic market. The Canadian Merger Enforcement Guidelines explain that "what matters is not the identity of the sellers, but buyers' ability or willingness to switch their purchases in sufficient quantity from one location to another in response to changes in relative prices. A relevant geographic market consists of all supply points that are regarded as close substitutes by buyers."[34] Similarly, the EC Guidelines state that when defining the geographic market, "the question to answer is again whether the customers of the parties would switch their orders to companies located elsewhere in the short term and at a negligible cost."[35]

The Guidelines should discuss the use of other indicia employed in geographic market definition.

The Section agrees that the Guidelines should discuss the use of other indicia employed in geographic market definition, such as legal and regulatory constraints. Although the Guidelines currently acknowledge legal and regulatory constraints in Section 1.43, which refers to special factors affecting foreign firms (e.g., exchange rates, quotas, and foreign export cartels), the Section believes that these and other indicia should be discussed in greater detail. Other legal and regulatory constraints can also play a material role in market definition, such as FDA approval, federal and state environmental requirements, unique state regulations for product quality and performance that differ from federal regulations or other regulatory constraints that can affect entry into distinct geographic regions.[36]

It would be helpful for the Guidelines to discuss or acknowledge additional factors or indicia, such as: (1) distance of supplier from customer; (2) transportation costs;

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31 ABA SECTION OF ANTITRUST LAW, MERGERS AND ACQUISITIONS 102-03 & n.173 & 175 (3d ed. 2008).

32 United States v. Phila. Nat'l Bank, 374 U.S. 321, 359 (1963) (citations and quotations omitted).

33 COMMENTARY at 9.

34 Canada Competition Bureau, Merger Enforcement Guidelines § 3.19 (Sept. 2004).

35 Commission Notice on the definition of relevant market for the purposes of Community competition law ¶ 29 (Sept. 1997).

36 ABA SECTION OF ANTITRUST LAW, MERGERS AND ACQUISITIONS 111 (3d ed. 2008).

(3) tariffs/duties; (4) ease of handling/transport; (5) relative prices across regions; (6) trade flows; (7) price movements; (8) infrastructure constraints; (9) anecdotal evidence of customer bargaining, i.e., use of threats to turn to suppliers located in other regions or countries; and (10) ITC proceedings.[37]

7. *Should the discussion of how market shares are measured (§ 1.4) or interpreted (§ 1.52) be expanded? Is the interpretation of market shares, or the probative value of market concentration, different in cases involving unilateral effects than those involving coordinated effects?*

Comment:

The Section believes the current Guidelines discussion of how market shares should be measured provides a good starting point for consideration of this important issue, but an expanded discussion, especially one that reflects more recent experience in considering mergers that raise unilateral effects issues would be desirable. The Guidelines should clarify that market share and related HHI calculations serve primarily as a screening tool for the agency at the outset of a merger inquiry, and that they are used as one indicator to the agency that a merger may warrant more in-depth investigation, but are not, standing alone, a sufficient demonstration of the competitive effects of a potential transaction to justify challenging a transaction.

Market shares and market concentration often may be less relevant for unilateral effects analysis than for coordinated effects analysis, and this issue merits further discussion. In particular, structural presumptions arising from market concentration may have limited probative value for unilateral effects cases. The economic literature indicates that unilateral effects should be addressed differently in commodity product markets and differentiated products markets, and a consideration of actual experience since the 1992 Guidelines were adopted could usefully inform this analysis.

The Section further recommends that the discussion of how market shares are measured (§ 1.4) should be expanded. In particular, greater explanation of when it is appropriate to use different measures of share is desirable. The current Guidelines include a brief discussion of when the Agencies might base shares on dollar sales or unit sales and acknowledge that in some situations shares based on capacity, reserves, or number of competitors might be appropriate. In practice, the Agencies also sometimes base shares on firms' excess or divertible capacity. More detailed analysis regarding the circumstances and factors to which the Agencies will look in determining which measure of share best represents the future competitive significance of the market participants would be valuable.

Such an expanded analysis should include an explanation of how market shares are calculated in bid model markets and when it is appropriate to use a bid model market. Section 1.4 of the Guidelines currently addresses this issue only in a footnote, but in many bid markets,

[37] *See also id.* at 105-10 (discussing transaction costs and how they affect the ability and willingness of consumers to trade different products across regions).

inclusion of all credible bidders as perceived by the customers and assigning each bidder an equivalent market share (1/N), can provide an accurate picture of the competitive dynamics in the market. Increasingly Agency practice appears to rely on historical market shares as a means of assessing competitive effects. However, reliance on past bidding opportunities can often give an inaccurate picture of present and future competition. To the extent this perception of Agency practice is accurate, the Section suggests that the Guidelines should contain an explicit discussion of the importance of competitive discipline from remaining competitors as distinct from post-merger market shares.

8. *Should the Guidelines be revised to explain more fully than in the current §1.521 how market shares and market concentration are measured and interpreted in dynamic markets, including markets experiencing significant technological change?*

Comment:

The Section believes that the current Guidelines provide a good starting point for consideration of how market shares and market concentration are measured and interpreted in dynamic markets, but that additional explanation would be useful to explain current agency practice.

Courts have long recognized that present market share data is not necessarily a reliable measure of the competitive situation. For example, in *Brown Shoe Co. v. United States,*[38] the Supreme Court stated that market share data should be supplemented by "further examination of the particular market—its structure, history, and probable future."[39] The Supreme Court again addressed market share in *United States v. General Dynamics Corp.*[40] and reiterated that it must be viewed in light of the structure, history and probable future of the relevant market.[41] In *General Dynamics*, the Court in fact concluded that market shares based on present sales was not indicative of the actual competitive situation. The Court instead considered the coal reserves of the merging companies as a yardstick of their ability to compete for future supply contracts.[42]

The Merger Guidelines as well have long recognized that market share may not be sufficient. Language substantially similar to the current §1.521 was added in the 1984 Guidelines as Section 3.21.[43]

Currently, the Guidelines state:

1.521 Changing Market Conditions

38 379 U.S. 294 (1962).
39 *Id.* at 322 n.38.
40 415 U.S. 486 (1974).
41 *Id.* at 498.
42 *Id.* at 502, 510-11.
43 U.S. DEP'T OF JUSTICE, MERGER GUIDELINES (1984), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,103 [hereinafter 1984 GUIDELINES], *available at* http://www.usdoj.gov/atr/hmerger/11249.htm.

> Market concentration and market share data of necessity are based on historical evidence. However, recent or ongoing changes in the market may indicate that the current market share of a particular firm either understates or overstates the firm's future competitive significance. For example, if a new technology that is important to long-term competitive viability is available to other firms in the market, but is not available to a particular firm, the Agency may conclude that the historical market share of that firm overstates its future competitive significance. The Agency will consider reasonably predictable effects of recent or ongoing changes in market conditions in interpreting market concentration and market share data.

This language is flexible and, accordingly, the Section agrees with the Antitrust Modernization Commission that "[c]urrent law, including the Merger Guidelines, as well as merger policy developed by the agencies and courts, is sufficiently flexible to address features in . . . industries [in which innovation, intellectual property, and technological change are central features]."[44] However, sufficient flexibility is not the same as sufficient guidance. The Section believes that additional explanation and/or examples concerning the impact of changing market conditions could enhance the predictability of the merger review process for the bar and merging parties without sacrificing the flexibility necessary for effective and expeditious merger review by the Agencies.

An expanded discussion reflecting recent experience in considering mergers in dynamic high tech markets would be desirable. In particular, the Guidelines could address how the Agencies view current market shares/concentration in dynamic high tech markets in light of lumpy orders, planned entry or exit, or prior changes in historic market shares. Moreover, the Section believes that it would be welcome if the Guidelines address the importance of current market shares/concentration in light of market conditions such as network effects, high fixed costs, etc., common in dynamic high tech industries.

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

Comment:

Based on the Agencies' own data, the Herfindahl-Hirschman Index ("HHI") thresholds in the Guidelines do not currently reflect actual practice by either of the Agencies. The Agencies generally should ensure that the Guidelines reflect actual agency practice as closely as possible so that the Guidelines can continue to serve as an accurate and transparent tool for the firms, practitioners, and courts that rely on them for guidance. To be most useful for the various audiences, the Guidelines should clarify that HHI calculations serve primarily as a screening tool for the agency at the outset of a merger inquiry, and that they are used as one indicator to the

44 ANTITRUST MODERNIZATION COMM'N, REPORT AND RECOMMENDATIONS 9 (2007)..

agency that a merger may warrant more in-depth investigation. Moreover, although the Agencies may cite HHI calculations when they challenge a merger, HHI thresholds are at best a static measure of market structure which, standing alone, are not a sufficient demonstration of the competitive effects of a potential transaction and should not be used as the sole basis for a determination on the legality of a transaction.

The current HHI thresholds are too low when compared to actual agency practice when decisions are made on whether to investigate a proposed merger and on whether to challenge a merger.[45] Furthermore, the Guidelines contain a presumption of market power based on those HHI thresholds that no longer reflects agency merger analysis. Therefore, the Agencies should increase the HHI thresholds in the Guidelines to comport more closely with actual agency merger analysis and also should eliminate any HHI "presumptions" based solely on HHI thresholds to reflect more accurately the fact that the HHI is used as merely one factor in a multi-factor, integrated, competitive effects analysis. The Guidelines should make clear that other evidence is used in combination with the HHI thresholds in this analysis so that no actual presumption as to the merger's competitive effects is attached to particular threshold levels.[46]

Guidelines that truly reflect modern merger analysis might usefully view market concentration in the context of an integrated competitive effects analysis rather than using presumptions based on specific HHI thresholds. Greater post-merger HHI levels may in some cases justify more rigorous agency inquiry and require a closer examination of factors such as the likelihood of coordinated interaction, efficiencies or entry, while lower post-merger HHI levels are rarely challenged unless there is evidence of unique anticompetitive effects. Furthermore, the probativeness of HHI concentration levels depends on the product market being analyzed and the theory of competitive effects being used. The Guidelines should be revised to reflect this.

