Roundtable: Current Substantive and Procedural Issues Facing Merger Practitioners
Debbie Feinstein, David Gelfand, Jeffrey Perry, and Carl Shapiro discuss the Horizontal Merger Guidelines, cluster markets, efficiencies, potential competition, and other topics with Joseph Krauss and Amanda Reeves.

Reinvigorated Antitrust Enforcement: Lessons for Non-Party Witnesses from Recent Merger Litigation
Amanda Wait and Brian Hauser examine how non-party witnesses may be swept up in the antitrust agencies’ merger investigations and provide practical tips for clients when this occurs.

Toward a More Complete Treatment of Efficiencies in Merger Analysis: Lessons from Recent Challenges
Jonathan M. Orszag and Loren K. Smith propose improvements to how merger-specific efficiencies should be evaluated by the agencies and describe a framework which puts them on equal footing to price effects.

Brexit: Merger Review Implications and Recommendations
Jay Modrall and Ian Giles track the recent developments and implications for antitrust merger review following the United Kingdom’s decision to leave the European Union earlier this year.

Practical Advice for Avoiding Hub-and-Spoke Liability
Rachel Brass and Caeli Higney analyze the key evidence courts use to find hub-and-spoke conspiracies and offer guidance for clients to avoid potential liability.
Roundtable: Current Substantive and Procedural Issues Facing Merger Practitioners

JOE KRAUSS: Thank you for your willingness to sit down with us today. The first thing I wanted to start with is the Horizontal Merger Guidelines. The 2010 revisions are now six years old. We have six years of experience and practice with those Guidelines on the private side, on the government side, and in federal court. I was wondering if you could give your perspectives on whether they are working, whether there are areas that you think need to be revised, or improved, or updated.

DEBBIE FEINSTEIN: Carl should chime in, but I think the 2010 Guidelines were really meant to reflect what the Agencies were already doing. In terms of helping guide the staff in how to think about whether to bring a case, I think they’re working quite well. Even though we have all been doing this for years, I’m amazed at how often we turn to the Guidelines as we are considering different issues.

The Guidelines are particularly helpful in spelling out theories that don’t arise every day. The Commission’s challenge to the Superior/Canexus transaction is a good example. The FTC challenged a combination of sodium chlorate producers. The FTC argued that the primary harm would come through coordination on output and output reduction, which is one of the theories laid out in the Guidelines at Section 6.3.
The Guidelines set forth a structure for us to consider what we would need to believe such an anticompetitive effect was likely and for the parties to argue why the conditions for the theory were not set forth. The Guidelines set forth a framework that allowed us to have a clear conversation with the parties about what evidence was relevant and what it showed—even if we did not ultimately agree.

In terms of litigation, the courts generally consider the Merger Guidelines even though they are not binding.

**CARL SHAPIRO:** Let me pick up on that. As someone who played a leading role at the Antitrust Division in the development of the 2010 Horizontal Merger Guidelines, I think transparency was certainly a big part of what we were doing. And, look, it’s not surprising—basically we were working with the 1992 Guidelines and there had been a significant shift in practice. So we were writing down that shift but at the same time we were changing emphasis in some ways.

From my perspective as someone who has worked with the Agencies and with private parties on mergers in the past four years since I came back to Berkeley from D.C., I think practitioners understand what the 2010 Guidelines say—it comports with their experiences. Plus, they are workable in terms of telling clients what needs to be done in front of the Agencies to most effectively address Agency concerns. So in that sense I think the 2010 Guidelines are working fine.

The litigation issues are distinct and only apply to those very few mergers that are litigated. The courts are certainly very interested in market definition, and this remains true even though the Guidelines probably do deemphasize market definition because that’s the way the Agency investigations actually proceed. When you get to court, market definition is going to play a significant role, and that is going to remain the case unless and until the case law changes.

**JOE KRAUSS:** Dave and Jeff, you both have had experience in presenting these Guidelines in court. What are your perspectives on how the Guidelines are playing in the courts?

**—DAVID GELFAND:** Before I get to how they’re playing out in the courts let me just echo a little bit of what both Debbie and Carl said in the following sense. This is a very important, substantive, and useful document. I actually view it as a bit more than Guidelines because there’s a lot of substance in here about how you think about competition problems.

It’s not just a set of principles about when the Agencies will act and when they won’t act. And in that sense I think they’re extremely helpful. It’s one of the only things I had on my desk my entire three years at DOJ. I actually had a pocket Guidelines, kind of like a pocket Constitution—the pages were worn at the edges because I was looking at them a lot.

No matter how much you think you know about antitrust, you’re a better lawyer if when confronted with a problem that is covered by the Guidelines you go back and just read it again. And just look at it, stare at it, and ask yourself, am I adhering to some of these basic principles?

In terms of how they play in the courts, I think that remains to be seen how influential they will ultimately be in cases that are decided. They’re obviously relied on for certain principles and taken as a substantive statement of law or at least legal and economic principles. But they’re also just one side’s version, and judges I think understand that. So whether courts will adhere to all of the sections we’re dealing with, all of the defenses or ways to think about market definition, etc., I think that remains to be seen.

**JEFF PERRY:** There have been a significant number of litigated merger cases recently, brought by
both the FTC and DOJ, and the Guidelines have been relied upon and cited extensively. In terms of whether the Guidelines are working, I generally agree with what’s been said so far, but I might come at this in a slightly different way.

At the very beginning of the Guidelines, there’s a comment to the effect that the Guidelines are intended to be instructive both for practitioners and for the business community. As for the first group, yes, the Guidelines are excellent and very helpful for practitioners. I think they are exactly what antitrust lawyers and antitrust economists need; they help us think about competition problems and issues and they really do reflect “how the sausage is made” at the Agencies.

Frankly, I’m less optimistic that the Guidelines are as digestible for the second group—clients and the courts. That’s not intended to be a criticism of the Guidelines or of these audiences. It’s just that the Guidelines are extremely specialized and are written in such a way and in a language that they are more easily understood by people who spend their entire careers practicing antitrust law. They’re better suited to that audience than a generalist judge or a business person who isn’t dealing with these issues on a daily basis.

And I think one point I would offer as evidence of that is what Debbie and Dave have already said, which I agree with completely, and that is that even experienced practitioners need to read the Guidelines frequently. The Guidelines are that dense and that technical, even for experienced practitioners.

And because of this, the Guidelines leave somewhat of a gap if the intention is to speak to the business community and to speak to generalist judges. So I think there’s tremendous value when the Agencies supplement the Guidelines with case-specific closing statements, with the frequently asked questions publications, and with merger statistics. This is critical, because, as helpful as the Guidelines are, if you take those other pieces out or if they’re not continually refreshed, I don’t think the Guidelines standing alone give us everything that we need.

MANDY REEVES: Can you comment about what role the Guidelines play in your case development and strategy as you prepare for litigation?

