

Through the Looking Glass: Ruminations on Improving the Current U.S. Merger Enforcement Guidelines

By Ilene Knable Gotts and Étienne Renaudeau

“Now, *here*, you see, it takes all the running you can do, to keep in the same place. If you want to get somewhere else, you must run at least twice as fast as that!”

—Red Queen, *Through the Looking Glass*, by Lewis Carroll

The time has arrived for the U.S. agencies to re-examine their merger enforcement guidelines to ensure that they are not misleading and remain the gold standard model for other jurisdictions. This article discusses numerous areas in which the current U.S. merger enforcement guidelines (MEGs)¹ might be revised. In addition, the article considers the advantages and disadvantages of revising the MEGs, alternatives to issuing new MEGs, and some procedural considerations for developing new MEGs.

■ **Ilene Gotts** is a partner in the New York law firm of Wachtell, Lipton, Rosen & Katz and currently the Chair-Elect of the ABA Section of Antitrust Law.

Étienne Renaudeau is an associate in the law firm of Darrois Villey Maillot Brochier (Paris). The views expressed herein are not to be attributed to their law firms, clients, or to the ABA Section of Antitrust Law. The authors are grateful for the input of Dennis W. Carlton, Andrew R. Dick, James W. Lowe, Ramsey Shehadeh, Scott A. Sher, and Gian Luca Zampa, and to Margaret F. Sanderson for Canadian precedent.

Substantive Areas in Which MEGs May Not Reflect State-of-the-Art Analysis

With the exception of the efficiencies section, it has been more than twenty-five years since the U.S. Department of Justice and the Federal Trade Commission issued MEGs. Moreover, the last update, in 1992, concerned horizontal transactions only; the agencies left intact the 1984 Guidelines’ analysis applicable to vertical and conglomerate transactions and potential competition theories.²

The MEGs have become widely accepted by courts³ and competition authorities throughout the world. Indeed, since the 1980s, over 50 percent of U.S. merger decisions have cited and relied upon the analytical framework contained in the MEGs. Since 1992, other mature competition authorities have issued one set, and in some cases, multiple generations, of guidelines that in many respects adopt the concepts found in the MEGs.⁴ In contrast, rather than issuing new

¹ Fed. Trade Comm’n & U.S. Dept. of Justice, Horizontal Merger Guidelines (1992, revised 1997) [hereinafter MEGs], available at <http://www.ftc.gov/bc/docs/hmg080617.pdf>.

² U.S. Dep’t of Justice, Non-Horizontal Merger Guidelines (1984) [hereinafter 1984 Guidelines], available at <http://www.usdoj.gov/atr/public/guidelines/2614.pdf>.

³ See, e.g., *United States v. Oracle Corp.*, 331 F. Supp. 2d 1098, 1108, 1111–13, 1117, 1122–23 (N.D. Cal. 2004); *FTC v. Whole Foods Market, Inc.*, 548 F.3d 1028, 1037–38 (D.C. Cir. 2008); see also James F. Riill & Christopher J. MacAvoy, Written Statement Concerning Antitrust Merger Enforcement Before the Antitrust Modernization Commission 3–5 (Oct. 31, 2005), available at http://govinfo.library.unt.edu/amc/commission_hearings/pdf/Riill_Statement.pdf.

⁴ See, e.g., Competition Bureau, Canada, Merger Enforcement Guidelines (Sept. 2004), available at [http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/vwapj/2004%20MEGs.Final.pdf/\\$file/2004%20MEGs.Final.pdf](http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/vwapj/2004%20MEGs.Final.pdf/$file/2004%20MEGs.Final.pdf); Eur. Comm’n, Guidelines on the Assessment of Horizontal Mergers under the Council Regulation on the Control of Concentrations Between Undertakings, 2004 O.J. (C 31) 5 [hereinafter EC Horizontal MEGs], available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2004:031:0005:0018:EN:PDF>; Eur. Comm’n, Guidelines on the Assessment of Non-Horizontal Mergers under the Council Regulation on the Control of Concentrations Between Undertakings, 2008 O.J. (C 265) 6, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2008:265:0006:0025:EN:PDF>.

MEGs, the U.S. agencies have informed the public of evolving nuances in their analysis through the issuance of speeches, data, and, in 2006, the publication of a joint Commentary on the Horizontal Merger Guidelines.⁵ The interpretations issued to date in these sources, however, do not provide an accurate or complete explication of the analysis that the agencies believe is state-of-the-art. As a result, the MEGs have the potential to mislead the business and legal community, particularly those practitioners who live “outside the Beltway.”

There are numerous sections of the MEGs that might be revised to describe accurately and completely the analyses that the agencies believe are state-of-the-art. These areas for improvement are discussed below in the same sequence as delineated in the MEGs.

Updated Description of the Analysis Process. The MEGs as currently drafted combine pieces of different theories that do not necessarily fit together coherently, if at all. A literal reading of the MEGs would have the reader engage in a step-by-step analysis of defining the relevant market, determining the current competitors, and calculating concentration levels (and drawing presumptions as a result of these levels), all before considering competitive effects. It is only after these steps are completed that entry, countervailing buyer power, efficiencies, and the failing firm defense are considered.

As more recently indicated in the Merger Commentary, however, the agencies do not rigidly engage in separate step analyses but instead seek to apply an integrated approach that focuses on the potential competitive effects. The MEGs would benefit from an explicit description of this integrated approach. It would be useful as well to explain how such an approach applies in evolving markets (e.g., high-technology or converging markets).

It is also unclear how the step approach in the current MEGs should work in the context of a unilateral effects analysis, where the focus is first on the effects of the merger (e.g., whether the merger will lead to a price increase), and where—as discussed in the Unilateral Effects Analysis section below—a market share threshold and structural presumptions may not be the best tools to assess the likely competitive effects of a merger. Some commentators, therefore, suggest that the analysis should start with competitive effects.⁶ A concern with such an approach, however, is that the agency may fail to delineate a cognizable relevant market, which remains a fundamental and a critical component for establishing a Clayton Section 7 claim in court.