The Guidelines currently state that a post-merger HHI below 1000 reflects an "unconcentrated" market and requires no further analysis. A post-merger HHI between 1000 and 1800 reflects a "moderately concentrated" market, and a merger increasing an HHI by 100 in this range may have anticompetitive effects. A post-merger HHI that exceeds 1800 reflects a "highly concentrated" market, and a merger increasing an HHI by 50 in this range may have anticompetitive effects, while those that increase the HHI by 100 are "presumed…to create or enhance market power or facilitate its exercise."[47] This presumption can be rebutted by other factors in the Guidelines.

Actual agency practice generally differs substantially from the thresholds set forth in the Guidelines. For example, the vast majority of DOJ and FTC challenges between 1999 and 2003 involved market concentration levels far above the Guidelines' thresholds. Less than 5 percent

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45 The HHI thresholds were first included in the 1984 GUIDELINES, a different era for merger enforcement policy and economic theory, and remained substantially unchanged in the 1992 version.

46 Although the Section supports eliminating the specific HHI presumptions, 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. See, e.g., FTC v. Heinz, 246 F.3d 708 (D.C. Cir. 2001).

47 GUIDELINES § 1.51.

of the challenged markets had concentration levels below 1,800, and only 14 percent of the challenged markets involved concentration levels below 2,400.[48] Indeed, more than half of the challenged markets involved post-merger concentration levels of more than 4,000.[49] Over 78 percent of the markets in which the Agencies pursued an enforcement action involved a post-merger HHI of 2400 or more and a change in HHI of more than 500.[50] Similarly, the most recent data released by the FTC demonstrates that, between 1996 and 2007, over 75 percent of the markets in which the FTC pursued an enforcement action involved a post-merger HHI of 2400 or more and a change in HHI of more than 500.[51]

For certain industries such as the petroleum, healthcare, and supermarket industries, investigation and/or enforcement activity appears to be correlated with somewhat lower HHI thresholds. If it is appropriate for certain industries to have lower screening thresholds, the Guidelines should describe the reasons for such different treatment, including any market characteristics that make these markets more conducive to coordination.

Assistant Attorney General Christine Varney has recently recognized the disparity between the Guidelines and agency practice. In her speech at the Third Annual Georgetown Law Global Antitrust Enforcement Symposium on September 22, 2009, AAG Varney stated that "[i]t is no secret that today the HHI thresholds offer relatively little in the way of meaningful guidance to businesses considering merging," and that "[a]ny gap between actual agency practice and the Guidelines' explanation of that practice is potentially misleading and should be corrected in order to enhance transparency."[52]

As written, the HHI thresholds in the Guidelines provide inaccurate and incomplete guidance to companies, practitioners, and courts, ultimately increasing the difficulty of predicting agency and judicial outcomes and unnecessarily increasing the cost of antitrust compliance. Increasing the HHI thresholds and/or clarifying HHI "safe harbor" levels would make the Guidelines a more accurate and transparent resource. Revising the HHI levels would also provide increased consistency between merger analysis in the United States and Europe.[53]

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48 US DEPT'T OF JUSTICE & FED. TRADE COMM'N, MERGER CHALLENGES DATA, FISCAL YEARS 1999-2003 Table 1 (2003), *available at* http://www.usdoj.gov/atr/public/201898.pdf.

49 *Id.*

50 *Id.*

51 FED. TRADE COMM'N, HORIZONTAL MERGER INVESTIGATION DATA, FISCAL YEARS 1996-2007 Table 3.1 (2008), *available at* http://www.ftc.gov/os/2008/12/081201hsrmergerdata.pdf.

52 Christine A. Varney, Ass't Attorney Gen., Antitrust Div., U.S. Dep't of Justice, Remarks at the Third Annual Georgetown Law Global Antitrust Enforcement Symposium (Sept. 22, 2009), *available at* http://www.usdoj.gov/atr/public/speeches/250238.htm ("[T]he Merger Guidelines provide that certain mergers that would result in moderately concentrated industries with HHI thresholds between 1,000 and 1,800 'potentially raise significant concerns.' Actual agency practice, however, suggests that only very rarely are mergers resulting in HHI concentration levels below 1,800 challenged.")

53 The HHI "safe harbors" in the European Commission horizontal merger guidelines contain higher thresholds than the U.S. Merger Guidelines. Under the E.C. guidelines, mergers likely require no further analysis if the post-merger HHI is below 1000; the post-merger HHI is between 1000 and 2000 with a delta below 250; or if the post-merger HHI is above 2000 with a delta below 150. Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings (2004), *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2004:031:0005:0018:EN:PDF.

In addition, the Guidelines should clarify that various industry-specific factors as well as other evidence of anticompetitive effects may lead to investigation and/or enforcement activity that may or may not correlate precisely with these thresholds.

Given the current state of agency merger analysis, the Guidelines also should be revised to eliminate the rebuttable presumption that mergers producing a change in HHI of more than 100 points where the post-merger HHI exceeds 1800 "are likely to create or enhance market power or facilitate its exercise."[54] This presumption is a remnant of prior guidelines, and both current enforcement statistics and the trend toward an integrated "competitive effects" analysis indicate that the presumption based solely on HHI levels is less relevant to modern merger analysis. Indeed, although the DOJ's 1982 Merger Guidelines introduced the use of HHI thresholds, the guidelines were revised in 1984 in part "to correct any misperception that the Merger Guidelines are a set of rigid mathematical formulas that ignore market realities, and rely solely on a static view of the marketplace."[55] The DOJ and FTC joint Merger Guidelines issued in 1992 further deemphasized the significance of HHI thresholds, explaining that "market share and concentration data provide only the starting point for analyzing the competitive impact of a merger."[56] This gradual evolution has produced Guidelines that are internally inconsistent. The Guidelines create a presumption of anticompetitive effects based on market concentration data in Section 1.51, but state that such data is "only a starting point" for analyzing competitive effects in Section 2.0. This contradiction makes the current Guidelines less useful for their intended audiences.

The Agencies themselves have recognized that HHI levels are simply one factor in a multi-factor, integrated analysis. For example, at a workshop on the Guidelines, then FTC Chairman Timothy J. Muris said, "I hope the data we released and the breadth of the analysis we will hear this week will finally put to rest the notion that HHI levels have any specific significance, except at very high levels."[57] Similarly, even the Commentary states that "[a]pplication of the Guidelines as an integrated whole to case-specific facts—not undue emphasis on market share and concentration statistics—determines whether the Agency will challenge a particular merger."[58]

Enforcement statistics, the evolution of merger analysis under the Guidelines, and agency statements all underscore the fact that statistical presumptions based on HHI levels are, at best, an imperfect proxy for whether a merger is likely to have anticompetitive effects. As repeatedly emphasized in these comments, rather than rely on such an imperfect proxy, the Guidelines should be revised to explain the role of market concentration generally (and HHI levels in particular) in this multi-factor, competitive effects analysis. Clarifying this role by eliminating any presumptions based solely on HHI levels would improve the usefulness and relevance of the Guidelines to firms and practitioners. In addition, although the HHI presumption in the Merger

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54 GUIDELINES § 1.51.

55 U.S. DEP'T OF JUSTICE, STATEMENT TO ACCOMPANY RELEASE OF 1984 MERGER GUIDELINES (June 14, 1984), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,103.

56 GUIDELINES § 2.

57 Timothy J. Muris, Chairman, Fed. Trade Comm'n, Remarks at the Workshop on Horizontal Merger Guidelines (Feb. 17, 2004), *available at* http://www.ftc.gov/speeches/muris/040217hmgwksp.shtm.

58 COMMENTARY at 15-16.

Guidelines is not binding on federal courts, numerous courts have cited to the presumption as an illustration of how market concentration should factor into the court's merger analysis.[59] Replacing the presumption with a more accurate multi-factor competitive effects analysis would therefore reduce the risk of judicial outcomes that diverge from modern merger analysis and economic theory.

10. The concept of unilateral effects was explicitly introduced into the Guidelines in 1992. Since then, the Agencies and private parties have acquired a great deal of experience evaluating unilateral effects using a variety of evidence and methods, and economic learning regarding unilateral effects has advanced. Should the Guidelines be updated to reflect this experience and learning?

Comment:

The Section believes that expansion of the unilateral effects discussion would be useful in general and that each of the topics listed is worthy of discussion—although as noted below, some of the detail may be better suited for discussion in other forums, such as speeches, FAQs or statements accompanying enforcement or closing actions. These discussions should reflect the agency practice developed over the last 17 years as unilateral effects analyses have become more common and as economic thinking has advanced. We note in this connection that the Merger Commentaries provided helpful examples and discussion on this issue that could serve as a useful starting point.[60]

In addition, the Section believes it is important for the Agencies to clarify their views on the types of evidence and analyses that may be relevant to assessing the various theories of unilateral effects. In discussing these theories, it is also important to clarify and explain the Agencies' views of the role of economic theory in conclusions about unilateral effects. The Section believes that economic theory will help to develop and assess evidence concerning unilateral effects but must be considered with evidence and not in a vacuum.