JEFF PERRY: I have the Guidelines in mind throughout the life of a merger investigation and litigation, but I would say the Guidelines are more of a focus during the Agency engagement, rather than during litigation. There’s a feeling that when you’re going in to meet with Commissioners, or with Debbie or Dave when he was at Justice, that everybody knows that the Guidelines are the “Bible.” Not everybody agrees with everything that’s in the Guidelines but you know they are going to be the touchstone that people look to. So this is the language you speak and this is the framework you use to present your arguments.

The Guidelines are helpful in front of a generalist judge too, but for somewhat different reasons. The Guidelines help to validate the arguments you make in litigation. So if you or your expert are going to offer a UPP (upward pricing pressure) analysis, for example, or talk about diversion ratios, or make some other point that may not be particularly intuitive, it’s extremely helpful to be able to point to the Guidelines and have the judge understand that even if he or she isn’t familiar with every word in the Guidelines, it’s clear that your arguments or analysis aren’t being made up for litigation, but instead are part of the principles of merger analysis put out by the Agencies themselves.

DEBBIE FEINSTEIN: Yes, and we certainly have seen that the way the Guidelines get discussed in the context of a litigation is through the experts. A good expert will explain how the Guidelines
apply in a simple way to the industry in issue and how these economic principles translate into real-world behavior. Of course, the other side’s expert will try to do the same. Usually, the parties’ economist will accept the framework of the Guidelines but disagree on how they should apply in a particular case.

CARL SHAPIRO: Let me pick up on the expert witness side of that because I agree with what Debbie just said.

I’ve tracked cases and in every case that I know of, the economic expert for the merging companies says, “Oh yes, I’m following the Guidelines too.” Now, this is significant, because then I imagine the judge is thinking, “OK, so both sides’ economic experts are following the Guidelines, so at least when hearing their testimony I can evaluate their testimony using that framework. And especially on the government side, I can ask whether the Agency is being faithful to its own Guidelines or have they left something out?” So the Guidelines have a substantial impact on litigation at least in this way.

Now, this is quite different from the investigation phase where, as Jeff said, everyone knows the Guidelines are like the Bible. But the impact on litigation remains significant. At the very least, the Guidelines are an interesting reference and authority to the judge. Plus, given that the defense expert says that he or she is following the Guidelines, this leads to certain logical questions, either from the judge or in cross-examination. “Did you apply the hypothetical monopolist test?” or “What is your basis for concluding that entry would be sufficient? So the Guidelines play an important role in framing the analysis and the issues in a way that is very much present in court.

JOE KRAUSS: I understand Judge Diane Wood in the Advocate argument last week did make a comment that maybe the district judge did get the hypothetical monopolist test wrong. Is this suggesting that perhaps some aspects of the Guidelines might be too complicated and “too economic” for generalist judges? If that is a fair criticism?

DEBBIE FEINSTEIN: I think there’s a difference between the hypothetical monopolist test conceptually and the hypothetical monopolist test in its application when there are various facts and data that are at issue. Generalist judges can—and do—understand the concept. In my view, the hypothetical monopolist test is conceptually driven from the Supreme Court’s Brown Shoe practical alternatives tests—what are the practical alternatives to which a buyer can turn?

Where it gets complicated is when one economist says “I use this particular model” and another economist criticizes this model or offers an alternative model. That kind of battle of the experts is obviously going to be an issue. Judge Amit Mehta talked at an ABA Fall Forum presentation about his inability to determine the precise equation that should be used for the hypothetical monopolist test when two economic papers suggested different equations. Obviously it will be difficult for a judge to make that kind of determination.

Then it comes down to whether our economist’s view of the hypothetical monopolist test is consistent with other evidence in the case. Judges do not typically have difficulty with that aspect of deciding product market.

CARL SHAPIRO: One of the things we did in working on the 2010 Guidelines was to go back and look at previous Guidelines and, indeed, how they were greeted when they were released. The hypothetical monopolist test dates back to the 1982 Guidelines when Bill Baxter was Assistant Attorney General for Antitrust. They were greeted with quite a bit of—how should I put it—skepti-
cism. Many practicing attorneys were wondering what the hell this “hypothetical monopolist test” was all about and what it meant for their practice. The test was criticized as being incredibly complicated, and many practitioners were wondering how to actually apply it.

Well, 35 years later, the hypothetical monopolist test has become routine at the Agencies, well established in case law, and widely adopted around the world. So I think the litigation issue now is not so much whether we use the test in court but, rather, how to perform the test in a manner that is understandable and credible to judges, what do judges make of conflicting expert testimony regarding the test, and how do judges balance the results of the test with other evidence regarding the relevant market.

DAVE GELFAND: Joe, coming back to your question of whether the Guidelines should be simplified or made more accessible to generalist judges. First of all, let me say that in my experience, people in our profession spend a lot of time agonizing about how you can explain things to judges that are very complicated concepts that we talk about among ourselves as antitrust lawyers and economists. And one thing that has struck me over the years is, every time an opinion comes out it is remarkable how much a judge who has never been exposed to a merger case before absorbs not just the Guidelines but the case law, how much they absorb from the witnesses, the business documents, and the economists.

They get what this whole exercise is about and ultimately, it’s about deciding whether a merger is going to hurt consumers and be anticompetitive; and there are steps along the way to try to get to that decision. So I think it would be a mistake for us to think that we have to oversimplify all of these concepts. But at the same time, we do have to have conversations among ourselves as antitrust lawyers and economists. We have to have conversations with the Agencies that are at a level that you’ll never think about putting into evidence at trial because it’s too extensive, it’s too esoteric, it’s too complicated, there’s too much “what if,” too many alternative runs with the model.

At the end of the day, you’ve got to decide what it is you’re going to distill it down to. And one of the big challenges we have as antitrust lawyers involved in a litigation is picking and choosing. You can’t put it all into the record, you’ve got to decide what your theme is, what your case is, what your key points are. And that’s an art that you’re never going to be able to capture in a single document.

JEFF PERRY: I agree with Dave. I think it’s a mistake to think that judges aren’t sophisticated enough to get it, they are. As I mentioned earlier, the issue is that the Guidelines are just written in a different language than most judges are used to speaking, and frankly in a different language than most of us spoke 20 years ago practicing antitrust law; it’s just changed. So that’s one point.

Second point, the cases that end up in litigation are almost always the types of cases where both sides are able to point to the Guidelines and say, “aha, they support our arguments.” There’s so much in the Guidelines that can be used by both sides in a litigation, particularly given the fact that the close cases are the ones that tend to litigate. So however these cases are decided, you’re always going to have one of the litigants who thinks the judge interpreted the Guidelines correctly and the other party that says the judge didn’t understand the Guidelines or misapplied them. And I think that speaks as much to the nature of the case as it does to the sophistication of the judges.

The other point that is important to keep in mind—and this isn’t a criticism of the document—but the Guidelines are not a formulaic, step-by-step document where you plug in market share and margins, and the time it takes to enter, for example, and then the Guidelines give you the answer. In other words, the Guidelines do a great job at highlighting the factors that weigh for or
against a merger, but they’re not easily or objectively implemented. Certainly, when I was at the FTC I was surrounded by a ton of lawyers and economists who understand the Guidelines, and still we had lots of good, vibrant debate about how to apply the Guidelines to a particular set of facts. So even apart from litigation arguments or advocacy, you can have serious differences of opinion among people as to a particular merger, even though they will all believe they are following the merger Guidelines precisely.