Market Definition and the SSNIP Test. Under the MEGs, the analysis commences with the delineation of the narrowest market cognizable when applying a “small but significant and non-transitory increase in price” (SSNIP) test. Usually a 5–10 percent increase is used in a SSNIP test, although the MEGs are silent as to when to depart from the 5–10 percent benchmark. Utilization of this test is not easy in practice and may portray an inaccurate picture of the actual state of market competition. Nor is it by any means clear that, in practice, either agency engages in such a sequential analysis of potential market definitions, but rather, organizes the evidence to select a test market and alternative broader markets.⁷

Nor is it by any means clear that, in practice, either agency engages in such a sequential analysis of potential market definitions, but rather, organizes the evidence to select a test market and alternative broader markets.

⁵ Fed. Trade Comm’n, U.S. Dep’t of Justice, Commentary on the Horizontal Merger Guidelines (2006) [hereinafter Merger Commentary], available at <http://www.ftc.gov/os/2006/03/CommentaryontheHorizontalMergerGuidelinesMarch2006.pdf>.

⁶ See, e.g., Fed. Trade Comm’n, Unilateral Effects Analysis and Litigation Workshop, tr. at 190 (Feb. 12, 2008) (statement of Constance Robinson), available at <http://www.ftc.gov/bc/unilateral/transcript.pdf>.

⁷ Malcolm B. Coate, *An Overview of Transparency at the Federal Trade Commission: Generalities and Innovations in Merger Analysis* 3–5 (Oct. 2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1111687.

The focus on the SSNIP test may also cause agency staff to focus too much on short term effects. As suggested by one commentator:

[G]iven the costs of effecting and implementing a merger, it is difficult to conceive of a merger done for the purpose of exploiting short run market power. . . . The short run analysis of the Guidelines has occasionally been misdirected at industry or firm restructurings that reduce capacity but that are not anticompetitive.⁸

Moreover, this test (or any test forcing the agency to focus on the smallest possible market) may result in too narrowly delineated markets, which recent history suggests courts find defy common sense.⁹ Thus, it is important to keep the dialogue—and focus—even during the market definition stage on sustainable long-term effects, which might be longer than two years.

This criticism of the SSNIP test is not intended to suggest that there is no role for applying a critical loss analysis.¹⁰ Although there can be problems in implementation, particularly in the analysis of unilateral effects, the use of critical loss analysis is clearly useful for both market definition and competitive effects analysis. Some of these concerns can be dealt with by undertaking the critical loss analyses for several different postulated price increases. Other of these concerns can be dealt with by augmenting the analysis with models that derive demand elasticities and costs, bidding model analysis, or natural experiments to minimize potential problems that can arise by relying on wrong assumptions from one set of data and analysis.¹¹

At a bare minimum, a more robust discussion of the critical loss analysis and its various inputs would be useful in a revised set of MEGs including the role that economics plays in these types of analyses. The agencies should clearly specify that they take a more holistic approach, taking into account data, customer and industry testimony, and documents, and focus on the overall industry and long-term marketplace dynamics. Economic analysis should be a complement to, not a substitute for, the full evidentiary record that supports a properly defined market.¹²

The MEGs also fall short in discussing a SSNIP test for defining a relevant geographic market. In addition, the MEGs do not address geographic cluster markets. For instance, spatial relationships between different geographic markets can lead to a broader geographic market definition through a chain of substitution effects (cluster markets are also not discussed on the product side).¹³

⁸ David T. Scheffman, *Ten Years of Merger Guidelines: A Retrospective, Critique, and Prediction*, 8 REV. INDUS. ORG. 173, 186 (1993).

⁹ See, e.g., *FTC v. Whole Foods Market, Inc.*, 548 F.3d 1028, 1037–39 (D.C. Cir. 2008).

¹⁰ Critical loss is the percentage of sales that the hypothetical monopolist can lose and still break even. See Barry C. Harris & Joseph J. Simons, *Focusing Market Definition: How Much Substitution is Necessary?*, 12 RES. IN L. & ECON. 207 (1989).

¹¹ The choice of model and analysis should depend on the characteristics of the market; for example, how is it that firms compete with each other for customers.

¹² See David T. Scheffman, *Assessment of U.S. Merger Enforcement Policy*, Testimony Before the Antitrust Modernization Commission 9 (Nov. 17, 2005), available at http://govinfo.library.unt.edu/amc/commission_hearings/pdf/Scheffman_Statement_FINAL.pdf.

¹³ The MEGs only address the aggregation of markets “as a matter of convenience.” MEGs, *supra* note 1, § 1321, at 11 n.14. The Canadian Guidelines dedicated to bank mergers contain a detailed discussion of these cluster markets for this sector. See Competition Bureau, Canada, *The Merger Enforcement Guidelines as Applied to a Bank Merger* ¶¶ 34–37, at 13–14 (Jan. 2003), available at <http://strategis.ic.gc.ca/pics/ct/ct02484e.pdf>. The European Commission’s Relevant Market Guidelines address the issue of cluster markets, specifically on the geographic side. See Eur. Comm’n, *Commission Notice on the Definition of Relevant Market for the Purposes of Community Competition Law*, 1997 O.J. (C 372) 5, ¶¶ 57–58, available at [http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31997Y1209\(01\):EN:HTML](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31997Y1209(01):EN:HTML).

A more fundamental question is whether there should be any presumptions of harm drawn on the basis of concentration.