For example, one situation is where the market involves customer by customer competition where suppliers compete "head-to-head", as in an auction or bidding market. In these cases, the analysis will focus on the competition for individual customers, which suppliers have competed against each, and how customers view the different alternatives. In such cases, a merger might combine the two best alternatives for many customers where other competitors are significantly worse alternatives so that prices might rise—either to those customers alone or across the board. The auction models behind this theory could be discussed. It can then be described in such cases that the information gathered will focus on who competes, who wins, who appears to be a key competitive constraint, how close are the options available to the

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59 *See, e.g.*, Chicago Bridge & Iron Co. v. FTC, 435 F.3d 410, 431 (5th Cir. 2008); FTC v. H.J. Heinz Co., 246 F.3d 708, 716 n.9 (D.C. Cir. 2001); FTC v. CCC Holdings, 605 F. Supp. 2d 26, 37 (D.D.C. 2009); United States v. Oracle Corp., 331 F. Supp. 2d 1098, 1112 (N.D. Cal. 2004); FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 124 (D.D.C. 2004); FTC v. Swedish Match, 131 F. Supp. 2d 151, 167 n.11 (D.D.C. 2000).

60 COMMENTARY at 25-36.

customers, and how competitive responses such as competitor repositioning may affect the likelihood of anticompetitive effects.

Next under discussion could be homogenous product markets where the merger might create a firm large enough to restrict output on its own. This section could discuss how a price increase would be profitable for an individual firm in a homogenous product market (using the dominant firm model as a basis for the approach). In essence, this approach would describe how a price increase for a firm will depend on the market demand elasticity, the firm's share and the supply elasticity of other firms and how a merger can increase the firm's share as well as reduce supply elasticity and thus potentially make a price increase profitable. In these cases, the key issues to assess are calculating shares, market demand elasticities and importantly the supply response of the competitive fringe—including the firm being acquired.

The Guidelines could also include a description of cases where products are differentiated (e.g., consumer products markets in many cases). The discussion could describe how a merger might provide incentives to increase price on one or more of the products if these products were significant competitive constraints on each other pre-transaction. Each merging firm currently would not raise prices because it would lose too much volume to other products, including the product of the other merging firm. Post transaction, the firm would now internalize lost sales between the merging parties and depending on how much volume this represents, this could make a price increase profitable. It would also be useful to point out that this assessment depends in part on whether both brands are likely to continue after the transaction or if one will be dropped. It also would be useful for the Agencies to outline the types of information used to assess the potential for unilateral effects in these circumstances—including estimation of diversion ratios using consumer surveys, evidence of past switching behavior, econometric analyses of demand, and examination of likely supply responses such as competitor repositioning and expansion.

Please comment on the value of including expanded discussion of the following topics:

a. The relationship between market definition and unilateral effects.

Comment:

Some economists have advocated either dispensing with market definition or at least changing the Agencies' burden based on a proffered unilateral effects analysis alone.[61] The Section does not believe that this would be a sound approach. Not only are the roles of market definition and market share firmly enshrined in the Section 7 case law, but also market definition necessarily, because of the breadth of the inquiry, informs any analysis of competitive effects.

As a matter of economic analysis, a proper competitive effects analysis must control for all potentially confounding factors. For example, in *Staples*,[62] one issue was whether there were

61 For example, an alternative approach to market definition is discussed in Joseph Farrell and Carl Shapiro, "Antitrust Evaluation of Horizontal Mergers: An Economic Alternative to Market Definition," (November 2008), *available at* http://faculty.haas.berkeley.edu/shapiro/alternative.pdf.

62 970 F. Supp. 1066 (D.D.C. 1997).

important factors other than the number of office supply superstore competitors underlying the price differences across geographic areas. Similarly, in the FTC's *Evanston* case, an important part of the competitive effects analysis the FTC proffered was to establish that the competitive effects evidence was not explained by other factors. In an unconsummated merger this is particularly important, since effects evidence in his situation is derived from a natural experiment that is supposed to be a proxy for the potential effects of the proposed merger. Thus, the types of analyses required to do market definition are also necessary for a properly conducted competitive effects analysis and the requirement to conduct a market definition analysis provides an important check on the competitive effects analysis.

Furthermore, to the extent the effects analyses are derived from technical economic analyses such as econometric models, it is not realistic that a court would (or should) reach a conclusion without addressing the wealth of evidence arising from the market definition inquiry. In the Section's view, the proper approach is that which was performed by the Court in *Staples*, where the Court found evidence to support a finding of anticompetitive effects that also supported a conclusion on product market definition. Competitive effects evidence alone, particularly in the case of unconsummated mergers, should not determine the product market but rather competitive effects analysis can provide important evidence bearing on the proper relevant market.

Shares and the number of participants within a properly defined market are likely to be relevant to a conclusion about unilateral effects. Specifically, if the share of the parties in a market properly defined under the hypothetical monopolist analysis are small, there should be a greater burden on the Agencies to establish that the merger is likely to be anticompetitive.

Finally, if the Agencies were to dispense with a proper 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.

b. Localized effects within a relevant market.

Comment:

The Section believes that this is an area that is important to clarify. One of the challenges the Agencies appear to have faced in court challenges involving unilateral effects is defining what appear to be contrived or too narrow markets. However, broader markets may result in shares that make it harder to argue unilateral effects. Thus, explaining that there can be significant localized effects within a relevant market would be useful. The Agencies should consider, however, how large such an effect must be to be significant.

c. Unilateral effects in markets with auctions or negotiations.

Comment:

See above discussion about head-to-head competition and auction markets.

d. The role of diversion ratios and price/cost margins in evaluating unilateral effects.

Comment:

The Section believes that these analyses can be useful and relevant to the assessment of unilateral effects, but only if they are well grounded in the facts of a specific case and not if they are done in a simplistic manner based only on theory. A diversion ratio model might be relevant in a specific situation, but a thorough factual analysis is required to develop a sound fact-based conclusion on unilateral effects. Such an analysis should not be limited to a mere estimate of diversion ratios, which are generally difficult, and sometimes impossible, to estimate reliably. Moreover, in markets that are undergoing current (and/or continuing) changes, past estimates of diversions may not reliably predict future behavior. In addition, the transaction itself may impact customer and competitor behavior – customers may turn to other suppliers, competitors may reposition or expand - thereby changing diversion ratios and affecting any predictive value of estimates of pre-merger diversion.

As discussed above in the response to Question 3, calculation of the appropriate margins to consider in the unilateral effects analysis can be complex. For example, what is the right time frame to conduct the analysis and what costs are fixed versus variable. In addition, what relevance should be given to the relationship between margins and the potential for unilateral effects given diversion ratios. Simple (but technically complex) economic models indicate that situations with high margins are, other things equal, more likely to problematic. These models, however, do not consider any characteristics of the industry other than that the products are differentiated (which itself requires some explication, since there are relatively few true commodity products). Thus, there may be many situations in which the conclusions of these models do not apply.

Given these issues, the Section believes that there may be limitations in how much can be discussed in the Guidelines about the role of diversion ratios and price/cost margins in evaluating unilateral effects. The Section believes that while the Agency may wish to list these as sources of evidence relevant to some unilateral effects theories, details about how these analyses are conducted may be better provided in other forums.

e. The use of market shares as proxies for diversion ratios.

Comment:

The use of market shares as proxies for diversion ratios has been criticized from the first time this appeared in the 1992 Guidelines. As a general matter, diversion ratios can not be reasonably approximated by market shares. If diversion ratios are to be used, they should be estimated from the specific facts in the investigation. Again, as discussed above, the applicability of the diversion ratio models should be demonstrated in the specific fact situation.[63]

f. The thirty-five percent combined market share threshold in §2.211 of the Guidelines.

Comment:

The Section believes that the discussion about the 35 percent threshold needs to be clarified. The Section believes, however, that this threshold should be maintained but with a change to the language to make clear that transactions below this threshold generally will only in very unusual situations be challenged. In practice, the 35% threshold is often used by practitioners as a likely safe harbor. While the Section understands that it is possible to have localized competitive effects for transactions with shares below this level, the Section believes that the Agencies have very seldom challenged transactions under a unilateral effects theory where shares were below 35%. Moreover, a 35% threshold helps to provide guidance to parties as to which transactions may trigger an in-depth investigation under a unilateral effects theory. Removing the threshold entirely would make it much more difficult for firms to anticipate when such investigations would occur.

g. The use of merger simulation models to predict unilateral effects.

Comment:

The Section believes that merger simulation models can in some circumstances be useful in assessing potential competitive effects. There is a growing economics literature about those models, and analysts may be able to make better use of these models as experience with them increases.[64] However, such models reflect necessarily highly simplified assumptions about likely conduct in a complex real world. And to validate such a model, it is necessary but

63 Gregory J. Werden, Luke M. Froeb, & David T. Scheffman, *A* Daubert *Discipline for Merger Simulation*, ANTITRUST, Summer 2004, at 89.