So I think the big challenge with generalist judges is just translating the language, it’s not a matter of simplifying things.

JOE KRAUSS: We could talk forever about various aspects of the Guidelines, but let’s move on to a couple of specific things. We’ve seen cluster markets used successfully by the FTC in the Staples case and alleged in some of the hospital merger cases. What does this recent use imply for market definition going forward?

JEFF PERRY: For better or worse, I’ve been on both the winning and losing ends of these cluster market cases. I had the good fortune to work on a number of hospital cases while I was at the FTC, and since then I have worked on some of the more recent cases. I don’t think there’s much controversial or new in the concept of a cluster market. For example, you won’t hear people clamoring in a shoe merger to define a relevant market for the sale of size nine and a half blue shoes.

So I think it’s well settled that, for analytical convenience, it’s appropriate to group products together for purposes of analysis, so long as you can do so in a way that doesn’t distort the analysis. If you ask 10 lawyers and 10 economists, you’ll get 20 people who all agree with that. The challenge, however, is the balance in how much evidence should be required to support the conclusion that competitive conditions are similar enough for that kind of grouping. Because on the one hand there has to be some meat on the bone; you can’t just group products together in a cluster without demonstrating that it’s appropriate and not misleading to do so. But, on the other hand, if you do a full-blown analysis to justify the clustering, at some point you’ve destroyed the whole benefit of cluster markets in the first place.

So the concept itself is pretty straightforward, but the implementation can be difficult. The way I tend to think about it is if you’re on the plaintiff side, you should need to demonstrate that the competitors are the same across products, that market shares are roughly the same, and that on the supply side entry and repositioning conditions are roughly the same. If you can show those things in a reasonably substantial way, then it’s fair to cluster products together and it’s a tried and true method to apply, but the debate is always going to center around the application.

CARL SHAPIRO: Let me pick up on that. The term I always heard and used in decades past was not “cluster markets” but “aggregation for convenience” which is the same concept. And Jeff even used the word “convenience” just now.

I agree with what Jeff just said: conceptually, the notion of a cluster market is not that complicated, it’s all about what is practical given the available data. But I do not see how the standard that Jeff described can work in practice. If you can measure the market shares for each individual product market that’s going to be in the potential cluster, then you’ve pretty much done the work. At that point, why cluster rather than define dozens or hundreds of individual markets?

In practice, the issue of cluster markets arises when you do not have the data to measure market shares in each individual product market or doing so is just impractical. In that situation, the plaintiff cannot show that the market shares are nearly the same in all of these markets. So the
plaintiff has to fall back on something else to say: “Well, here’s other evidence that these individual markets look similar enough so that I’m going to use an aggregated market share, for which I do have the data.” I think you have to be able to go that route otherwise it’s just a mess practically.

DEBBIE FEINSTEIN: Yes, look, this is not a new concept, I agree completely with that. Brown Shoe was a cluster market; it didn’t use the phrase cluster market but it clearly was a cluster market. The Guidelines don’t use the phrase cluster market, they don’t use the phrase bundle market. There were moments where we thought, “Darn, I wish someone got those concepts in the Guidelines.”

The Guidelines are never going to explain everything and so you go back to the question of: are the Guidelines enough? You’re never going to be able to explain every concept that comes into a merger analysis in the Guidelines; that’s not what it’s meant for. But the litigated decisions give a lot of guidance. I don’t think anybody can honestly say that we haven’t given guidance on how we think about a cluster market in light of the hospital cases and Staples, between our briefs and our expert reports and the ultimate opinions.

I think the world now pretty well understands what a cluster market is, not that I thought that there was any doubt beforehand. And now the question really is about “OK, what does it mean to prove a cluster market?” And that’s really no different than what does it mean to prove any market in terms of the various types of information that we look at.

DAVE GELFAND: I think one of the things you have to think about in these cases is, why are we defining markets in the first place? What is the purpose of that? The purpose is to try to find a line of commerce where competition is really going to be harmed by a merger or harmed by a particular conduct at issue.

If we end up obsessing about market definition simply so that parties can say, “Well, something has been proven or not,” it can undermine the objective of antitrust, which is to get to the bottom of competitive effects. For me the question is, what is the end effect on competition?

I don’t know why the debate really exists. It seems natural to me that you would group products like others have said, it’s something that’s been done forever. Unless you’re just trying to say, well, that’s not an appropriate thing to do, therefore you can’t prove your market, therefore you lose the case. But does it really serve the end purpose of figuring out the impact on competition to be obsessed with whether there’s something called a cluster market or a bundled market?

MANDY REEVES: Another topic on which there’s been recent litigation is potential competition. We have the Steris decision, which gives us one judicial perspective on that. I’d be interested to hear the group’s thoughts on Steris and how that shapes what you think the legal standard is for assessing potential competition.

DEBBIE FEINSTEIN: It was interesting. The judge basically said, “I’ll accept the government’s view of what the standard is for potential competition,” and it was basically a likelihood standard. And the debate came down to what is likely. And on the facts, I think we just came out in different places; we viewed entry as likely because of all the steps that they were taking. Of course they had not actually done everything necessary to enter or they would have been in the market. And so the question is how far you have to go in proving that they would be in the market. We think it’s bad for antitrust policy if the standard is you must prove that a company already has entered before we can show that it is likely to have entered.
And I think in any case other than FDA cases, that is going to be a factual challenge. It’s easier in the FDA cases where we routinely get consents because you’ve taken all the steps necessary other than FDA approval and we can show that the FDA approval is likely. I think parties recognize that and so they walk in saying “we understand your concerns and know we need to settle in these areas.” I think it’s going to be more of a challenge in the other areas.

I don’t think anything about the Steris opinion will keep us from bringing the next potential competition case. They just don’t arise early and often outside the pharmaceuticals area, but we will continue to look for cases that raise concerns.

Interestingly in Steris, the court wanted to focus only on the question of whether entry was likely and did not let us put in any of the evidence on what the markets look like, on what the competitive effects would be. And it might be that a court that looked at the broader context might have come to a different view of what was required to show that entry was likely.

DAVE GELFAND: It struck me as a fact-based decision, but I haven’t read the opinion in a while.

CARL SHAPIRO: Yes, it’s a rather short opinion very much focused on the facts. It doesn’t really get into conceptual issues. So I don’t think it has very much precedential impact. This decision will not change how I envision working with clients or the Agencies to look at cases because it’s so fact based. There is a broader discussion about the evidentiary standards for potential competition and loss of innovation competition that is currently swirling about. But I see this case as very narrow.

JEFF PERRY: The court in Steris very specifically said that it assumed the validity of the potential competition doctrine, so I agree that the opinion clearly is fact specific. I think it was a fair standard for the judge to use to say, “FTC, you have to prove to me that Synergy probably would have entered.” I don’t think the judge expected to see actual entry, just the probability. Obviously, whether the judge’s ultimate findings were correct can always be debated, but I think it was a fair standard for the judge to use and a fair way to approach the case.