HHI Thresholds and Presumptions. The data released by the agencies clearly show that the HHI thresholds specified in the MEGs for various levels of investigation are out of sync with actual merger enforcement priorities. In 2003, then FTC Chairman Timothy J. Muris noted that “[m]ore than 20 years have passed since the introduction of the Herfindahl-Hirschman Index as an important initial factor in the review of horizontal mergers.”¹⁴ A 2003 report, and subsequent workshop,¹⁵ engaged the private bar in a dialogue regarding the role of concentration in agency decision making. The report shows that the vast majority of government challenges from 1998 to 2003 involved market concentration levels (concerning both postmerger HHI and increases in HHI) far above the safe-harbor thresholds set forth in the MEGs. The data indicate that less than 5 percent of the challenged markets had concentration levels below 1,800 (and almost all of these enforcement actions were in the petroleum sector). Only 13 percent of the challenged markets involved concentration levels of 2,500 or below. Indeed, more than half of the challenged markets involved postmerger concentration levels of more than 4,000.¹⁶

The only industries in which there are any examples of enforcement at or near the levels in the MEGs are supermarkets and the petroleum industry. Thus, it is potentially misleading to set safe harbor levels that are significantly below what is in practice likely to be problematic and, as such, the current MEGs may result in less experienced practitioners and the business community drawing the wrong conclusions regarding the scrutiny that a particular transaction might face.

In addition, just as the paucity of recent appellate court and Supreme Court precedent may suggest that concerns and presumptions expressed in older precedent¹⁷ may still be appropriate, the MEGs, as drafted, may lead a court to reach conclusions of law that a merger is likely to create an anticompetitive concentration at levels below what current economic thinking or retrospective studies support. Keeping these levels in place could erode the very credibility of the MEGs. Thus, the agencies, should, at the least, indicate higher safe harbor levels that would be more in line with enforcement trends.¹⁸ In addition, these low presumptions may also impede the global leadership role of the U.S. agencies since the MEGs have served as a model for other jurisdictions.

Moreover, the Merger Challenges Data report is silent regarding when, despite the absence of market shares, the agencies might be concerned with a merger premised upon “innovation markets” and “potential competition” theories. It is also not clear that the harms the MEGs presumptions are designed to prevent are valid in innovation markets where competitive characteristics unique to these markets may exist. It would be useful if the agencies expressly excluded innovation markets from such presumptions.

A more fundamental question is whether there should be any presumptions of harm drawn on the basis of concentration. The 1992 presumptions are a remnant of prior guidelines. Although the presumption for mergers in the 1,800/100 category are considerably weaker in the current MEGs

¹⁴ Press Release, Fed. Trade Comm’n, FTC and DOJ Plan Analysis of Past Merger Enforcement Cases (Nov. 18, 2003), available at <http://www.ftc.gov/opa/2003/11/mergercases.shtm>.

¹⁵ See Fed. Trade Comm’n & U.S. Dep’t of Justice, *Merger Challenges Data, Fiscal Years 1999–2003* (Dec. 18, 2003) [hereinafter *Merger Challenges Data*], available at <http://www.ftc.gov/os/2003/12/mdp.pdf>; see also Press Release, Fed. Trade Comm’n, FTC and Department of Justice Issue Merger Challenges Data, Announce Upcoming Merger Enforcement Workshop (Dec. 18, 2003), available at <http://www.ftc.gov/opa/2003/12/mergereffects.shtm>.

¹⁶ See *Merger Challenges Data*, *supra* note 15, tbl. 1.

¹⁷ See, e.g., *Brown Shoe Co. v. United States*, 370 U.S. 294, 341–44 (1962) (the merged firm would have a combined share of 5 percent).

¹⁸ The HHI levels set forth in the EC Horizontal MEGs are higher than the MEGs’ HHI levels. Compare EC Horizontal MEGs, *supra* note 4, ¶¶ 19–20, with MEGs, *supra* note 1, § 1.5.

than in its predecessors, the MEGs nevertheless continue to state that mergers in this category will be challenged absent offsetting evidence. The record is far from clear regarding at what level of concentration, if at all, a presumption of decreased competition should follow. The inclusion of presumptions of competitive harm results in too much attention being drawn to the exercise of delineating narrow markets, rather than on the ultimate analysis of competitive effects. Too often the outcome is “won or lost” on market definition rather than the ultimate likelihood of harm.

Although perhaps too radical a change from the current analysis paradigm, a better approach might be not to include any presumptions or conclusions of concern based on concentration levels or changes, but rather to have the number of participants and the respective size of each of the participants be one of a series of factors discussed in detail that could impact the competitive dynamics of the affected market. Such presumptions tend to focus attention on market definition, while market definition is not the ultimate purpose of merger review. In the meantime, presumptions—when they reflect state-of-the-art analysis—may provide clarity if they effectively perform a safe harbor screening role. Thus, the MEGs could still include safe harbor screens indicating where no issue will likely arise, even if the remainder of the benchmarks and presumptions were dropped.

Coordinated Effects Analysis. Section 2.1 of the MEGs indicates that a coordinated effect will arise if the merger increases the likelihood that the remaining firms will coordinate their actions to reduce competition due to a change in the incentives and/or the ability of the competitors to engage in tacit or explicit coordination. The current discussion of factors for detecting markets susceptible to coordination is in many ways too simplistic. For instance, traditional coordinated interaction theory assumes that collusion will reduce the firms’ incentives to innovate and create new products. It would be helpful to have a more robust discussion of the structural factors that impact the likelihood of coordination and the limitations of such analysis.

Coordinated interaction often turns in large part on the number of significant competitors operating in the market. “A ‘significant competitor’ is a firm whose independence could affect the ability of the merged firms to achieve an anticompetitive outcome.”¹⁹ Although such an analysis is typically part of the unilateral effects model, it appears that in practice the agencies also consider this information (and the respective “leadership” and “fringe” roles of firms) as relevant to a coordinated interaction theory when coupled with additional structural considerations. The MEGs should discuss how these factors interact, particularly in light of such models of competitive concern as “regime shifts” or loss of the “maverick” in the market as increasing the likelihood of less competitive performance. To the extent that the agencies believe that structure can impact market performance, the MEGs should identify the relevant variables (e.g., the ratio of the share of the leading firm to its largest rival, customer sophistication, product homogeneity, vertical interaction, and dynamic efficiencies). The DOJ now has had significant experience with large industry-wide cartels through its criminal enforcement program and should be in a good position to provide guidance based on its empirical experience.