64 Oliver Budzinski & Isabel Ruhmer, *Merger Simulation in Competition Policy: A Survey*, J. COMPETITION L. & ECON. (2009), *available at* http://ssrn.com/abstract=1138682; Gregory K. Leonard & J. Douglas Zona, *Simulation in Competitive Analysis*, *in* ABA SECTION OF ANTITRUST LAW, ISSUES IN COMPETITION POLICY (2008); Craig T. Peters, *Evaluating the Performance of Merger Simulation: Evidence from the U.S. Airline Industry*, 49 J. L. & ECON. 627 (October 2006); ABA SECTION OF ANTITRUST LAW, ECONOMETRICS: LEGAL, PRACTICAL, AND TECHNICAL ISSUES Ch. 11 (2005); Douglas D. Davis & Bart J. Wilson, *Differentiated Product Competition and the Antitrust Logit Model: an Experimental Analysis*, 57 J. ECON. BEHAVIOR & ORG. 89 (2005); Roy L. Epstein & Daniel L. Rubenfeld, *Merger Simulation: A Simplified Approach with New Applications*, 69 ANTITRUST L.J. 883 (2001), *available at* http://www.royepstein.com/ALJ_final_proof_sup.pdf; Gregory J. Werden, *Simulating Unilateral Competitive Effects from Differentiated Products Mergers*, 11 ANTITRUST 27 (Spring 1997); Gregory Werden, et al., *The Use of the Logit Model in Applied Industrial Organization*, 3 INT'L J. OF THE ECON. OF BUS. 83-105 (1996); Jerry A. Hausman, , Greg K. Leonard & J. Douglas Zona, *Competitive Analysis with Differentiated Products*, ANNALES D'ECONOMIE ET DE STATISTIQUE (1994), at pp. 159-180, *available at* http://econ-www.mit.edu/files/1017; Gregory Werden & Luke Froeb, *The Effects of Mergers in Differentiated Products Industries: Logit Demand and Merger Policy*, 10 J. L., ECON, & ORG. 407-26 (1994).

generally not sufficient to show that it predicts current margins.[65] In addition, for past periods in which there were changes in, for example, costs or demand, the model should reasonably predict the actual prices. Generally, such models would be one element used to assess the potential for unilateral effects. The Section, believes, however, given the complexities associated with the use of such models, little detailed guidance could be provided in the Guidelines as to the use of merger simulation models other than potentially to list them as one source of evidence that may used in appropriate circumstances.

h. The role of product repositioning in evaluating unilateral effects.

Comment:

Product repositioning is an important topic that should be discussed and given due weight. Product repositioning is common in markets even without the incentives that would be created by an otherwise anticompetitive merger. Moreover, such repositioning can have a large influence on the effects of a merger.[66] The Section believes that the Agencies should confirm the potential significance of repositioning in the assessment of competitive effects; this is particularly important when, as is common in many types of products, there is ongoing repositioning occurring.[67]

11. The discussion of price discrimination in the Guidelines (chiefly §1.12 and §1.22) is quite limited. Should this discussion be expanded? Specifically, please comment on the value of elaborating on the identification of "targeted buyers" and on the analysis of competitive effects in markets where prices are negotiated.

Comment:

The Section believes that more detail on how the Agencies address the potential for anticompetitive effects where price discrimination is possible would be useful as it believes that price discrimination arguments are common in the Agencies. It is important to have rigorous standards for defining price discrimination markets and determining exactly how the competitive effects within these markets would occur. It may also be useful to discuss how critical loss analysis would be employed in these cases. In particular, there may be circumstances where it is not appropriate to consider an across the board price increase, but rather one targeted at a particular set of customers. Generally this set of customers would be less price elastic and have a lower actual loss than the market as a whole (hence why it might be the target of price discrimination) but it will still be important to assess the actual loss relative to the critical loss.

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65 Gregory J. Werden, Luke M. Froeb, & David T. Scheffman, *A* Daubert *Discipline for Merger Simulation*, ANTITRUST, Summer 2004, at 89.

66 *See, e.g.*, Amit Gandhi, Luke Froeb, Steven Tschantz, & Gregory J. Werden, *Post-Merger Product Repositioning*, (Vanderbilt Univ., Working Paper, 2005).

67 The observation in the COMMENTARY (at 31) 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" expresses a skepticism about repositioning that the Section believes the Agencies should avoid in clarifying the role of repositioning in unilateral effects cases.

Moreover, an important part of the analysis is to assess how readily the targeted set of customers can be identified and differential prices can be maintained. If price discrimination is not likely to be perfect, then the actual loss may be larger as more than the targeted group would be affected.

The Guidelines should note that differences in margins (or "netbacks") across geographic areas or product or customer types are not necessarily evidence of price discrimination markets. The economics literature points out that there can be a number of reasons for price or margin differences that do not give rise to market power-based price discrimination.[68]

12. The Guidelines do not explicitly address the implications of large buyers. Merging firms commonly argue that the merged entity would not be able profitably to raise price because it will be selling to large, powerful buyers. Should the Guidelines be revised to discuss the implications of large buyers for merger analysis? For example, even if large buyers are able to negotiate more favorable terms than smaller buyers, what further evidence is required to establish that they are immune from harm due to the loss of competition resulting from the merger? Are large buyers less susceptible to non-price effects than small buyers? Even if large buyers are protected, under what circumstances should antitrust analysis attend to the interests of smaller buyers?

Comment:

The Section believes that the characteristics of buyers in a market, including the size of those buyers, should be considered in assessing the potential competitive effects of a merger. Depending upon other factors, the size of buyers can affect the likelihood that a merger will lessen competition. This is already recognized to some extent with respect to coordinated interaction in Section 2.12 of the Guidelines, which explains:

> "In certain circumstances, buyer characteristics and the nature of the procurement process may affect the incentives to deviate from terms of coordination. Buyer size alone is not the determining characteristic. Where large buyers likely would engage in long-term contracting, so that the sales covered by such contracts can be large relative to the total output of a firm in the market, firms may have the incentive to deviate [from the terms of coordination]."

The Agencies have in fact considered buyer power in analyzing transactions.[69]

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[68] DENNIS W. CARLTON & JEFFREY M. PERLOFF, MODERN INDUSTRIAL ORGANIZATION 308 (4th ed. 2005).

[69] Both speeches by agency officials and the experience of U.S. antitrust practitioners suggest the importance of buyer power in merger analysis. *See, e.g.*, Mary Lou Steptoe, The Power Buyer Defense in Merger Cases, Remarks before the ABA Section of Antitrust Law (Aug. 10, 1992); Robert Pitofsky, Thoughts on "Leveling the Playing Field," Remarks before the National Health Lawyers Association Twentieth Annual Program on Antitrust in the Health Care Field (Feb. 13, 1997); Marius Schwartz, Buyer Power Concerns and the *Aetna-Prudential Merger*, Address at the Fifth Annual Health Care Antitrust Forum (Oct. 20, 1999); *see also* Mary Lou Steptoe, *The Power-Buyer Defense in Merger Cases*, 61 ANTITRUST L.J. 493 (1993);

The Section believes that it would be beneficial to practitioners and to merging parties to receive additional guidance on how the Agencies view the significance of large buyers in assessing the competitive effects of mergers.[70] Specifically, the Guidelines should be updated to reflect that there are at least three ways that the presence of large, powerful buyers is relevant to the competitive effects analysis. First, these buyers may have the ability to sponsor entry. Second, the presence of large buyers may reduce coordinated effects by creating an incentive for suppliers to deviate from the terms of coordination. Third, large buyers may have a greater ability to resist post-merger price increases.

The European Commission has provided guidance on buyer power in its Guidelines on the Assessment of Horizontal Mergers under the Council Regulation on the Control of Concentrations between Undertakings ("EC Guidelines"),[71] and that has proven useful to parties whose transactions have been reviewed by the Commission. The same is true of the Canadian Merger Guidelines.[72]

Large buyers can constrain prices in a variety of ways, though the size of buyers must be considered in conjunction with other facts. As noted in the EC Guidelines, large buyers can "credibly threaten to resort, within a reasonable timeframe, to alternative sources of supply should the supplier decide to increase prices. ... This would be the case if the buyer could immediately switch to other suppliers, credibly threaten to vertically integrate into the upstream market or to sponsor upstream expansion or entry for instance by persuading a potential entrant to enter by committing to place large orders with this company."[73] The size of a buyer is relevant because having substantial purchase volumes may be necessary to justify a switch or make it economically feasible to vertically integrate or sponsor entry. The availability of large purchase volumes also provides a strong incentive to suppliers to deviate from the terms of coordination.

Large purchasers can exercise countervailing buyer power in other ways as well. For example, buyer power can be exercised by multi-national or multi-regional customers where they have the ability to retaliate against the merged entity by taking action in other geographic markets in which either party operates (but in which the competitive conditions may be different). Similarly, customers could withdraw or reduce their business in relation to other products (outside the relevant product market) or future products of the merged entity. Large buyers also often have the resources and sophistication necessary to track cost and price trends, analyze

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ABA SECTION OF ANTITRUST LAW, MERGERS AND ACQUISITIONS: UNDERSTANDING THE ANTITRUST ISSUES 160-63 (2d ed. 2004).

70 The Section takes no position at this time on whether additional guidance should be provided by adding a separate section about large buyers to the Guidelines or by adding discussions of large buyers to individual sections of the Guidelines.

71 Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings, 2004 O.J. (C 31) ¶¶ 64-67.

72 Canada Competition Bureau, Merger Enforcement Guidelines at ¶¶ 7.1-7.3 (Sept. 2004).

73 EC Guidelines ¶ 65.

supply alternatives, and negotiate effectively. It is often more difficult to raise prices to such buyers than it is to smaller buyers.[74]

The Section believes that the impact of large buyers needs to be assessed on a case-by-case basis. For example, where the merging parties argue that large buyers could switch to other suppliers, the Agencies should assess whether alternative suppliers have sufficient capacity to satisfy the buyers' demand. The Agencies should also consider historical evidence in assessing whether buyers are likely to be able to exercise buyer power. Evidence of buyer power includes the historical ability of strong customers to extract lower prices from suppliers or their ability to demand discounts or other more favorable conditions, which are beyond or not directly linked to cost savings. In particular, this may arise in markets where relationships between suppliers and buyers are of a long-term nature and where buyers have an intimate knowledge and understanding of the supplier's business, including its cost structure. Therefore, the Agencies should include in their examination historic evidence of price negotiations prior to the merger in order to assess whether buyers will possess the ability to resist price increases by the merging parties.

