

Pandora's Box Opened: The New Horizontal Merger Guidelines

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At the 2009 ABA Antitrust Section Spring Meeting, I participated in a program titled "Revisiting the 1992 Merger Guidelines: Is It time to Open Pandora's Box?" On that program, I took the lonely position that revising the 1992 Guidelines was unnecessary, but not because merger analysis has remained stagnant in the past eighteen years. Of course some things have changed. For example, HHI thresholds outlined in the 1992 Guidelines are lower than those applied by the Agencies in practice today. But in general, the 1992 Guidelines continued to work well. As the Antitrust Modernization Commission concluded in 2007: "There's general consensus that the Merger Guidelines have acted as the 'blueprint [] for the architecture' of merger analysis and, overall, provide a guide that 'functions well'."¹ So why change a good thing? Do we know what we're getting into? In short, is it really time to open Pandora's Box?

Last fall, the Federal Trade Commission and the Department of Justice, Antitrust Division answered, "yes." One of my reservations about opening Pandora's Box was whether the Agencies would have the institutional commitment to take on such a big effort. I had the privilege of working on the Competitor Collaboration Guidelines several years back at the FTC and learned first hand the difficulties and challenges a project like that faces.² The process is time intensive, resource draining, and a distraction from other Agency priorities. It requires intra-agency cooperation and input from outside lawyers, economists, and businesspeople.

The Agencies put to rest that reservation of mine when they issued draft revised Guidelines in a lightning-fast seven months from the announced start. The Agencies deserve credit for committing the necessary resources and conducting an open process that sought the input of outside lawyers, economists, and business persons. After receiving comments and making further adjustments to the draft, the Agencies issued final revised Guidelines on August 19, 2010.³

I would describe the revisions in the new 2010 Guidelines as fitting into three categories. "As anticipated" is the first category. Most of the revisions fit into this first category. They are largely updates to the 1992 Guidelines that more accurately reflect actual Agency practice and thinking. These revisions are not controversial in the sense that they update the Guidelines while maintaining, by and large, the successful blueprint of the 1992 Guidelines. The second category of revisions is "hoped for a little more." In this category, because Pandora's Box was opened, I would have liked to see the Agencies go a little further with a few of the revisions. The third category is

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¹ ANTITRUST MODERNIZATION COMMISSION, REPORT AND RECOMMENDATIONS 54–55 (2007) [hereinafter AMC REPORT], available at http://govinfo.library.unt.edu/amc/report_recommendation/toc.htm.

² U.S. Dep't of Justice & Fed. Trade Comm'n, Antitrust Guidelines for Collaborations Among Competitors (2000), available at <http://www.ftc.gov/os/2000/04/ftcdojguidelines.pdf>.

³ U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines (2010) [hereinafter 2010 Guidelines], available at <http://www.ftc.gov/os/2010/08/100819hmg.pdf>.

“wait and see.” This includes revisions that, in my view, push the envelope on accepted economic theory and merger analysis. I refer to this category as “wait and see” because the open question is how the Agencies will use these new tools in practice.

“As Anticipated” Revisions

Most of the revisions update the Guidelines to more accurately reflect current Agency practice and thinking. The 2010 Guidelines move away from the more rigid, linear analysis outlined in the 1992 Guidelines and call for a “fact-specific” assessment that is focused on the likely competitive effects of a potential transaction.⁴

One way the Agencies emphasize the fact-intensive nature of merger analysis in the new Guidelines is by introducing a new Section 2, Evidence of Adverse Competitive Effects. This section discusses the “categories and sources of evidence that the Agencies . . . have found most informative in predicting the likely competitive effects of mergers.”⁵ Although a new addition to the Guidelines, Section 2 simply confirms what we already knew about the types and sources of evidence relied upon by the Agencies.