Unilateral Effects Analysis. Although the concept of unilateral effects theory existed prior to 1992, the 1992 MEGs constituted the first MEGs to recognize “unilateral effects” as a separate theory of harm. In the ensuing two decades, the agencies have almost always asserted unilateral

¹⁹ Malcolm B. Coate & Shawn W. Ulrick, *Economic Issues, Transparency at the Federal Trade Commission: The Horizontal Merger Review Process 1996–2003* at 51 (FTC Bureau of Economics, Feb. 2005), available at <http://www.ftc.gov/os/2005/02/0502economicissues.pdf>.

effects as a basis for their enforcement actions rather than challenging the transaction solely on the basis of coordinated effects.²⁰

As with the description of concentration levels that could give rise to a concern, the discussion of unilateral effects is one of the most frequently referenced sections where practice diverges from the MEGs. Section 2.2 of the MEGs indicates that a “merger may diminish competition even if it does not lead to increased likelihood of successful coordinated interaction, because merging firms may find it profitable to alter their behavior unilaterally following the acquisition by elevating price and suppressing output.”

Section 2.2 of the MEGs currently distinguishes between firms that are primarily differentiated by their products (i.e., so-called Bertrand oligopoly model), and firms that are primarily differentiated by their capacities (i.e., so-called Cournot oligopoly model). This distinction is complicated, however, and economists may differ in their conclusions about which model applies in a particular merger. These models all suffer to some extent by being static and assumption driven. In addition, while the MEGs focus on two models, there are at least four different models describing unilateral behavior: Bertrand oligopoly, Cournot oligopoly, auction situations, and bargaining situations.

At a minimum, merger analysis would be improved if more precise thinking and discussion were provided regarding the theories of harm that are currently lumped together under the unilateral effects nomenclature. Also, the agencies should discuss when they might be concerned with a transaction despite the harm identified by the investigation not fitting neatly into either a unilateral effects theory or the coordinated effects theory.²¹ In addition, reference to a 35 percent market share threshold (or any market share presumption) should probably be eliminated or explained.²² As discussed elsewhere, the inclusion of such shares may cause the agencies to focus on delineating markets that are too narrow to be sustainable in court. Instead, as discussed in the above section on coordinated effects, the number of significant rivals and the ability to expand/enter/reposition is likely to significantly impact the likelihood of unilateral effects. The MEGs, however, are effectively silent regarding these factors.

Finally, the distinction between coordinated interaction and unilateral effects is complicated and the MEGs do not do an adequate job of explaining the differences. Perhaps the agencies would be better off abandoning the need to label the harm as being either coordinated or unilateral in nature, but instead focus on the dynamics of the marketplace and an assessment of whether such dynamics are likely to be conducive to harm from the combination of the merger parties.

Committed and Uncommitted Entrants, Entry, and Potential Competition. The MEGs currently create a distinction between uncommitted entrants (which count as being in the market under Section 1.3 of the MEGs as firms that are likely to participate through a supply response) and com-

²⁰ See Thomas O. Barnett, Assistant Att’y 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 3–5 (June 26, 2008), available at <http://www.usdoj.gov/atr/public/speeches/234537.pdf>.

²¹ The Merger Commentary points out that the agencies do not narrowly apply these two theories and that they challenge anticompetitive mergers even if they do not neatly fit in the unilateral effects or coordinated effects theory. See Merger Commentary, *supra* note 5, at 17.

²² Indeed, the utility of structural presumptions, and specifically a market share threshold may depend on the context (e.g., Bertrand oligopoly, or Cournot oligopoly). Revisions to the MEGs only should be made if they improve upon the existing framework. Joseph Farrell and Carl Shapiro, for example, propose an alternative unilateral test that raises many of the same concerns as the market share presumptions discussed above and would not be the sort of change we would favor. See Joseph Farrell & Carl Shapiro, *Antitrust Evaluation of Horizontal Mergers: An Economic Alternative to Market Definition* (Nov. 25, 2008), available at <http://faculty.haas.berkeley.edu/shapiro/alternative.pdf>.

mitted entrants (which are considered as entrants under Section 3.0 of the MEGs and, therefore, can provide a mitigating force in the attempted exercise of market power). Such a distinction raises not only theoretical problems but also practical problems of correctly factoring into the analysis the impact of such potential competitors.²³ Thus, it may be better merely to consider whether these firms are considered actual potential competitors such that they may actually be playing a role in discouraging or defeating the exercise of market power. As a fundamental point, it is important that market definition, and likelihood and timing of supply responses, not be too rigidly defined to determine if a firm is “inside” the market (and therefore counted as an effective competitor) or “outside” of the market, and ignored. It would be useful to state in the MEGs that even if a firm is not “counted” initially in its analysis, its existence will be considered ultimately in the effects analysis. This distinction also potentially creates a dichotomy with the burden of proof—on the agencies to demonstrate that the committed entrant is not in the fringe, and on the merging parties to demonstrate that entry is likely within the two year time frame stated in the MEGs, which may be resolved if the agencies bear the burden in both situations.

The agencies could also specify that the relevant issue is not whether entry will occur within the two year time frame, but rather whether a credible threat of entry exists that is sufficient to deter or counteract the anticompetitive market behavior of the merging firms.