Where a market is characterized by both large and small customers, an important consideration is whether suppliers can discriminate between these groups. This is often the case where supply contracts are individually negotiated. In such markets, even if large buyers can exercise countervailing buyer power and constrain the prices of the merged entity, small buyers may remain vulnerable to a price increase. The Section believes that in such cases, the Agencies should separately assess the competitive effects of the merger on large and small buyers.[75] If suppliers are not able to discriminate between customers, then the buyer power of large customers may be sufficient to protect smaller customers from a price increase as well.

The Section notes that even though the presence of large customers and the existence of countervailing buyer power is a relevant factor in assessing competitive effects of a merger, it is not sufficient to offset the competitive effects of all mergers. Even where a buyer has monopsony power (*e.g.*, defense procurement), mergers that result in very high levels of concentration or that combine close competitors may result in unilateral or coordinated competitive effects. Any guidance provided by the Agencies should therefore make clear that the presence of large buyers is a relevant but usually not dispositive factor in the analysis.

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74 The Section notes, however, that even smaller customers can exercise buyer power. This can occur, for example, where the customer's business has unique importance to competing suppliers or where small losses in volume have a significant impact on suppliers' costs because of sensitivity to the level of capacity utilization.

75 The EC Guidelines provide that "[c]ountervailing buyer power cannot be found to sufficiently off-set potential adverse effects of a merger if it only ensures that a particular segment of customers, with particular bargaining strength, is shielded from significantly higher prices … after the merger." EC Guidelines, ¶ 67. However, the Section does not believe that buyer power should be disregarded simply because it affects only some customers. Buyer power should be considered in assessing the competitive effects of a merger on those customers that have buyer power. Depending upon the circumstances, there may be other factors that inform an analysis of competitive effects relating to customers that do not have buyer power. For example, smaller customers might not view the merger parties as particularly close substitutes or might have other alternatives available. In particular, smaller customers may be able to buy from fringe suppliers that are not a viable alternative for larger buyers.

13. *The Guidelines distinguish between uncommitted and committed entry. Uncommitted entrants (§1.32) are treated as market participants and can be assigned positive market shares. Committed entrants (§3.0) are not. How useful in practice is the distinction between uncommitted and committed entry? How should the market presence of uncommitted entrants be measured?*

Comment:

The Section does not believe that the distinction between uncommitted and committed entry is a useful one in practice, largely because an analysis of uncommitted entrants as contemplated by the Guidelines is rarely, if ever, undertaken. The Section believes that the Guidelines should be revised so that they more accurately describe Agency practice. The Agency practice appears to focus, appropriately, on whether firms not currently supplying the product at issue are likely to enter in the event of a SSNIP with sufficient force and speed to counter the potential for an anticompetitive effect from the transaction. The largely artificial and potentially confusing separation of the analysis between "uncommitted entrants" that are given market shares and "committed entrants" that are analyzed under the entry rubric is not helpful. Indeed, under the integrated analysis that the Agencies currently undertake, it makes more sense to consolidate the analysis of potential supply responses in a single section.

To the extent that the debate over the distinction between uncommitted and committed entry is a proxy for a discussion regarding how supply responses should be measured when determining the boundaries of the relevant market, the Section believes some consideration should be given to revising the Guidelines to provide further guidance on the subject to courts and practitioners. Some have suggested that the Guidelines be revised to expressly state that supply substitution, and not just demand substitution, is taken into account when the Agencies define the relevant market, and not only when determining the participants in that market or analyzing the likelihood of entry. For example, the European Commission's market definition guidelines explicitly take supply substitution into account in this way.[76] Others have argued that consideration of both demand and supply substitution during the market definition stage could be confusing and difficult because, among other things, the supply substitution analysis may actually depend upon the demand substitution analysis under certain circumstances.[77]

The Section believes that both demand and supply substitution should be considered when the Agencies define a relevant market and the Guidelines should be revised to provide additional guidance to courts and practitioners regarding how supply substitution analysis should be applied.

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76 *See* "Commission Notice on the definition of relevant market for the purposes of Community competition law," Official Journal C 372, 09/12/1997 P. 0005–0013, ¶¶ 20-23 (1997) (*available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31997Y1209(01):EN:HTML) ("Supply-side substitutability may also be taken into account when defining markets in those situations in which its effects are equivalent to those of demand substitution in terms of effectiveness and immediacy.").

77 *See* Jonathan B. Baker, *Market Definition: An Analytical Overview*, 74 ANTITRUST L.J. 129 (2007).

14. The Guidelines ask (§4) whether cognizable efficiencies are sufficient to reverse the merger's potential to raise price. In making this determination, the Guidelines distinguish between fixed and marginal costs, with savings in marginal costs more likely to influence price. Should the Guidelines be updated to state that any cognizable cost reductions are relevant to the extent that they are likely to generate benefits for customers in the foreseeable future? Who should bear the burden of making this showing?

Comment:

It is clear that both Agencies treat fixed cost savings that may lead to lower prices in the short term, or which may benefit consumers in the long term, as relevant to their competitive effects analysis. As noted in the Commentary, 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."[78] The Commentary also observes that "under certain market or sales circumstances, fixed-cost savings may result in lower prices in the short term."[79] One example included in the Commentary involves "[s]elling prices that are determined on a 'cost-plus basis' (*e.g.*, cost-based contracts)," which "can be influenced by changes in fixed costs."[80] Another example in the Commentary acknowledges that contractual arrangements may require fixed-cost savings to be passed through to the customer.[81]

This greater receptivity to fixed costs is echoed by the Report of the Antitrust Modernization Commission (AMC), which asserts that the FTC and DOJ "should account for the value of fixed-cost efficiencies in assessing the likely competitive effects of a merger."[82] The AMC Report cites with approval a commenter who observed that "[s]ince all costs vary in the long run, reductions in capital expenses or other costs fixed in the short run should also be considered."[83] The AMC Report warns that "failure to take account of and give proper weight to such fixed costs in evaluating a merger could deprive consumers and the U.S. economy of significant benefits from a procompetitive merger."[84]

To reflect the actual practice of the Agencies, the evolution of economic learning, and the recommendation of the AMC, the Section therefore recommends that the Merger Guidelines be revised (1) to acknowledge (in accordance with the Commentary) that fixed cost savings may result in lower prices in the short term; and (2) to state that the Agencies will consider as cognizable those fixed cost savings that are likely to result in long term benefits to consumers, with the weight accorded to projections or claims of fixed cost savings dependent on, among other things, the relative level of certainty that those savings will be achieved, and the timeframe

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78 COMMENTARY at 58.
79 *Id.*
80 *Id.*
81 *Id.*
82 *See* ANTITRUST MODERNIZATION COMM'N, REPORT AND RECOMMENDATIONS 58 (2007) [hereinafter AMC REPORT].
83 *Id.*
84 *Id.*

within which those savings are projected to be achieved.[85] Moreover, the Section recommends that the Agencies revise or delete footnote 37 of the Merger Guidelines, which in its current iteration is inconsistent with the suggested text.[86]

These changes would insure that the Guidelines more accurately reflect the current practice of the Agencies, and therefore promote transparency. In addition, the proposed changes would increase the uniformity of efficiencies analysis within and across the Agencies. Finally, the proposed changes would indicate to the courts that fixed cost efficiency claims are (and should be) treated seriously and may be a significant factor in determining the competitive effects of a transaction.

Burden

The Agencies have asked who should bear the burden of demonstrating the certainty, timeframe, and likely effect of fixed cost savings. Section 4 of the Merger Guidelines correctly notes that "much of the information relating to efficiencies is uniquely in the possession of the merging firms;" thus, it is appropriate to continue placing upon merging parties the burden of demonstrating these efficiencies. But, it is important the Agencies clarify the evidentiary burden the merging parties must meet to show that fixed cost savings (and other efficiency claims) are cognizable. We believe the Agencies apply a lower certainty threshold to their determination of the likelihood of anticompetitive effects post-merger than they impose on the parties regarding the likelihood of procompetitive effects.[87] The Section respectfully suggests that the Guidelines make clear that the levels of proof required to demonstrate anticompetitive effects and cognizable efficiencies are symmetrical. If they are not, the Agencies should explain the rationales for the asymmetry.

It is appropriate to require the merging parties to satisfy the standards of merger specificity, substantiation, and verification for claims regarding fixed cost savings.[88] The Guidelines should make clear that substantial weight is accorded to evidence that one or both of the merging parties have achieved similar types of cost savings in the past.

Pass-On

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85 *See, e.g.*, Gary L. Roberts & Steven C. Salop, *Efficiencies in Dynamic Merger Analysis*, 19 WORLD COMPETITION L. & ECON. REV. 5 (1996) (noting that "[a]pplication of an appropriate discount rate to future time periods would ensure that greater weight is given to relatively more certain, short-run effects").