There are a few points in Section 2 that I would have considered putting in the “wait and see” category if the Agencies had not made further revisions before issuing the final Guidelines. For example, in Section 2.2.1, the Agencies clarified in the final 2010 Guidelines that “[setting] price well above incremental cost” is not in itself anticompetitive and further clarified and defined incremental cost.⁶ The Agencies also clarified in Section 2.2.1 that a purchase price “in excess of the acquired firm’s stand alone market value” is not necessarily an indicator of a likely anticompetitive effect but may simply indicate that the acquiring firm is paying a premium “because it expects to be able to . . . achieve efficiencies.”⁷

A departure from the 1992 Guidelines is the treatment of market definition. Unlike the 1992 Guidelines that formalistically began with market definition, the 2010 Guidelines state that the “analysis need not start with market definition.”⁸ The 2010 Guidelines use market definition as a tool to help discern the likely competitive effects of a transaction.⁹ This approach more accurately reflects how the Agencies, in my experience, already treat market definition in merger analysis. It also reflects more accurately how clients are counseled. I do not remember ever advising a business executive on a proposed transaction with a detailed discussion of market definition. SSNIP (small but significant and non-transitory increase in price) is not an acronym of interest to a busy executive.

After the draft Guidelines were issued in April, some expressed concern that revisions to the market definition section may be intended to de-emphasize the necessity or importance of market definition in merger analysis.¹⁰ I do not think that is the case. In the final version of the 2010

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⁴ The Overview states: “[Merger analysis] is a fact-specific process through which the Agencies . . . apply a range of analytical tools to the reasonably available and reliable evidence to evaluate competitive concerns” *Id.* at 1.

⁵ *Id.* at 2.

⁶ *Id.* at 4.

⁷ *Id.*

⁸ *Id.* at 7.

⁹ “The Agencies define relevant markets to help analyze the competitive effects of a horizontal merger. Market definition is not an end in itself: it is one of the tools the Agencies use to assess whether a merger is likely to lessen competition.” *Id.*

¹⁰ General Electric Company, United Technologies Corporation and Honeywell International Inc., Comments to the Federal Trade Commission and Department of Justice on the Proposed Horizontal Merger Guidelines (June 4, 2010), available at <http://www.ftc.gov/os/comments/hmgrevisedguides/548050-00028.pdf>.

Guidelines, the Agencies clarified that they “will normally identify one or more relevant markets in which the merger may substantially lessen competition.”¹¹ More importantly, the Agencies are bound by case law¹² and Section 7¹³ itself, which require identifying a relevant market. The Agencies would be unwise to go to court without including market definition in their case.

“Hoped for a Little More” Revisions

There are a few areas where I wish the revisions had gone a little further. For example, Section 10, Efficiencies, is largely unchanged from the 1992 Guidelines, as amended in 1997. While the 1997 efficiencies amendment took a huge leap forward by formally recognizing the relevance of efficiencies in merger analysis, the 2010 Guidelines barely tiptoe forward.

First, the 2010 Guidelines continue to concentrate on static efficiencies, cost savings that reduce prices to consumers in the short term.¹⁴ Little credit is given to fixed-cost savings that reduce total costs in the longer run but may not necessarily have an immediate impact on short-term prices to consumers.¹⁵ As the AMC Report pointed out, in the long run, fixed cost savings are likely to benefit consumers as well and should be given more credit than they generally have received.¹⁶

In my experience, companies expend tremendous effort on identifying, quantifying and committing to achieve all likely cost savings in a transaction. The 2010 Guidelines could have given greater weight to all verifiable cost savings that reduce total costs in the long run and make the combined entity more efficient and competitive.

Second, the 2010 Guidelines continue to discount dynamic efficiencies relating to research and development that can spur innovation. The 2010 Guidelines explain that those efficiencies “are potentially substantial but are generally less susceptible to verification”¹⁷ Verifiable or not, these efficiencies are extremely important. At the ABA Antitrust Section Innovation Symposium earlier this year, innovation experts were incredulous at the notion that short-term price benefits to consumers from verifiable cost savings could be more important to competition than longer term innovation efficiencies.¹⁸ Despite the difficulty of quantifying and verifying innovation efficiencies, the 2010 Guidelines could have better recognized the significance and importance of innovation efficiencies in competition.