Section 3.2 of the MEGs discusses what the agencies consider “timely” entry: “The Agency generally will consider timely only those committed entry alternatives that can be achieved within two years from initial planning to significant market impact.” The MEGs indicate that for durable goods products, consumers may defer purchases and in this way deter or counteract for a time the competitive effects of concern. Accordingly, “[i]n these circumstances, if entry only can occur outside of the two year period, the Agency will consider entry to be timely so long as it would deter or counteract the competitive effects of concern within the two year period and subsequently.”

In practice, there have been other situations in which entry beyond two years was considered relevant (e.g., in XM/Sirius, where there were long-term contracts).²⁴ It would be useful for the MEGs explicitly to recognize a broader set of circumstances in which a longer time horizon will be used for entry analysis (as well as for market delineation), or where a shorter period might be appropriate.

Interestingly, the MEGs do not expressly limit the examination of competitive effects to two years, and the agencies have considered expected effects beyond the two year horizon, particularly in matters involving innovation or next generation products. The agencies should consider whether for entry, as well, a presumptive two year time frame should apply or perhaps instead delineate a more flexible time frame that could take into account the specific dynamic characteristics of the impacted marketplace.²⁵ The agencies could also specify that the relevant issue is not whether entry will occur within the two year time frame, but rather whether a credible *threat* of entry exists that is sufficient to deter or counteract the anticompetitive market behavior of the merging firms.

The MEGs do not directly address the other side of potential competition, i.e., the harm to competition that may arise from the elimination of a potential competitor as a result of the transaction. The most recent statement of the potential competition theory by either agency was the 1984 Guidelines dedicated to non-horizontal mergers. Paradoxically, the FTC did not issue a special

²³ See U.S. Dep’t of Justice & Fed. Trade Comm’n, Joint Workshop on Merger Enforcement, tr. at 198–204 (Feb. 18, 2004) (Remarks of A. Douglas Melamed), available at <http://www.ftc.gov/bc/mergerenforce/040218ftctrans.pdf>.

²⁴ See Press Release, U.S. Dep’t of Justice, Statement of the Department of Justice’s Antitrust Division on Its Decision to Close Its Investigation of XM Satellite Radio Inc.’s Merger With Sirius Satellite Radio Inc. (Mar. 24, 2008), available at http://www.usdoj.gov/atr/public/press_releases/2008/231467.pdf.

²⁵ See Ilene Knable Gotts, Scott Sher & Michele Lee, *Antitrust Merger Analysis in High-Technology Markets*, 4 EUR. COMPETITION J. 463 (2008), available at <http://www.wsg.com/PDFSearch/sher1208.pdf>.

official statement addressing this theory,²⁶ but briefly mentions it in its Guide to Mergers.²⁷ The 1984 Guidelines describe the elimination of a perceived or actual potential competitor as one of the principal theories of competitive harm.

Under the theory of harm to perceived potential competition, a merger may significantly impede competition if the potential entry of the acquired firm previously threatened the market participants. Under the theory of harm to perceived actual competition, a merger may significantly impede competition through the elimination of an impending entrant. Surprisingly, the theory of potential competition was barely mentioned during the joint workshop held by both agencies in 2004 on merger enforcement, and the Merger Commentary does not discuss the theory at all. Yet, the enforcement decisions that involved either innovation markets or nascent markets often raise concerns regarding the elimination of potential competition, as did some recent matters.²⁸ Typically, these matters involve the assertion that there are only a few firms in the market and/or only a few firms have the ability to enter the market due to unique assets or attributes, referred to as “entry advantage.”²⁹ The agencies should provide better guidance regarding the criteria that they would apply to determine whether the elimination of potential competition by a merger party will be a basis for challenging the transaction and how such a role differs simply from the analysis to be undertaken as to all parties as uncommitted entrants.

Efficiencies. The 1997 revision to the MEGs added for the first time a section on efficiencies as a defense. This express recognition constituted a significant advance in merger analysis, but as drafted in the MEGs, is still a remnant of static price theory models rather than the dynamic analysis found in modern economic thinking.³⁰ Moreover, placing efficiencies in a separate step of the analysis suggests that efficiencies are only relevant after market delineation and analysis of potential competitive effects occurs. It is only in the Merger Commentary—not in the MEGs themselves—that the agencies clarify that efficiencies are not to be analyzed at the end of such a linear progression. It would be helpful if the agencies made clear that efficiencies are expressly to be considered in Section 2 of the MEGs, rather than Section 4, as part of the net assessment of the merger’s likely effects.³¹

In addition, the current MEGs do not go far enough in recognizing the types of efficiencies that can be procompetitive. As recommended in the Antitrust Modernization Commission (AMC) Report,³² the MEGs should expressly recognize certain fixed-cost savings in addition to savings in R&D, dynamic efficiencies,³³ and synergies that result from combining complementary

²⁶ The only official statement is the endorsement of Section 4 of the 1984 Guidelines when the current MEGs were issued.

²⁷ See Fed. Trade Comm’n, *An FTC Guide to Mergers 2–3*, available at http://www.ftc.gov/bc/antitrust/factsheets/FactSheet_Competitive.pdf.

²⁸ See, e.g., Press Release, Fed. Trade Comm’n, *Inverness Medical Innovations Settles FTC Charges that It Stifled Future Competition in U.S. Market for Consumer Pregnancy Tests* (Dec. 23, 2008), available at <http://www.ftc.gov/opa/2008/12/inverness.shtm>.

²⁹ See 1984 Guidelines, *supra* note 2, § 4.133.

³⁰ See U.S. Dep’t of Justice & Fed. Trade Comm’n, *Joint Workshop on Merger Enforcement*, tr. at 66 (Feb. 19, 2004) (remarks of William J. Kolasky, former Deputy Assistant Att’y Gen., Antitrust Div.), available at <http://www.ftc.gov/bc/mergerenforce/040219ftctrans.pdf>.

³¹ The EC Horizontal MEGs, for example, indicate that efficiencies are part of the “overall competitive appraisal.” See EC Horizontal MEGs, *supra* note 4, ¶ 76.