Also, whether it’s Steris or any other case, there’s always a risk of overreaction to court decisions, whether they are wins or losses. It’s important to remember that each case is just one data point—it’s one case, with one set of facts in front of one particular judge. It’s very easy to read too much into what each case means about the likelihood of winning or losing the next case, and that’s particularly true here given how fact-specific this opinion is.

DAVE GELFAND: I think an interesting offshoot of this case and this discussion is, whether there’s a different standard for entry as a defense and entry as a Section 7 violation based on potential competition. And I think the government does have to think about whether it wants to be taking the position that certain sets of facts qualify as a potential competition case, if that same government enforcer is unwilling to recognize similar facts as potential entry that could be used as a defense.

MANDY REEVES: Debbie mentioned pharmaceutical cases. How do you think about potential competition in the context of pharmaceutical cases when you know the potential entrants but entry itself may not occur until well into the future? Are there any rules of thumb that you find work in that context?
DEBBIE FEINSTEIN: Typically we do not have concerns where one of the parties is pre-clinical, although there are cases where we have had such concerns depending on the facts of the specific product. When considering likely anticompetitive effects, we consider where the various competitors stack up in terms of when they are likely to obtain FDA approval and enter the market.

Sometimes we hear “Company X is a year behind but they will absolutely be an entrant so you should not worry about the combination of Companies A and B, which are farther along.” That doesn’t end the inquiry. First, it might still leave the market with only three competitors rather than four. Second, if we believe there is likely to be interim harm because prices will be higher until that additional entrant enters, we are going to have concerns. In the pharmaceutical market we know that the impact of entry doesn’t happen until the new entrant has actually entered the market. In other markets, that might not be the case. For instance, starting to build a supermarket might lead an incumbent competitor across the street to begin reducing prices or taking other steps to build customer loyalty. So how to think about the relevant time frame for new entry will depend on the industry.

CARL SHAPIRO: Let me link this to what I see as one of the bigger topics in the antitrust economics discussions these days: industrial consolidation in the American economy.

People are pointing to overall consolidation, let’s say nationally. A lot of that has occurred, some of it due to geographic rollups. I think we are going to be hearing a lot about industrial consolidation, at least for the next year or two.

To illustrate my point, consider a case where you’ve got two companies which are in the same retail or other distribution business but in different parts of the country. Suppose they are both large and they want to merge to have nationwide presence. Maybe there is already one or two nationwide players. Do we say, “Oh this merger is fine, because you’re not competitors at all, you’re in different regions,” or do we say, “No, this merger is a problem, because if you can’t merge you’ll grow to be national yourself and you’ll attack the other guy’s region”?

What would it take in terms of business plans showing that one of the merging firms planned to enter the other merging firm’s region for this fact pattern to qualify as a serious potential competition case versus a garden variety non-horizontal merger? If anybody can answer that, I’ll be impressed.

DEBBIE FEINSTEIN: We figured if you couldn’t, nobody could.

JEFF PERRY: I’m not about to try.

JOE KRAUSS: Let’s turn to price discrimination, another area that has been dealt with and addressed in some several recent cases, such as GE/Electrolux, Sysco, and Staples.

What’s the view in terms of how the Agency should best assess and evaluate price discrimination markets?

DAVE GELFAND: Well, just speaking briefly based on public information about GE/Electrolux, obviously we saw the contract market there as a so-called price discrimination market or a targeted customer market.

I need to just come back to the same point I tried to make earlier, but for me the purpose of antitrust is figuring out if there is going to be significant harm from either conduct or a transaction. And if there is a group of customers that depend on competition between the merger parties in an important way and the other factors that weigh into the analysis like entry, repositioning, etc.
don’t really protect them, then really what antitrust ought to be seeking to do is get to that answer rather than treating the market definition exercise as if it’s just an exercise in its own right.

Price discrimination markets or targeted customers are just a localized form of competition that can be impacted by a merger or by a transaction. We certainly saw that with the contract customers in GE/Electrolux who depended on bid competition from just three companies. Two of them were the merger parties and there was a third but it was a three-to-two in bid competition for a very large portion of that contract business, and that competition was going to be lost after the transaction.

If you just pull up to 30,000 feet, many markets are price discrimination markets. That’s the whole reason it’s a market, because competitors can price based on the competitive set that is in a particular market. Now at the same time, obviously antitrust needs to be sensible. You don’t want to take targeted customers to such an extreme that you start worrying about one or two small customers in a big transaction that has a lot of efficiencies which will benefit the customer base as a whole.

I think we were absolutely right in GE/Electrolux and I have a fair degree of confidence especially after reading the Staples decision that Judge Sullivan would have gone in our favor on that issue.

I think the big issue that remains unresolved, which Dave alluded to, is how to handle situations where a deal looks likely to harm certain targeted customers, but these customers are pretty small compared with all of the customers served by the merging firms. What should we do in these situations? This was certainly the case in Staples/Office Depot because the large customers were a relatively small share of the overall revenues of the two companies, even in office supplies. This is where cognizable efficiencies come into play. How does one balance harm to targeted customers with possible benefits to other customers?

As somebody who teaches MBAs and works with a lot of companies, my view is that price discrimination is simply the business reality in a great many markets. Many companies have sophisticated pricing strategies that target and segment customers. And that’s why the concept of “targeted customers” was given central billing in the 2010 Guidelines. We recognized that devoting an early section of the Guidelines to targeted customers—before market definition—was a significant change in the narrative flow of the Guidelines. We did this because our internal reviews at the DOJ and the FTC showed that an increasing number of cases involved targeted customers. The Agencies commonly look for vulnerable customer groups and structure their investigations around those customers. We felt it was important for the Guidelines to make that clear.

One point I’d like to add, which is reflected in the Guidelines, is that to prove up a case based on price discrimination, it’s not enough just to show that there is a group of customers who appear to consider the merging companies as their top two choices and believe that other competitors or alternatives are less attractive. There has to be an identifiable group that can actually be targeted with an exercise of market power post-merger.

In other words, it’s not just how large or small that customer group is and how we’re going to balance harm against efficiencies, but instead the question of whether the allegedly vulnerable customers are identifiable and can be targeted? And that’s really where the rubber meets the road in these price discrimination cases because if you don’t focus on that issue you end up with a situation where, in any merger of two companies you can find a few customers who will say, “the merging companies are my two best choices.”
So when you’re analyzing whether a truly identifiable group of customers exist, the question is, are there a bunch of other customers who look just like the so-called vulnerable customers but believe they have plenty of other competitive options? And if that’s true, then the similarly positioned customers who believe they are vulnerable should actually be protected. So I think that’s a really important part of the analysis and if you lose focus on that you run the risk of the price discrimination theory really over-predicting harm.