“Wait and See” Revisions

There are a few revisions that are “wait and see” because they possibly go beyond accepted economic theory and merger analysis. The issue is how the Agencies will use these new tools in practice.

One of the revisions in the “wait and see” category is the introduction of Upward Pricing Pressure (UPP) theory in Section 6.1, Prices of Differentiated Products. It is perhaps not surpris-

¹¹ 2010 Guidelines, *supra* note 3, at 7.

¹² *FTC v. Lundbeck, Inc.*, Civil No 08-6379 (D. Minn. Aug. 31, 2010); *FTC v. Arch Coal, Inc.*, 329 F. Supp. 2d 109 (D.D.C. 2004).

¹³ Section 7 of the Clayton Act, 15 U.S.C. § 18.

¹⁴ 2010 Guidelines, *supra* note 3, at 31 n.15.

¹⁵ *Id.*

¹⁶ AMC REPORT, *supra* note 1, at 58.

¹⁷ 2010 Guidelines, *supra* note 3, at 31.

¹⁸ Antitrust and Innovation Symposium, co-sponsored by the ABA Section of Antitrust Law and Stanford Law School (May 20–21, 2010).

ing to see UPP theory introduced here because it was developed in an academic article by Carl Shapiro and Joseph Farrell, the current chief economists at the Agencies.¹⁹ However, the theory raises concern because it almost always predicts some price increase resulting from a horizontal merger.²⁰ While the theory may be one tool that is part of a competitive effects analysis, placing too much weight or reliance on that theory could be misleading and inaccurate. Time will tell how the Agencies choose to use this tool.

Another revision I would include in the “wait and see” category is the inclusion of “reduction in product variety” as an independent anticompetitive effect in Section 6.4, Innovation and Product Variety.²¹ Although the Agencies attempted to clarify this theory through further commentary and an example in the final 2010 Guidelines, there is still little guidance for parties to determine whether and how the Agencies would find an anticompetitive effect from a proposed combination, apart from any impact on price or quality, based solely on a theory of “reduction in product variety.” Time will tell how the Agencies choose to use this new tool as well.

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Conclusion

The Agencies opened Pandora’s Box. They deserve credit for quickly and efficiently managing to close it. Most of the revisions in the 2010 Guidelines appropriately reflect current Agency practice and thinking. Of course, there are a few areas where I would have “hoped for a little more” and a few areas where we will have to “wait and see” what the Agencies do with their new tools. Most importantly, though, the Agencies have managed to preserve the well-functioning “blueprint for the architecture of merger analysis” from the 1992 Merger Guidelines by concentrating revisions on updating the Guidelines to more accurately reflect current Agency practice and thinking. At the end of the day, the Agencies must challenge a merger in court with testimony by customers and others, with documentary evidence, and with empirical evidence supported by credible theories of competitive harm in a relevant market.²² The 2010 Guidelines will be used and tested in that context. ●

¹⁹ Joseph Farrell & Carl Shapiro, *Antitrust Evaluation of Horizontal Mergers: An Economic Alternative to Market Definition*, B.E. J. THEORETICAL ECON. vol. 10, no. 1, art. 9 (2010), <http://www.bepress.com/bejte/vol10/iss1/art9>.

²⁰ Dennis W. Carlton, *Comment on Department of Justice and Federal Trade Commission’s Proposed Horizontal Merger Guidelines*, June 4, 2010, available at <http://www.ftc.gov/os/comments/hmgrevisedguides/548050-00034.pdf>.

²¹ “If the merged firm would withdraw a product that a significant number of customers strongly prefer to those products that would remain available, this can constitute a harm to customers over and above any effects on the price or quality of any given product.” 2010 Guidelines, *supra* note 3, at 24.

²² The FTC’s view that it needs only to establish “substantial questions,” rather than “likelihood of success on the merits,” as does the DOJ, at the preliminary injunction stage in federal court to halt a transaction, *FTC v. CCC Holdings*, 605 F. Supp. 2d 26 (D.D.C. 2009), is a separate issue from the 2010 Guidelines that in practice creates an irreconcilable difference in merger enforcement between the FTC and DOJ when applying the same 2010 Guidelines.