86 Footnote 37 of the Guidelines states that "The result of this analysis over the short term will determine the Agency's enforcement decision in most cases. The Agency also will consider the effects of cognizable efficiencies with no short-term, direct effect on prices in the relevant market. Delayed benefits from efficiencies (due to delay in the achievement of, or the realization of consumer benefits from, the efficiencies) will be given less weight because they are less proximate and more difficult to predict."

87 This asymmetry may result from the Agencies' lingering skepticism regarding the extent to which merging parties are able to achieve projected efficiencies. *See generally* Proceedings of the FTC Roundtable on "Understanding Mergers: Strategy & Planning, Implementation and Outcomes" (December 9-10, 2002).

88 *See* COMMENTARY at 58 ("As with any other type of efficiency, reductions in fixed costs must be substantiated by the parties and verified by reasonable means").

As the Section observed in comments filed with the Antitrust Modernization Commission,[89] the Merger Guidelines contemplate a pass-on analysis[90] but is silent concerning the analysis employed by the Agencies. The Section recommends that the Agencies identify the evidentiary factors used to determine the likelihood, rate, and extent of pass-on. Because there is confusion over whether and to what extent (if any) a merger will lessen or eliminate a firm's incentive to pass on cost reductions (particularly marginal cost reductions),[91] the Section recommends that the Agencies correct the fallacy that a firm's incentive to pass-on merger-specific efficiencies is positively correlated to the number of post-merger competitors. Any revised Guidelines should include a presumption—well supported by the economic literature—that merger-specific marginal cost-savings will, at least in part, be passed on to consumers.[92] The Agencies may overcome this presumption by showing that the merging parties do not have, or are unlikely to have post-merger, a downward sloping demand curve.

Improved Products

The Section also reiterates its suggestion to the Antitrust Modernization Commission[93] that the Guidelines be revised to provide greater clarity regarding the Agencies' consideration of the consumer welfare effects of merger-induced improvements to existing products. There may be instances in which a merger will reduce competition in the sale of one product, but will enhance (or create the ability or incentive to enhance) existing products. Consumer (and total) welfare may be substantially increased where the improved product replaces the older product, even where the improved product is only available at a higher price. In such situations, the Agencies must balance the welfare effects on those users who are able to switch to (or simply prefer) the improved product with those users who are not able (or would prefer not) to switch.

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89 *See* American Bar Association, Section of Antitrust Law, Comments Regarding the Role of Efficiencies in Merger Enforcement, submitted to the Antitrust Modernization Commission (Nov. 10, 2005), at 4.

90 *See* GUIDELINES § 4 (requiring substantiation of "how each [asserted efficiency] would enhance the merged firm's ability and incentive to compete" and stating that "the Agency considers whether cognizable efficiencies likely would be sufficient to reverse the merger's potential to harm consumers in the relevant market, e.g., by preventing price increases in that market").

91 *Compare* HORIZONTAL MERGER GUIDELINES OF THE NATIONAL ASSOCIATION OF ATTORNEYS GENERAL (1993) § 2, *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,406 ("to the extent that a merger increases market power, there is less likelihood that any productive efficiencies would be passed on to consumers"), *available at* http://www.naag.org/assets/files/pdf/at-hmerger_guidelines.pdf, *and* EC Guidelines ¶ 84 ("the incentive on the part of the merged entity to pass efficiency gains on to consumers is often related to the existence of competitive pressure from the remaining firms in the market") *with* Michael Vita & Paul Yde's, *Merger Efficiencies and Pass-Through Analysis* (comment to the Antitrust Modernization Commission) *available at* http://govinfo.library.unt.edu/amc/public_studies_fr28902/merger_pdf/060316_Vita_Yde.pdf ("the extent to which a firm passes on firm-specific marginal cost reductions is determined by the shape of the demand curve it faces and that the pass through rate … is directly related to the merged firm's market power.") and authorities collected within.

92 *See, e.g.*, Jerry A. Hausman & Gregory K. Leonard, *Efficiencies from the Consumer Viewpoint*, 7 GEO. MASON L. REV. 707 (1999) (economic theory predicts that even a monopolist will pass on cost savings obtained as a result of a merger); Paul L. Yde & Michael G. Vita, *Merger Efficiencies: Reconsidering the "Passing-On" Requirement*, 64 ANTITRUST L J. 735, 736 (1996) ("A reduction in marginal cost invariably increases the firm's incentive to expand output. If the firm faces a downward sloping, firm-specific demand curve … then the firm also will reduce its price.")

93 *See* American Bar Association, Section of Antitrust Law, Comments Regarding the Role of Efficiencies in Merger Enforcement, submitted to the Antitrust Modernization Commission (Nov. 10, 2005), at 4.

The Guidelines should confirm that the disappearance of the older product is not sufficient competitive harm to violate Section 7. In addition, the Agencies should provide guidance on how these conflicting welfare effects will be analyzed and weighed.

15. Should the Guidelines be updated to address more explicitly the non-price effects of mergers, especially the effects of mergers on innovation?

Comment:

Former FTC Chairman Majoras observed that "competition's role in spurring innovation … has secured a central position in antitrust analysis . . . . Not so long ago, antitrust largely focused only on static efficiencies. The learning of recent decades, however, has made it clear that a broader lens, reaching issues of innovation and progress over time, is essential. Today, we care enormously about innovation and the competitive forces that drive it."[94]

Chairman Majoras' statement reflects the broad consensus that innovation is a significant engine of economic growth.[95] In its submission to the OECD in connection with the Roundtable on Dynamic Efficiencies, for example, the United States observed that "[r]esearch and development by individual firms, especially basic research, has contributed significantly to increases in their productivity, and at the macro level, technical progress has been estimated to have accounted for as much as three-quarters of the economic growth in major industrialized countries."[96] Similarly, the AMC observed that "there is 'broad agreement . . . that research and development is a major source of economic growth.'"[97]

Consensus also exists concerning the substantial benefits that innovation generates for consumers. The Commentary states, for example, that mergers "may lead to increased innovation that results in lower costs and prices or in more rapid introduction of new products that benefit consumers."[98] Similarly, the United States noted in its OECD submission that

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94 Deborah Platt Majoras, Chairman, Fed. Trade Comm'n, Welcoming Remarks for the Patent Reform Conference (June 9, 2005), at 3, *available at* http://www.ftc.gov/speeches/majoras/050609comppolicy.pdf.

95 In this response, the Section uses the term "innovation" interchangeably with dynamic, rather than static, efficiencies. Static efficiencies result from enhancing existing products and capabilities, while dynamic efficiencies result from developing new ways of doing business. Joseph Schumpeter described dynamic efficiency as "competition from the new commodity, the new technology, the new source of supply, the new organization . . . competition which commands a decisive cost or quality advantage and which strikes not at the margins of the profits and the outputs of the existing firms but at their foundations and their very lives." JOSEPH SCHUMPETER, CAPITALISM, SOCIALISM AND DEMOCRACY 84 (1942).
While the 1992 Merger Guidelines provide detail regarding the analysis of static efficiencies, whether and to what extent the Agencies analyze the impact of proposed mergers on dynamic efficiencies is less clear. One complicating factor may be the failure (on the part of both the bar and the Agencies) to distinguish rigorously between a merger's effect on innovation and its effect on participation in markets for future goods.

96 *See* Note by the United States submitted in connection with the OECD Roundtable on Dynamic Efficiencies (May 22, 2007).

97 AMC REPORT at 59 (citations omitted).

98 COMMENTARY at 49.

"dynamic efficiencies … are important in the formulation and implementation of competition policy … because they contribute greatly to consumer welfare."[99]

Given the importance of innovation to both economic growth and consumer welfare, it is critical for the agencies to consider the impact on innovation that proposed mergers may have. As the AMC observed, "As the nation's economy moves toward an increasing role for goods and services involving intellectual property . . . it becomes even more important for U.S. consumers that the value of efficiencies and innovation that can result from mergers in such industries be realized where possible. A failure by the agencies to take into account fully the benefit of such efficiencies in evaluating whether a merger will harm or benefit consumers could deprive consumers of significant benefits and value."[100]

As written, however, the Merger Guidelines currently do not provide an analytical framework for evaluating innovation claims or concerns. Similarly, there have been few Agency statements on how innovation issues are incorporated into the Guidelines' competitive effects analysis, and few enforcement actions driven by innovation concerns.[101] Because innovation is a "central" concern of the Agencies, more guidance on the factors that drive the evaluation of an innovation concern or claim is both necessary and consistent with the Agencies' commitment to transparency.

The AMC made several recommendations regarding the manner in which innovation should be evaluated by the agencies within the merger context. First, the AMC recommended that the Agencies "should give substantial weight to evidence demonstrating that a merger will enhance consumer welfare by enabling the companies to increase innovation,"[102] and that the Agencies should be flexible in adjusting the two-year time horizon for entry to account for innovation that may change competitive conditions.[103] In addition, the AMC recommended that "the agencies and courts should give greater credit for certain fixed-cost efficiencies, such as research and development expenses, in dynamic, innovation-driven industries where marginal costs are low relative to typical prices."[104] Moreover, the AMC recommended that the Agencies "should ensure that merger enforcement policy is appropriately sensitive to the needs of companies to innovate and obtain the scope and scale needed to compete effectively in domestic and global markets, while continuing to protect the interests of U.S. consumers."[105] Other commentators have suggested that it is important to consider the potential for diffusion of

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99 *See* Note by the United States submitted in connection with the OECD Roundtable on Dynamic Efficiencies (May 22, 2007).