³² See ANTITRUST MODERNIZATION COMM’N, *REPORT AND RECOMMENDATIONS 58–59* (2007), available at http://govinfo.library.unt.edu/amc/report_recommendation/amc_final_report.pdf.

³³ This category of efficiencies could be particularly relevant in declining or financially distressed industries. See Ilene Knable Gotts & Calvin S. Goldman, *The Role of Efficiencies in M&A Global Antitrust Review: Still in Flux?*, in *ANNUAL PROCEEDINGS OF THE FORDHAM CORPORATE LAW INSTITUTE 201* (Barry E. Hawk, ed. 2003).

strengths, which may have a significant positive impact on competition long-term but may be difficult to quantify. The AMC Report further urges that a longer time horizon be taken for counting efficiency gains, particularly in sectors in which innovation is important. The AMC Report points out that the current MEGs only mention innovation in a footnote. It would be useful if the agencies set out a detailed discussion regarding how to assess the effects of a merger on innovation, and how to balance an improvement in innovation against possible anticompetitive effects of the merger.

Perhaps the most troubling aspect of the MEGs efficiencies discussion is the emphasis on “merger specificity,” particularly given the oft-overlooked language that “the Agency will not insist upon a less restrictive alternative that is merely theoretical.”³⁴ The agencies should make clear that parties do not need to show that there is not “a less restrictive alternative means” to achieve the efficiencies. Moreover, in considering “merger specificity” the agencies should also give credit to the transaction to the extent that the achievement of the efficiencies by the parties to the transaction may change behavior in the underlying game; e.g., if efficiencies create greater diversity/asymmetry in costs, then they frustrate coordination, or if, as a result, other firms step up innovation or collaboration to achieve synergies, consumer welfare is further enhanced.

One of the politically most sensitive issues is how to treat efficiencies that may result in a market outside the relevant market, or in the case of a world market, outside of the United States itself as an offset to possible adverse effects in the relevant market. The MEGs are silent on this point (apart from a footnote relating to “inextricably linked markets,” for which the MEGs do not explain how and under what circumstances such efficiencies should count).

Given the important role of efficiencies in lowering costs and fostering innovation, which in the long-term promotes competition, some consideration should be given to how the consumer welfare standard is applied. Former FTC Chairman Robert F. Pitofsky indicated before he became Chairman of the FTC, that the “pass through” requirement is a “killer qualification.”³⁵ In Canada, for instance, a broader social welfare perspective is used.³⁶ Perhaps, if a long enough time horizon is permitted for the recognition of the efficiency gains, the social welfare approach converges into the consumer interest standard for many mergers.³⁷ Accordingly, the recognition of a longer time frame would be a good starting point.

Also, the standard of proof required of the parties regarding likely efficiencies gains should be the same as that deployed in reaching the decision that a proposed merger is problematic rather than using a sliding scale standard. Such a standard creates a disconnect between the agencies and the merging parties, whose burden of proof increases proportionately with the agencies’ concerns.

Financial Distress. The financial condition of a company is expressly considered in Section 5, which is dedicated to the failing firm and failing division theories. The MEGs require four conditions to be fulfilled to enable merging parties to invoke successfully the failing firm defense: (i) a grave probability of a business failure, (ii) no alternative transaction or position available to the firm that poses less damage to competition, (iii) the firm is not capable of successful reorganization under Chapter 11, and (iv) absent the acquisition, the assets of the firm would exit the market. Until

³⁴ See MEGs, *supra* note 1, § 4, at 28.

³⁵ Robert Pitofsky, *Proposals for Revised United States Merger Enforcement in a Global Economy*, 81 GEO. L.J. 195, 207 (1992).

³⁶ See Gotts & Goldman, *supra* note 33.

³⁷ See Dennis W. Carlton, *Does Antitrust Need to be Modernized?*, J. ECON. PERSP., Summer 2007, at 155.

the recent financial crisis, these conditions were difficult to meet.³⁸ The Merger Commentary does not even contain any discussions on failing firm case examples.

As with efficiencies, the failing firm defense should no longer be treated as a separate consideration, but rather should be integrated into the competitive effects analysis. Indeed, having the failing firm defense in the last step suggests that the failing condition of a firm is considered only after the potential competitive harm of a merger, even though the failing condition precisely affects the competitiveness of a firm.

In addition to Section 5, the MEGs acknowledge the *General Dynamics*/failing firm defense in subsection 1.521 relating to the changing market conditions, where they provide that “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.” This concept is broad enough to recognize the situations currently arising in the economy, although it might be useful if the MEGs addressed how these concepts, i.e., failing/flailing firm, work when an entire industry/economy is failing.³⁹

Countervailing Buyer Power and Monopsony. The MEGs identify “buyer characteristics and the nature of the procurement process” as one factor that must be considered in analyzing a merger’s potential to facilitate coordinated interaction. Such buyer power exists to the extent that buyers have access to reasonable commercial alternatives, i.e., are not captives of the merging parties. It would be useful if the agencies could expand the discussion of buyer countervailing power, particularly the discussion of fringe expansion by alternative suppliers and sponsored entry as a part of such countervailing customer disciplinary behavior. For instance, the EC Horizontal MEGs contain an entire section discussing the countervailing effects of buyer power.⁴⁰

In the last decade, the concern that the merger may lead to the exercise of too much buyer power has arisen as an issue in some investigations and even a few enforcement actions.⁴¹ The agencies have focused on whether the merging parties on a combined basis constitute a sufficiently large percentage of the purchases of a product such that they might be able to and can exercise “monopsony” power post-transaction. The MEGs limit the discussion of such market power to the introductory section and indicate that “[i]n order to assess potential monopsony concerns, the Agency will apply an analytical framework analogous to the framework of these Guidelines.”⁴² It is unclear from this statement how such analogous framework would apply and at what level of concentration a concern would arise.⁴³

Indeed, having the failing firm defense in the last step suggests that the failing condition of a firm is considered only after the potential competitive harm of a merger, even though the failing condition precisely affects the competitiveness of a firm.