**DEBBIE FEINSTEIN:** That may or may not be right depending on the facts. The Guidelines make clear that you do not have to have clear categories of customers who have the same preferences. If it’s an individualized negotiation I may learn things from prior negotiations or what you requested in an RFP that allows me to determine the extent to which you have good alternatives. As a result, having this information about the extent to which you have alternatives can impact the negotiation even if I am not 100 percent certain of your options.

**CARL SHAPIRO:** For the analysis to properly focus on a group of targeted customers and the merger’s effects on them, the merged company must be able to say, “Here are the characteristics of the customers to whom we are raising price.” However, this absolutely does not mean that the merged entity has to be perfectly accurate in terms of who will then pay the price increase rather than go somewhere else.

The *Ticketmaster/LiveNation* case we handled when I was at DOJ provides a good example. In that case, there were a whole bunch of different types of venues. It turns out that for very large sports stadiums, a lot of the ticketing was done in the form of season tickets, and these venues were not necessarily vulnerable to a post-merger price increase by the merged entity. The situation was quite different for major concert venues. These venues were the targeted customers identified in the DOJ complaint. We did not include in the set of targeted customers the large sports stadiums or a very large number of smaller venues. This reflected the reality of the ticketing business.

So, the key question there was whether the merged entity could profitably impose a targeted price increase on major concert venues. Such a price increase could well be profitable even if some of these venues would shift to other firms for primary ticketing services. The key question is whether an identifiable set of targeted customers is, on the whole, significantly less likely to switch than are other customers.

**JEFF PERRY:** Yes, I generally agree with Carl. I’m not suggesting that for a price discrimination theory to hold water, the suppliers need to have perfect information about customer preferences or that there are no similarly situated customers who serve as counter examples. But if you find enough counter examples—customers who look the same, who seem to fit in the category of allegedly vulnerable customers, but are expressing different preferences—then I think you have to ask the question, would it in fact be profitable to try to target these customers with a price increase?

I agree that if price discrimination would be profitable, then it can support a viable theory of harm, even if the price discrimination couldn’t be implemented perfectly. But if you look at a marketplace and you see that very similar customers are buying from many different suppliers—then I think at some point you have to conclude that trying to price discriminate against a certain group of customers might not be viable or profitable, not just that it wouldn’t be perfect.
CARL SHAPIRO: I agree with that. I would also bring in supply side substitution: if there are suppliers who are serving other types of customers, you have to ask whether they easily could and would serve the targeted customers in the event of a price increase directed at those customers.

DAVE GELFAND: So far we’ve been talking about this as a market definition exercise but again, we should come back to the point that the ultimate purpose here is to try and figure out what the effects are. A lot of the arguments about that go into this market definition exercise related to whether customers turn to alternatives. Will they turn to alternatives? Those issues feed into the parties’ arguments about competitive effects as well.

So you define a market and you get some shares and maybe the shares are high and maybe the court views it as presumptively a violation of Section 7. But parties are still free to come in and bring all that same evidence to bear on the issue of whether there’s a competitive effect, whether the presumption is rebutted in the particular case. If it’s a close call on these questions of whether these can identify a discrimination market or whether you can identify a cluster market, a lot of the same factors that make that a close call can rebut the presumption even if you have high shares, and can be used to persuade the court that those customers are not going to suffer anticompetitive harm as a result of the transaction. They have alternatives to turn to, the suppliers are not going to have an incentive to raise price, there are potential entrants, potential repositioners, etc.

DEBBIE FEINSTEIN: If you go back to the Guidelines, the targeted customers and price discrimination section comes before the market definition section; it is not part of market definition. Courts may discuss it as part of market definition, but I think over time, courts will understand we are talking about the impact of a transaction on a particular group of customers and not need to include the customers as part of the market definition.

MANDY REEVES: Following up on David’s comments about entry, I’d be interested to hear the group’s thoughts on how you think about entry from the standpoint of analyzing the likelihood that a transaction will have competitive effects. In the case of Staples/Office Depot, for example, you had the parties arguing that Amazon was a growing competitive constraint, which the court dismissed. In Google/AdMob, the FTC declined to block the deal because of Apple’s entry. What’s the right way to think about the standard for assessing whether a relatively new and disruptive entrant is or will become a sufficient competitive constraint?

JEFF PERRY: In many ways, this is a highly case-specific and fact-specific question. But one overarching point I want to make is that, when you’re analyzing competitors with different business models, there needs to be symmetry in the analysis so that a disruptive market participant is given similar competitive weight, whether it’s one of the merging parties or a third party. The danger, I think, is that if the Guidelines aren’t applied correctly, or aren’t applied faithfully, you end up looking at the merging companies when they have very similar business models and saying, “Aha, we’re looking at narrow product markets, so these similar competitors must be the first and second choices for customers, and this third-party entrant with a different business model must be a more distant and less important competitor, so we’re not going to give them much weight.”

And the point I want to make is that, if that’s your view, you should stay faithful to that view, so if instead the maverick or disruptor happens to be one of the merging parties, you shouldn’t then change course and say, “Aha, these mavericks with different business models are the ones that really drive competition, so we’re going to more heavily scrutinize an acquisition of a company like...
this.” The role of a maverick, or disruptive entrant, shouldn’t change depending on whether they are one of the merging parties versus a third party.

To your direct point about Amazon’s role in the *Staples* case, this was a case where the FTC argued that Amazon’s business model was more distant and that Amazon wasn’t going to be significant enough to maintain competition. The parties obviously felt differently, and believed a point that comes up in a number of industries, which is that sometimes the real threat to a business and what really constrains their pricing and competitive behavior is not the company that looks most similar to them; it’s the company that threatens to do something in a way that may be different and better. We argued that this view was reflected in Staples’ and Office Depot’s documents and in the companies’ ordinary course thinking—and that was a factual question in that case, but one that comes up in many cases.

**DEBBIE FEINSTEIN:** I do not think it has to be symmetrical because we are looking at different issues. In one case, we are asking whether competition is going to be harmed because of a transaction. Considering whether the elimination of a new entrant might harm competition is not the same as asking whether new entry will be timely, likely, and sufficient to mitigate competitive harm.

But putting that issue aside, the question of whether a disruptive innovator will mitigate competitive harm cannot be answered simply by examining the parties’ documents. For instance, if customers say—as they did in *Staples*—that the “disruptive innovator” is a sufficiently distant competitor, certainly in a bid situation, that competitor will not mitigate the harm, even if the merging companies tell you that is what keeps them up at night. I note that the fact that we look at it case by case is shown by the fact that in *Staples/Office Depot*, we brought a challenge based on harm in the contract market, but not in the retail market. And we made clear in *Office Depot/OfficeMax* that we were crediting online suppliers such as Amazon and competitors such as Wal-Mart in the retail market because that’s where the facts took us.

**JEFF PERRY:** Yes, the point I’m trying to make is not that the company’s documents should trump customer testimony or some other source. The point I was really trying to drive home is, if you believe in a given market that a certain company with a different business model is a significant competitive threat, the analysis shouldn’t change depending on whether they are one of the two merging companies or whether they’re a third party. It’s either a constraint on competition or isn’t.