100 AMC REPORT at 59.

101 There are a number of pharmaceutical consent orders that seek relief for products not yet on the market; those challenges generally involved the elimination of potential competitors, or the elimination of a competitor in a market for a future goods, and do not focus on the effect of the merger on innovation. The Agencies and the existing Merger Guidelines handle this inquiry reasonably well because of the highly regulated nature of the pharmaceutical industry. While there may be substantial uncertainty regarding the use and efficacy of the product, and whether it ultimately will be approved by the FDA, it is frequently easy to determine the uses for which the product is being developed, the timing of potential FDA approval, and the identities of existing and pipeline products that may offer competition.

102 AMC REPORT at 10.

103 *Id.*.

104 *Id.*

105 *Id.*

claimed efficiencies; the faster a process or technology is diffused among industry producers (and producers in other industries), the greater the economy-wide resource savings brought about by the innovation.[106] The Section recommends that the foregoing principles be incorporated into the Guidelines.

In addition, because of the importance of innovation to economic growth, the Guidelines should make clear that innovation effects may, in appropriate cases, be of significant importance to the Agencies' competitive effects analysis. At this time, however, the Section urges the Agencies to refrain from incorporating into the Guidelines any presumptions about how a merger may affect the incentives or ability of the combined firm (or its remaining competitors) to engage in innovation. As former FTC Chairman Muris recognized in his analysis of Genzyme's acquisition of Novazyme, there does not exist today a widely accepted framework for evaluating a merger's effect on innovation.[107] Because economic theoretical and empirical work has not found a conclusive relationship between concentration levels and the pace of innovation, presumptions are inappropriate. For this reason, the Guidelines should make clear that innovation inquiries must be factually intensive, and will conducted on a case-by-case basis. This clarification would be consistent both with Agency practice and the economic literature.

As noted in the response to Question 14, the Section also reiterates its suggestion to the Antitrust Modernization Commission[108] that the Guidelines be revised to provide greater clarity regarding the Agencies' consideration of the consumer welfare effects of merger-induced improvements to existing products. In some instances, a merger may produce increases in product quality that may increase consumer welfare, on balance, even if the merger also would have a price effect. For example, in a two-sided market, a merger may enhance quality on one side of the market that offsets a nominal price increase on the other side of the market because, on a quality-adjusted basis, the benefits to platform users increase substantially. As currently written, the Merger Guidelines do not seem to allow for this possibility. The Guidelines should clarify that changes in quality (whether up or down) will be modeled or estimated and considered

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[106] *See, e.g.*, Gary L. Roberts & Steven C. Salop, *Efficiencies in Dynamic Merger Analysis*, 19 WORLD COMPETITION L. & ECON. REV. 5 (1996).

[107] Statement of Chairman Timothy J. Muris in the matter of Genzyme Corporation / Novazyme Pharmaceuticals, Inc. at 2-3, *available at* http://www2.ftc.gov/os/2004/01/murisgenzymestmt.pdf (hereinafter "Muris Genzyme Statement"). FTC Chairman Muris relied heavily on the Pitofsky Commission's 1996 Report, *Anticipating the 21st Century: Competition Policy in the New High-Tech, Global Marketplace*, in observing that "the Commission properly has been cautious in using innovation market analysis." The 1996 Report "acknowledged that 'economic theory and empirical investigations have not established a general causal relationship between innovation and competition.'" Id. at 2-3. Consequently, both the 1996 Report and Chairman Muris suggested that a "careful, intense factual investigation is necessary" to "distinguish between procompetitive and anticompetitive combinations of innovation efforts" even though "there are a number of theoretical models that suggest [ ] a monopolist may have a disincentive to invest in research and development." Id. at 3-5. Commissioner Tom Rosch has also recently recognized that "there is not yet a universally accepted consensus as to the kind of market structure that best facilitates innovation." J. Thomas Rosch, Commissioner, Fed. Trade Comm'n, Antitrust Regulation of Innovation Markets, Remarks before the ABA Antitrust Intellectual Property Conference, Berkeley, CA (Feb. 5, 2009), at 10, *available at* http://www2.ftc.gov/speeches/rosch/090205innovationspeech.pdf.

[108] *See* American Bar Association, Section of Antitrust Law, Comments Regarding the Role of Efficiencies in Merger Enforcement, submitted to the Antitrust Modernization Commission (Nov. 10, 2005), at 4.

while conducting the competitive effects analysis in appropriate cases. In addition, the Guidelines should provide guidance on how the Agencies will analyze and weigh these welfare effects.

16. *Should the Guidelines be updated to address acquisitions involving minority interests?*

Comment:

Over the past several years, the Agencies have brought numerous cases involving acquisitions of minority interests.[109] In light of the frequency with which the Agencies are bringing such cases, the Section believes that it would be useful if the Guidelines included a short section addressing the different types of competitive concerns potentially arising from acquisitions of minority interests.

There are three general theories of competitive harm relating to a company's acquisition of minority interests in a competitor:[110]

1. *Ability to influence management or limit management's options.* Even when the acquisition of a minority interest does not confer direct control, it is possible that a competitor's acquisition of the minority interest would facilitate some degree of influence over the competitor's management. For example, as a significant, albeit non-controlling, shareholder in a company, it is likely that the company's management would listen carefully to the interests and concerns of such significant shareholders, particularly if other shareholders are much more diffuse. Alternatively, even if the circumstances are not conducive to the minority interest holder's ability to influence the actions of the company's management, the minority interest may enable the holder to exercise negative control over some management decisions, such as raising capital through a share issuance, or other corporate actions requiring shareholder consent.

2. *Access to competitively sensitive information.* The acquisition of a minority interest may facilitate access to a competitor's competitively sensitive information. This may need to be addressed through the use of firewalls or similar mechanisms.

3. *Entirely passive minority interests may nevertheless harm competition by changing incentives.* Even with an entirely passive minority interest with no degree of control over the competitor's management, the transaction nevertheless may change the incentives of the acquirer to compete with the competitor. For example, after acquiring a minority

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109 Ilene Knable Gotts & Franco Castelli, *Special Antitrust Issues Raised By Private Equity Minority Investments*, THE THRESHOLD 10-13 (Summer 2008) (identifying seven minority interest cases brought by the Agencies in the past few years).

110 *See, e.g.*, Steven C. Salop & Daniel P. O'Brien, *Competitive Effects of Partial Ownership: Financial Interest and Corporate Control*, 67 ANTITRUST L.J. 559-614 (2000); Jon B. Dubrow, *Challenging the Economic Incentives Analysis of Competitive Effects in Acquisitions of Passive Minority Equity Interests*, 69 ANTITRUST L.J. 113 (2001); Steven C. Salop & Daniel P. O'Brien, *The Competitive Effects of Passive Minority Equity Interests: Reply*, 69 ANTITRUST L.J. 611-625 (2001); Ilene Knable Gotts & Franco Castelli, *Special Antitrust Issues Raised By Private Equity Minority Investments*, THE THRESHOLD 3 (Summer 2008).

interest in Company B, Company A may have a lesser incentive to compete vigorously against Company B, because Company A could re-capture through its minority interest some of the sales that otherwise would have been diverted to Company B. In other words, Company A may be able to implement successfully a price increase on its own products that previously would not have been profitable, because a sufficient amount of the diverted sales will go from Company A to Company B. The more challenging part of this theory is that it relies on the assumption that Company A can easily realize the profits attributable to increased sales achieved by Company B after Company A's price increase. Because in many instances such benefits may only be realized indirectly over the long term through dividends or increased share prices, it may be difficult for Company A to justify sacrificing an immediate drop in sales and profits in exchange for the prospect of indirectly benefiting some time in the future from the price increase through its minority interest in Company B.

Moreover, minority acquisitions of assets may require different analysis than minority acquisitions of companies. For example, in the pharmaceutical industry, it is common to acquire a revenue stream for certain pharmaceutical products. Similarly, in the energy industry, it is common to acquire an undivided interest in pipelines. If the Agencies anticipate analyzing such acquisitions differently, then they should clarify their position on this issue in the revised Guidelines.[111]

17. Should Section 5 of the Guidelines, "Failure and Exiting Assets," be revised?

Comment:

In the United States, this provision has had little practical effect because of the difficult (and strictly applied) standards contained in the Guidelines. The Agencies and the courts have applied the failing firm defense narrowly, particularly when analyzing the likelihood of failure and/or reorganization and competitive-preferable purchasers. In light of this experience and the recent focus on this issue because of the financial crisis, it may be appropriate to review actual transactions in which the defense was denied and analyze subsequent outcomes to determine the resulting competitive effect.

If the Agencies elect to revise this Section on "Failure and Exiting Assets," the focus, as the title correctly reflects, should be on the requirement that the assets inevitably would exit the market in the near future in the absence of the transaction. To address this point, possible revisions to the Guidelines might be considered, including: (1) eliminating the reorganization requirement; (2) clarifying what firms must do to satisfy the competitive-preferable purchaser requirement; (3) creating an "expedited" failing firm review for mergers facilitated or mandated

[111] As indicated in its response to Question 18, the Section generally does not believe it would be appropriate to address remedies within the Guidelines. To the extent that remedies will be addressed in the Guidelines, the Section believes that it would be helpful for the Agencies to clarify that behavioral remedies, such as fire-walls, non-voting interests, etc., can be used to address concerns arising from the acquisitions of minority interests. Alternatively, the Agencies could clarify this issue in the joint publication on remedies proposed in the Section's response to Question 18.

by the government; (4) allowing greater consideration of the probability of assets exiting the market and the speed with which that might happen; and (5) relaxing the failing firm defense for transactions in failing industries or industries where capital is scarce. In addition, the Agencies may want to expand on the kind of evidence that might be appropriate in reviewing failing firm and failing division defenses.[112]

In some cases, even where a firm or division might reorganize or otherwise continue in operation, the assets might be so constrained (for example in terms of investments in maintaining their productive capacity) as to limit their competitiveness or even constitute a likely gradual exit from the market. Even if such circumstances fall short of satisfying the failing firm or failing division defense, the financial distress of market participants should be considered in evaluating the competitive effects of a transaction. There may be cases where the firm or division being acquired is in such financial distress that this is most appropriately considered when evaluating its likely near-term competitive significance is greatly reduced. Similarly, output levels might be higher with the acquisition than with the acquired firm or division continuing independently. In both cases, these factors could be considered as part of the competitive effects analysis.