³⁸ See Ilene Knable Gotts & Nathaniel L. Asker, *Antitrust Aspects of Acquisitions of Financially Distressed Businesses*, ANTITRUST REP., Dec. 2008, at 6.

³⁹ See Ramsey Shehadeh, Joseph Larson & Ilene Knable Gotts, *The Effect of Financial Distress on Business Investment: Implications for Merger Reviews*, ANTITRUST, Spring 2009, at 12. Robert D. Willig even suggests adding a new “Section 5.3” to the MEGs, recognizing a “failing economy defense.” See *ABA Chair’s Showcase Probes Effects of Faltering Economy on Enforcement*, ANTITRUST & TRADE REG. REP. (BNA), Apr. 3, 2009, at 315. Other commentators posit that the failing firm defense as currently discussed in the MEGs is adequate, even in the current economic environment. See Ken Heyer & Sheldon Kimmel, *Merger Review of Firms in Financial Distress*, Economic Analysis Group Discussion Paper, Mar. 2009, available at <http://www.usdoj.gov/atr/public/eag/244098.pdf>.

⁴⁰ See EC Horizontal MEGs, *supra* note 4, ¶¶ 64–67.

⁴¹ See Complaint, United States v. JBS S.A., No. 08CV5992 (N.D. Ill. Oct. 20, 2008), available at <http://www.usdoj.gov/atr/cases/f238300/238388.htm>.

⁴² MEGs, *supra* note 1, § 0.1.

⁴³ The EC Horizontal MEGs contain a framework specifically describing mergers creating buyer power in upstream markets. See EC Horizontal MEGs, *supra* note 4, ¶¶ 61–63.

Minority Interests. Throughout the last two decades, many of the transactions investigated have raised issues as a result of minority equity holdings by one or both merging parties.⁴⁴ Yet the MEGs are silent as to the theories of competitive harm that such relationships can raise, both in terms of incentives and ability to raise price or restrict output, including those situations in which a minority holding can raise a more significant potential for anticompetitive harm than would an outright combination of the two firms.⁴⁵ In addition, the inclusion of a discussion of minority interests in the MEGs would be an appropriate place to provide safe harbors for such transactions.

Non-Horizontal Mergers. The AMC Report (and the ABA Section of Antitrust Law Transition Report for 2008,⁴⁶ as well as the American Antitrust Institute Transition Report⁴⁷) recommend a revision of the MEGs to describe the analysis applicable to non-horizontal mergers. To leave intact the discussion contained in the 1982 and 1984 Guidelines when there have been significant developments in analyzing competitive effects of such mergers since 1984 is misleading.

There has recently been a renewed interest in vertical merger enforcement, based on “Post-Chicago” analysis.⁴⁸ In that regard, the recently issued EC Non-Horizontal MEGs reflect a generational leap over the 1982/1984 Guidelines that the United States indicates are to be relied upon for vertical and conglomerate mergers. The global policy debate would be furthered if the United States were to issue its own state-of-the-art discussion of how vertical and conglomerate mergers should be analyzed, particularly if the statements contained in the 1984 Guidelines do not mirror the current discussion of burdens of proof for efficiencies in vertical transactions and portfolio effects for conglomerate mergers. To the extent that the MEGs use concentration levels as indicators of levels of scrutiny for horizontal mergers, the non-horizontal merger discussion should also include safe harbor thresholds.

Innovation and High-Tech Markets. The MEGs are silent as to how the agencies assess mergers involving innovation or high-tech markets even though distinctions may be appropriate in such situations. For example, the assumptions underlying the coordinated effects theory (i.e., collusion reduces the incentives to create new products) may not be applicable to high-tech markets, particularly where there are only limited sunk up-front costs. In such high-tech markets, products are usually highly differentiated, and coordinated effects are difficult to prove. The inclusion of a discussion of innovation and high-tech markets in the MEGs would, therefore, be useful.

⁴⁴ See, e.g., Ilene Knable Gotts & Robert C. Weinbaum, *Partial Ownership Interests: The Antitrust Concerns and Structural Techniques for Minimizing Them*, ANTITRUST REP., Oct. 2000, at 18.

⁴⁵ The inclusion of a discussion of minority interests in the MEGs would be an appropriate place to provide safe harbors. More generally, the discussion contained in the Antitrust Guidelines for Collaborations Among Competitors might constitute a useful starting point to address the issue of minority interests. See Fed. Trade Comm’n & U.S. Dep’t of Justice, *Antitrust Guidelines for Collaborations Among Competitors* (2000), available at <http://www.ftc.gov/os/2000/04/ftcdojguidelines.pdf>.

⁴⁶ See ABA Section of Antitrust Law, 2008 Transition Report on the Current State of Federal Antitrust and Consumer Protection Enforcement 36–37 (Nov. 2008), available at <http://www.abanet.org/antitrust/at-comments/2008/11-08/comments-obamabiden.pdf>.

⁴⁷ See Am. Antitrust Inst., *The Next Antitrust Agenda: The American Antitrust Institute’s Transition Report on Competition Policy to the 44th President of the United States* 151 (Oct. 2008), available at <http://www.antitrustinstitute.org/Archives/transitionreport.ashx>.

⁴⁸ See Michael A. Salinger, Director, Bureau of Economics, Fed. Trade Comm’n, *Is It Live or Is It Memorex? Models of Vertical Mergers and Antitrust Enforcement*, Speech Before the Association of Competition Economics Seminar on Non-Horizontal Mergers (Sept. 7, 2005), available at <http://www.ftc.gov/speeches/salinger/050927isitlive.pdf>.

Does It Make Sense to Revise the MEGs?