I agree that customer views can be critically important and if customers on the whole don’t consider a potential new entrant that has a disruptive new business model to be attractive or a good substitute, then that’s important and should be given significant weight.

**DAVE GELFAND:** I’d like to make a couple of points in response to both Debbie and Jeff.

First, I agree that you can’t rely on company documents exclusively. I think all categories of evidence have the potential to be dispositive and they also have the potential to be absolutely irrelevant. You can’t categorically say without knowing the circumstances of a case how much weight to put on documents versus testimony versus economic analysis, etc. But that’s just a general point.

To Jeff’s point about disruptive competition, leapfrogging the existing competitors can still leave a very serious competitive issue. The example I would give is probably the most disruptive competition or among the most disruptive sources of competition we’ve seen in the last 15 or 20 years, namely online news competing with traditional newspapers. Online sources of news have taken an enormous amount of readership away from traditional newspapers.

But when we brought the case involving newspapers in Orange County, California, the fact is that competition between those two local hard copy newspapers which sat right next to each other
on the newsstand still was very meaningful for the 200,000 people who consume their news through newspapers rather than online. So it’s not enough to just say, “Well, there’s going to be disruptive competition that’s going to leapfrog.” The question is, how important is the remaining competition? They might lose 80 percent of their market to an outside alternative, but they still compete for what’s left.

And the third point I want to make and I think this is really important and it often gets confused, is the distinction between entry as it is thought about in the Guidelines or as we sometimes talk about it, and entry that’s going to happen in any event. I think if you have an entrant that’s coming in no matter what, then the analysis is whether that’s going to leave the market so competitive that the loss of competition between the two merger parties just isn’t going to make much difference. The entry that is technically talked about in the Guidelines is entry in response to a price increase or threat of entry that discourages price increases.

Often you’ll hear somebody say, well, we have three competitors going to two, but there’s an entrant about to enter so it’s really a three-to-three transaction. That’s not correct, it’s a four-to-three transaction. There was going to be that third competitor no matter what, so that’s how you have to analyze it. And that really gets mixed up a lot when people are talking about deals and even when evidence is going in at trial.

CARL SHAPIRO: I would just second that, Dave. In fact, in the Staples/Office Depot trial, Amazon obviously was a big factor in terms of their entering. They were entering the market with or without the merger, so the question was whether that entry would be so powerful as to negate concerns about the merger of Staples and Office Depot.

I actually tried in my testimony to make precisely the distinction that you just made, Dave. I even tried to show projected market shares given Amazon’s own plans, which is a good way to handle entry that is not conditional on the merger. To be honest, I think the distinction between unconditional and conditional entry got lost in the larger battle about the significance of Amazon’s entry.

JEFF PERRY: Yes, I generally agree with the distinction. At the same time, however, if you have a case where entry is not prompted by or enhanced by the merger, but instead is happening one way or another, I still would say—as I think Dave said—that if the entry is sufficient to deter or counteract any harm from the merger, then it “counts,” and the merger shouldn’t be a problem. The extreme example would be a situation where ten competitors are entering next Tuesday, and they’re entering whether the merger happens or not. If that entry is sufficient to maintain competition, then the merger should not be a problem.

DEBBIE FEINSTEIN: I think it is quite clear that we always ask who else is entering. In the pharmaceutical cases, we ask about the other companies in the pipeline. In Google/AdMob, the Commission statement said that the Commission initially had concerns, but then saw new entry during the course of the investigation that alleviated its concerns.

We take new entrants into account whether or not they are entering as a reaction to a transaction. It is just a question of how we think about them—as committed entrants pursuant to Section 5.1 of the Guidelines or as new entrants pursuant to Section 9.

JOE KRAUSS: And doesn’t the credit that you give to it really get back to what is the evidence that that entry is likely to occur?
DEBBIE FEINSTEIN: Right. Sometimes I think people think that as long as you can show entry it ends the inquiry. You have to ask what the entrant’s market share and market impact is likely to be. In Staples, Carl actually calculated what Amazon’s share would be in 2017. It was trivial.

So we agreed Amazon was coming; “yes, they’re good.” I mean Carl said on the stand numerous times, they’re—I don’t know what the adjective was, excellent, amazing, outstanding company but in . . .

CARL SHAPIRO: “Awesome” I believe is the correct word.

DEBBIE FEINSTEIN: Sometimes people think that as long as they can point to another company that is entering, our concerns will be eliminated. But that ignores the sufficiency prong of entry.

CARL SHAPIRO: Let me pick up on that. I think this is where the rubber hits the road. Suppose you’ve got a company that’s coming to the market in the next six months let’s say and everybody agrees about that. What share are we going to attribute to that company? Ideally, we’d like to project market shares including that company’s presence and then use those shares for any sort of structural, Herfindahl type of analysis.

If the government does this, and the entering firm’s share is low, the merging firms are going to say: “Come on, these guys are just entering. They may still be pretty small in 6 months or 12 months, but that share understates their competitive significance. They are growing rapidly and shaking things up.” In practice, it can be very hard to tell whether that’s true or whether this entrant is just coming in as a small player with limited competitive impact. I think that’s where the real issue gets joined.

JEFF PERRY: Yes. Much of what Debbie and Carl said in concept I agree with. We should be conducting a forward looking analysis and trying to estimate what an entrant’s market share will be over the near and medium term, and hopefully doing more than just projecting market share, but also thinking more broadly about what their competitive significance will be going forward. I think we agree that’s the right way to think about it. This is one where, on the facts of particular cases, obviously we come out very differently in terms of what each side thinks the right answers are but I think for the most part we agree on the question.

I also want to echo something Dave said about disruptive innovators. When you’re thinking about this disruptive competitor with a new business model coming in you’ve really got to look at the particular facts and circumstances to determine how competition will be affected. In some cases that disruptive competitor comes in and steals customers away and essentially shrinks the size of the existing market and creates a new and distinct market. In that case, which I think is the newspaper example Dave gave before, competition within the old market remains important.

But again, every case is different. There are some industries where a company faces a disruptive new competitor and they start bleeding customers, but instead of two distinct markets being created the incumbent has to continue competing against this disruptive entrant to try to keep customers and win new ones. In other words, the customers don’t really separate into distinct, identifiable groups, and so the new entrant will continue to compete against and constrain the existing competitors for all customers. So I really just want to stress that this is a fact intensive inquiry, and you could see both flavors of this.

DAVE GELFAND: I agree. And even if they have an identifiable set of customers, they might still choose to compete to retain a broader set of customers. So it is highly fact specific.
JOE KRAUSS: We’ve been talking about innovation markets and it gets back to the 2010 Merger Guidelines, does it adequately address innovation markets? And is this a place where the next administration might consider revisiting and seeing if there are any places where the Guidelines can be improved with dealing with these types of markets?