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

a. The overall goal of protecting customers by preserving pre-merger levels of competition.

b. The relationship between the remedy and adverse competitive effects.

c. The shortcomings of behavioral remedies in horizontal merger cases.

Comment:

The Section recommends against broad expansion of the Guidelines to address extensively the numerous factors involved in a merger remedies analysis. However, the Section recommends that the Agencies work together to issue a joint statement to complement the Guidelines.

A joint publication (in addition to speeches, investigation closing statements, and complaints) is well-suited for elaboration on the fact-specific nature of remedies. While the Guidelines should make reference (perhaps in the competitive effects section) to the fact that the Agencies will consider remedies that address the competitive harm identified,[113] to address meaningfully remedies in the context of the Horizontal Merger Guideline would require the

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112 The U.K. Competition Commission/OFT's recently released draft Merger Assessment Guidelines (April 2009) contain a thoughtful discussion of failing firm claims. Expanding the Guidelines along these lines might be beneficial.

113 For example, the Section believes that the Agencies should acknowledge that in the case of minority acquisitions, certain behavioral remedies narrowly focused on the competitive harm at issue may be appropriate.

addition of a large new section to the Guidelines. The Guidelines generally do not address the fact-specific iterative process between the Agencies and merging parties that is a necessary part of any remedy analysis. The addition of a remedies section may suggest the need for other revisions so that the Guidelines consistently address the nature of that iterative process.

Much has been written about merger remedies. The Agencies themselves have each issued unique materials to assist in the analysis of merger remedies. In 2003, the FTC published a "Statement of the Federal Trade Commission's Bureau of Competition on Negotiating Merger Remedies."[114] In October 2004, the DOJ published the "Antitrust Division Policy Guide to Merger Remedies."[115] These materials have been helpful to provide clarification on the process of negotiating remedies with each agency. Nonetheless, the Section believes that a joint statement from both Agencies would harmonize remedies policies and enhance predictability for businesses and the bar.

The Section recommends that prior to issuing a joint statement, the Agencies gather more and better information on how well particular remedies work and strive to improve the remedy processes. The FTC and the DOJ should consult with each other to identify and implement remedies that work well and practices that enable the staff to be flexible and timely on remedies. The FTC and DOJ should also work to develop a process to increase transparency and consistency between the agencies on remedies. Moreover, as the Antitrust Modernization Commission recognized, the DOJ and FTC should work with the states to "consider on a continuing basis how best to avoid seeking or imposing inconsistent remedies."[116] Finally, the Agencies should consult with international enforcers, because as Assistant Attorney General Christine Varney has recently recognized, "enforcement actions increasingly have an impact beyond the borders of our respective jurisdictions" and "substantial divergence in remedial approaches risks inconsistent results that may undermine one or more jurisdictions' enforcement, and may also frustrate a firm's good faith efforts to comply."[117]

19. Should the Guidelines include illustrative examples? If so, which aspects of the current or revised Guidelines would benefit from the inclusion of examples? Would real-world examples or hypothetical examples be more valuable? Would the inclusion of examples risk undue reliance on them and, if so, what caveats should be provided?

Comment:

Although hypothetical examples have been used in other agency guidelines,[118] the Section believes that illustrative examples in the Guidelines should only be used in limited

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114 http://www.ftc.gov/bc/bestpractices/bestpractices030401.htm.

115 http://www.usdoj.gov/atr/public/guidelines/205108.htm.

116 Antitrust Modernization Commission, Report and Recommendations, at 196 (April 2007).

117 Christine A. Varney, Ass't Attorney Gen., Antitrust Div., U.S. Dep't of Justice, Out Progress Toward International Convergence, Remarks as Prepared for the 36th Annual Fordham Competition Law Institute Annual Conference on International Antitrust Law and Policy (Sept. 24, 2009), *available at* http://www.usdoj.gov/atr/public/speeches/250264.htm.

118 *See, e.g.*, U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST GUIDELINES FOR COLLABORATIONS AMONG COMPETITORS (2000), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,161, *available at*

circumstances and should not take the place of other ways the agencies have used to explain their enforcement decisions.

The Section has reservations with respect to the use of illustrative real-world examples as appropriate to the purposes of revised Guidelines. Because individual transactions each involve unique facts that influence both the application of the Guidelines analysis and the manner in which the agency applies its enforcement discretion, reference to real-world examples could potentially interfere with the clarity and utility of the Guidelines. Certain of the unique facts associated with individual transactions can lose relevance over time as markets change, and many important facts must remain confidential. Thus, there is some question whether real-world examples would provide useful guidance over the life of the Guidelines. Moreover, in practice, one would expect that the individual elements of the Guidelines analysis will necessarily be weighted differently to fit the varying competitive dynamics of distinct markets that are affected by a given transaction. Readers of the Guidelines therefore may find it difficult to draw inferences from agency action in one market that are useful to analysis of transactions in unrelated markets, unless the examples are accompanied by a commentary which could distract from the general thrust of the Guidelines.

The Section suggests that if the Guidelines include real-world examples, it would be appropriate to explain that they are being provided for illustrative purposes only. The Guidelines should indicate that any such real-world examples have no precedential value with respect to future transactions. Rather, each new transaction, even those that appear to affect the same markets implicated in the illustrative examples, will be subjected to a fact-specific analysis which may result in different outcomes.

The Section believes that transparency of the merger review process might be better achieved through (a) expanded use of Closing Statements in significant investigations, (b) provision of explicit discussion in DOJ Competitive Impact Statements and FTC Analyses to Aid Public Comment to explain how the Guidelines were applied in a specific transaction, and (c) issuance of an update or supplement to the 2006 Merger Review Commentary. The Section believes that each of these formats offers an important opportunity to assist business people and practitioners to deepen their understanding of the ongoing merger review process. Such enhanced understanding can lead to more efficient merger review to the extent it enables practitioners to be more proactive in the presentation of information to the Agencies. The Section therefore urges the Agencies to devote resources to ensure regular and robust use of these mechanisms to provide insight into new developments in merger review.

20. Should the Guidelines be revised to reflect learning based on merger retrospective studies?

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http://www.ftc.gov/os/2000/04/ftcdojguidelines.pdf; U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST GUIDELINES FOR THE LICENSING OF INTELLECTUAL PROPERTY (1995), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,132, *available at* http://www.ftc.gov/bc/0558.pdf; U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, STATEMENTS OF ANTITRUST ENFORCEMENT POLICY IN HEALTH CARE (1996), *available at* http://www.ftc.gov/bc/healthcare/industryguide/policy/hlth3s.pdf.

Comment:

The Section believes that the Guidelines should reflect learning from whatever the source, including merger retrospective studies. The Section commends the Agencies for the retrospective studies that have been, and are being undertaken by them. The Section recommended in its Transition Report issued in November 2008 that the Agencies "select a sample of prior merger decisions and assess whether subsequent developments in the markets involved justified the decisions."[119] In the event that retrospective studies result in meaningful information concerning the accuracy of the Guidelines in identifying mergers or acquisitions that will reduce competition, the Agencies should use such information in any contemplated revision of the Guidelines. At the current time, however, the Section is unaware of specific learning from retrospective studies that should be incorporated into the Guidelines. Furthermore, due to the inherent difficulties in designing and undertaking a meaningful retrospective studies, the Section believes that the Agencies resources would be better served at the present time in concentrating its efforts in other areas of its enforcement priorities.[120] The Section does believe that a review of developments in markets impacted by merger enforcement decisions could shed light on the accuracy of the current Guidelines in identifying potentially anticompetitive mergers.

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119 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.

120 Numerous commentators have noted the limitations and potential pitfalls of using retrospective studies in assessing the Agencies' performance. *See, e.g.*, Dennis Carlton, Deputy Ass't Attorney Gen., Antitrust Div., U.S. Dept. of Justice, The Need to Measure the Effect of Merger Policy and How to Do It (Dec. 2007), *available at*, http://www.usdoj.gov/atr/public/eag/228687.pdf; Thomas O. Barnett, Ass't Attorney Gen., Antitrust Div., U.S. Dep't of Justice, Current Issues in Merger Enforcement: Thoughts on Theory, Litigation Practice, and Retrospectives, Lewis Bernstein Memorial Lecture (June 26, 2008) (discussing the Whirlpool/ Maytag merger), *available at* http://www.usdoj.gov/atr/public/speeches/234537.pdf. As the FTC noted in its self-assessment from January this year "it can be hard to devise controls for the counterfactual ('but for') world for allowed and blocked mergers, which can affect the inferences that can be drawn from merger retrospectives." FEDERAL TRADE COMMISSION, THE FEDERAL TRADE COMMISSION AT 100: INTO OUR SECOND CENTURY 150 (2009), *available at* http://www.ftc.gov/os/2009/01/ftc100rpt.pdf.