Those who oppose issuing new MEGs suggest that the current MEGs are flexible enough to permit tweaking, with such tweaks being best reflected through the issuance of policy statements (e.g., closing statements/analysis to aid public comment, speeches, and commentary).⁴⁹ These commentators suggest that the MEGs have a unique place in the global competition arena, being widely accepted and cited as the gold standard of review. To revise the MEGs could constitute an opening of Pandora's Box and it is unclear that there would be a consensus on appropriate revisions. To issue new MEGs could alter the United States position as the policy leader and raise the need to continue to update the MEGs periodically to meet expectations that they remain current. Such an ongoing exercise would not only be resource draining, but potentially infeasible on a joint agency basis given the rifts that exist from time to time between the FTC and DOJ. In addition, the agencies may find that a more elaborated exposition of their analysis in new MEGs will provide more fodder to be used against them in court, or on the other hand, that courts will place less weight on the MEGs, believing that there is nothing concrete in their exposition. There is some merit to keeping the existing MEGs as *the* "Bible" and having the interpretations be Talmudic in stature. Such interpretations can more easily be drafted and issued (as well as revised from time-to-time) than trying to reexamine and agree upon the fundamental principles.

But there is something intellectually honest and educational in the process of starting from scratch to draft MEGs that build upon our learning over the last few decades of merger enforcement and that can be held out as state-of-the-art. After all, the 1992 Guidelines were not the first guidelines issued by a U.S. competition authority (the 1968 Guidelines were followed by the 1982 and 1984 Guidelines). Rather, when the guidelines no longer accurately represented enforcement policy, agency officials have issued new guidelines. Having the up-to-date analysis reflected in one document ensures that there is no ambiguity regarding what the analysis should be, and such transparency is useful for merger parties, agency staff, and the courts. Indeed, the agencies, having already issued guidelines, created the expectation that they would be maintained to reflect accurately current agency thinking. Moreover, relying on the existing MEGs to ensure the United States' role as the competition policy leader going forward is by no means a given outcome. That leadership role is more likely to be bestowed upon the authority that provides the best practices in analysis in its guidelines, rather than merely the longest standing guide.

Procedural Considerations If the MEGs Are to Be Revised

The process followed by other jurisdictions provides some guidance as to how the MEGs might be revised, were they to be revised. Of course, the situation in the United States is complicated by the existence of two agencies with concurrent jurisdiction that may nevertheless diverge on some important aspects. Indeed, until 1992, each agency had its own statement of analysis. It is essential, however, that a consensus be reached for any guidelines to be issued in the future, with the possibility that divergence might exist due to specific conditions unique to an industry that one or the agency reviews exclusively. Clarification for that industry could be provided in a separate statement. We are unaware of any such peculiar industry analysis, however. Perhaps the process itself can help to mend the gap between the agencies that appears to exist today.

⁴⁹ See Rill & MacAvoy, *supra* note 3, at 16.

Merger Retrospectives. An important preparatory step could be for the agencies to assess the actual effects of the “close-call” consummated mergers. An ex post evaluation of a significant and relevant set of enforcement decisions may help the agencies to gain deeper insight into whether or not their merger analysis always fits with the market conditions and the evidence at hand, and to identify potential rooms for further improvements, if any. The European Commission, for example, recently conducted an ex post analysis of ninety-six of its decisions clearing mergers subject to commitments. As a result of this retrospective study, the European Commission then issued a new notice on remedies in 2008, revising the previous 2001 notice.

Indeed, some commentators have strongly urged the U.S. agencies to analyze the effects of mergers, both those consummated mergers that the agencies permitted to proceed despite staff recommendations to challenge the merger and those transactions that the agencies unsuccessfully tried to stop.⁵⁰ In addition, the agencies could study what efficiencies parties have been able to achieve in those transactions in which efficiencies played an important role in the enforcement decision. These merger retrospectives could then be used to flesh out the conditions and criteria that impact competition.

Public Consultations. Both the FTC and DOJ have held hearings on various aspects of their merger analysis during the past two decades since the MEGs were issued. As a result of the joint workshop held in 2004, the agencies found that the MEGs achieve their underlying goal, and therefore concluded that they did not need to be revamped.⁵¹ Rather, the agencies issued the Merger Commentary. Having the antitrust analysis contained in a compilation of documents, i.e., the MEGs and the Merger Commentary, may be confusing. Additionally, the Merger Commentary in some instance departs from the MEGs, at least facially (e.g., the MEGs describe the analytical framework that the agencies follow on a step-by-step basis while the Merger Commentary specifies that the agencies conduct an integrated assessment of mergers). It would be useful to start the drafting process by holding a series of hearings or workshops on various aspects of the analysis. The agencies could thereafter endeavor to draft guidelines, preferably circulated for public consultation.

Conclusion

Numerous areas of the MEGs do not reflect the current enforcement policy of the agencies or the economic developments of the past two decades. In addition, the MEGs lack sufficiently detailed discussions to ensure that the courts, business community, and enforcement staff understand what recommended practices should be part of merger analysis. The MEGs therefore do not achieve their intended and primary goal, and, in this respect, should be revised. Moreover, although burdensome, the very process of revising the MEGs could result in a productive study and dialogue that could improve further our understanding of markets, competitive harm, and mitigating factors. Even if at the end of such an exercise, the two agencies are not able to reach a consensus and issue new MEGs, the thought process that takes place and the work product that is generated would be a step in the right direction, allowing the United States to maintain its leadership role globally. ●

Moreover, although burdensome, the very process of revising the MEGs could result in a productive study and dialogue that could improve further our understanding of markets, competitive harm, and mitigating factors.

⁵⁰ See, e.g., Dennis W. Carlton, *The Need to Measure the Effect of Merger Policy and How to Do It*, ANTITRUST, Summer 2008, at 39.

⁵¹ See Merger Commentary, *supra* note 5, at v.