DAVE GELFAND: I’ll take a quick run at that. I don’t know whether the next administration can improve on it or not. It’s actually just to me an undeveloped area of the law. People don’t quite know how to think about innovation markets in the context of a Section 7 case, you can’t really measure it. If you’re talking about a pure innovation market where the question is whether there are going to be fewer inventions, I can’t really point to which products it’s going to be in. I just know these are the two companies that are doing a lot of research in a general field and if you lose competition between them there are going to be fewer inventions.

I don’t know, it’s kind of hard to find a case on that, it’s kind of hard to find a way to model that. There’s certainly disagreement in the literature about whether even going from two to one, much less three to two, or four to three, whether any of that increases or decreases the incentive to innovate. There are situations where combining R&D programs can lead to more innovation.

So how you capture that in a set of Guidelines when there haven’t been any cases litigated that have really zeroed in on that issue, when there isn’t a well-developed body of economic consensus around how to think about it—I think that’s a big, big challenge.

DEBBIE FEINSTEIN: The phrase innovation market gets used to describe a vast amount of things that are not actually what I think of as a classic innovation market as Dave has explained. The Guidelines are certainly able to take into account R&D concerns in addition to product concerns; that was the case in the DOJ’s Tokyo/Electron challenge. GM/Toyota also raised innovation concerns. The FTC’s investigation of Genzyme/Novazyme (which it ultimately closed) is often referred to as an innovation market case. It was about future competition in a very identifiable product. So not everyone would call that an innovation market.

In contrast, innovation markets are often more generalized innovation concerns, but for products that are not yet identified. There can be a concern that merged firms might compete in a to-be-determined product because they both have a history of innovation. This is an issue the Commission considered in its investigation of Teva/Allergan, e.g., were Teva and Allergan uniquely able to innovate? As the Commission statement makes clear, it did not find such a concern.

So I think it is important to distinguish between the precise innovation concerns at issue in a given matter.

DAVE GELFAND: I agree.

CARL SHAPIRO: Most of the time when people talk about an innovation market, they’re really talking about competition in some product market in the foreseeable future.

This was certainly true in the Genzyme/Novazyme case, and I would say other pharmaceutical cases as well. Personally, I prefer this framing: “Okay, here is the product, here are the customers, we can see the competition coming, and we believe these companies are likely to bump directly up against each other in the foreseeable future for certain identifiable products.”

A broader type of case arises if the merging firms have the best capabilities in some area but we cannot reliably identify specific products that they will likely be selling in direct competition in the foreseeable future. This type of case would really fit more with the notion of an “innovation mar-
ket” rather than a future product market. One could also call this a “capabilities overlap” that could affect a variety of future product markets. The key to such a case would be to identify the technical area where the firms have overlapping capabilities possessed by few if any other firms. Logically, such a case would present horizontal concerns. However, the anticompetitive effects are uncertain and could be very hard for the government to prove since it cannot identify with confidence even the products and customers for which competition may be diminished.

JEFF PERRY: When you get into potential competition and innovation cases, I think these are areas where extra caution is really needed. In a typical merger case, where you’re assessing how a merger will affect competition in an existing market, even that analysis is necessarily predictive because it’s forward looking. And when you get into potential competition cases or pure innovation cases, you get into areas where you’re really pushing the bounds of prediction.

So I agree that these are important and hot topics, but I think we have to be realistic about how far forward the Agencies and courts can reasonably predict marketplace dynamics, particularly if we’re talking about a true innovation case with affected markets that don’t even exist yet. And one potential risk here is that you may condemn a proposed merger and sacrifice near-term and relatively certain efficiencies based on a much longer-term concern about amorphous harm.

I would also echo a point that Dave made, which is that there’s very little case law in this area to fall back on. It’s one of the things that was disappointing about the Steris case that it failed to offer much discussion or critique of the potential competition doctrine. And as a result, we’re left in a place where, when it comes to potential competition or innovation cases, we’re all citing these non-litigated merger investigations like Genzyme/Novazyme and Applied Materials/Tokyo Electron, where you never had a judge even weigh in on the theory of harm, let alone provide guidance on how the theories should be applied to the facts.

CARL SHAPIRO: Well, there is a line that I’ve seen in the press lately suggesting that antitrust is missing something because big tech companies are purchasing smaller upstarts which could threaten them down the line although they’re not threatening them yet. I don’t know what to make of that, but it’s out there.

JEFF PERRY: Yes, it’s out there, but this is potentially a dangerous area for false-positives in antitrust enforcement.

In many of these potential competition type cases, you have transactions that can be tremendously procompetitive—think about the pharmaceutical area, where you have a whole industry of small innovative companies that are really great idea factories but may be poorly capitalized, or without the resources to really complete R&D, or get to scale production, or actually get a product distributed efficiently to customers. And as Dave and others have mentioned, there can be huge efficiencies—and not just financial efficiencies—but real benefits to patients that come from these transactions.

So when you’re thinking about possible competitive harm from these types of transactions, there’s often so much on the other side of the ledger that I think we’ve got to be really cautious about enforcement here.

DAVE GELFAND: Yes, and if you’re referring to the same sort of commentary that I’m thinking about, Carl, there are several things missing from that. And I view it as a relatively superficial view point to have been articulated.
First of all, you’ve got to be able to predict something about future competition. You can’t just say well, large established companies shouldn’t buy startups or innovators. You’ve got to predict something about the competition that’s going to be lost and it’s very speculative when you have a startup company.

Second, the analysis needs to incorporate how the large company is going to improve what the startup or the smaller company brings to the market. They’re going to invest, they’re going to combine it with their platform, and they’re going to probably bring a lot of great benefits to what that smaller company has to offer.

Third, you can’t forget about the incentive that smaller companies have to invest in the first place, which is usually to be bought by the highest bidder. And if you start interfering with that dynamic, you really run the risk of discouraging investment in biotechs and tech startups and that’s a very dangerous path to start going down based on a speculative competition theory.

And one other problem is you can’t win that case as a government enforcer because you’ve got serious litigation risk trying to find a line of commerce in which competition would be harmed.

**JOE KRAUSS:** Let’s finish with efficiencies. Debbie, this best starts with you because I was intrigued by your blog in March, and it really hit home with me in discussing efficiency arguments with clients because every time you try to point to some government action evaluating efficiencies, it’s a litigation where the government is trashing the efficiencies claims for the most part. This makes it difficult to talk to clients about how important efficiencies are when they see that and say, well why do I go through the effort to try to do that?

What can the Agencies do and what can we as private practitioners do to better articulate the true standard in terms of how the Agencies are evaluating efficiencies in mergers and not be tilted by that skewed perspective if you only look at the litigated cases?

**DEBBIE FEINSTEIN:** I think the disconnect is that business efficiencies are not Merger Guidelines efficiencies. Often we keep hearing for months about the business efficiencies before the parties focus on what we might consider efficiencies under the Guidelines. It’s great that you think you’re going to get $2 billion in cost savings, but come to me with a number that reflects an honest assessment of what meets the Guidelines test.

I often hear about nebulous best practices that one party can bring to another. But these are not best practices arising from one party being able to share a particular technology with the other. Rather, parties claim that one firm has smart people who have developed great practices that they can apply to the other firm. But this is clearly not a merger specific benefit.

Similarly, we often hear about cost reductions from rationalizing suppliers. Sometimes those can be credited, but often, the companies are already beginning that effort and they include in their efficiencies everything they will achieve unilaterally and everything that they would do together. Focusing only on the merger-specific and cognizable efficiencies to give us a reasonable assessment of efficiencies from the outset will save a huge amount of time.

In Sysco, we recognized there would be some efficiencies. But even their own economic experts didn’t agree on the numbers. And what their experts said in court was much lower than what they had argued to us throughout the investigation. It would have been more useful for them to come in with those lower numbers from the outset. Instead, we did the work to come up with a reasonable assessment.

The second point is that parties often fail to consider the extent to which the efficiencies would be passed through. For instance, in bid markets, the economics make clear that not all efficiencies get passed through. Yet, parties often don’t take on this issue.
In the early stages, come in with a reasonable number that reflects the Guidelines approach and some consideration of pass-through so we can start from a reasonable point and go from there. Then we’re in a position to say “Great, if you are right on that number, that would address our concerns so now let’s all dig a little bit deeper to see if those numbers hold up.” But we often start so far apart that there’s no way to have that reasonable conversation.

CARL SHAPIRO: I think the situation regarding efficiencies is unfortunate and could be improved upon. I say this having seen from both sides how efficiencies are viewed. The Agencies are very skeptical of efficiencies and have a high bar before they are credited. In part because of this, merging companies often seem to say: “Well, let’s not seriously develop and present an efficiency claim early on because we doubt it will get us very far.” The net result is that the merging companies do not develop an efficiency claim that meets the Agencies’ standards, particularly as regards merger specificity. Or they present an efficiency claim later, which may be less credible.

I think progress could be made, at least in some cases, if merging companies went in earlier with a credible efficiency claim and if the Agencies were more willing to engage with the merging parties on such claims. I realize that it can be very difficult to develop a detailed, credible efficiency analysis, as this often requires combining confidential information from the two companies. The DOJ and the FTC could reward such efforts by taking them seriously and indicating which parts are convincing and which are not, giving the merging parties a chance to refine and strengthen their efficiencies claims.

More generally, if the merging firms can tell a credible goodness story with their merger at an early stage of the investigation, it affects the Agency’s thinking about the deal, even if the Agency sees some problems.

DAVE GELFAND: I was simply going to say that one of the things I was struck by during my three years at DOJ was—and I’m not speaking about any particular case now because there were some cases in which a stronger showing was made on this topic—but I was struck by how superficial the efficiencies arguments often were. They weren’t even arguments half the time, they were just statements to the effect that millions of dollars in overhead would be saved by firing a lot of people.

As Debbie said, parties really need to do something that ties in to merger specificity and the benefit that the market will receive from it.

CARL SHAPIRO: The biggest opening here, in my view, is for companies that can show efficiencies they have actually achieved in other deals that are comparable to the deal on the table. I thought this was a big opportunity for Staples, given the Office Depot/Office Max deal that had happened just a few years earlier. And it’s a pity they never put on a defense so their efficiency claims were never properly presented in court and subjected to cross-examination. Those claims were disputed by the FTC, but Judge Sullivan never had the opportunity to ask questions of the efficiency witnesses on either side.

JEFF PERRY: I don’t agree with that, but I also don’t want to re-litigate the Staples case, so let me just briefly say this. The expert reports, documents, and efficiency arguments in the Staples case were all in evidence. The fact witnesses and expert witnesses were all deposed at least once; so the efficiencies evidence was in the record, but obviously the claims were not ultimately credited by the judge. As Carl points out, there was a recent (Office Depot/OfficeMax) transaction that
looked very similar and led to hundreds of millions of dollars in annual savings that I don’t think anyone debated. And Staples’ own files in the current transaction supported the point that the current acquisition was motivated by, and the valuation was driven by, significant efficiencies of more than a billion dollars per year. And yet in response, the FTC’s efficiency expert said there would be zero dollars in cognizable efficiencies, literally zero dollars. So you can draw from that what you will, but you can see how the private bar or the business community might see that as extraordinarily skeptical.

To your earlier point, I do think that litigation cases provide a skewed sample set—I agree completely. First, because the Agencies are in litigation mode and at that point they’ve made a decision to challenge a transaction, and they do what they should do—they go in guns blazing to try to win that case. But second, and I think this is reflected in the Guidelines, efficiencies really matter the most in marginal cases. So if you bring me a five-to-four merger with combined market shares in the high 20s, I would say get your efficiencies arguments in order, let’s engage early, let’s do everything that Carl, Debbie, and Dave said.

But, if there’s a transaction that the Agencies believe is not a close call, and they believe will lead to significant harm, it’s hard to advise a client that efficiencies are going to be given significant weight. There’s also the question of whether the level of proof required to demonstrate efficiencies in that subset of deals may exceed the level of proof or certainty required when analyzing competitive effects. And, there’s a real risk in these transactions that if you make a strong efficiencies argument, it can be flipped against you where the Agencies may say, “Aha, clearly these smaller competitors don’t have the scale to compete and you’ve made that clear by arguing that this transaction will lead to efficiencies.”

So I agree with Carl on the fact that we’re in somewhat of a bad cycle and there’s room for improvement on both sides, frankly. On the private bar side, there’s room to get in and engage early and more effectively. And respectfully, on the Agency side, there’s room to give a little more credit to efficiencies and to more fully appreciate the challenge in quantifying forward-looking efficiencies to the ledger level of detail.

**DEBBIE FEINSTEIN:** Where the intuitive story of efficiencies makes sense and is consistent with other facts we are hearing, we do not necessarily need to have mathematical precision on the efficiencies. But often we hear these contradictory stories. On the one hand, we will get scale economies and need those to compete, but the small competitors will constrain any post-merger exercise of market power. That may be right because you have built up an inefficient system but we need an explanation of the seeming inconsistency.

**MANDY REEVES:** I think that’s a great place to end. Thanks everyone for a terrific discussion.
Non-party witnesses—usually customers, competitors, or suppliers of the merging parties—often play a prominent role in federal antitrust merger challenges. For example, over 200 non-parties were served with discovery requests in the FTC’s challenge to Staples’ now-failed proposed acquisition of Office Depot in 2016; and 18 non-parties appeared in the U.S. Department of Justice Antitrust Division’s challenge to Electrolux’s now-failed proposed acquisition of the appliances business of General Electric Company in 2015.\(^1\) While some non-parties welcome the opportunity to oppose or support a proposed merger, others prefer not to be involved. Regardless of whether they support, oppose, or are neutral to a proposed transaction, all of these non-parties have one thing in common: the unexpected expense and management distraction that comes from being a witness in a merger investigation or litigation.

Non-party witnesses traditionally have played a role in federal merger investigations and litigation in the United States.\(^2\) The FTC/DOJ Horizontal Merger Guidelines ascribe particular importance to customer information gathered during their investigations:

> Information from customers about how they would likely respond to a price increase, and the relative attractiveness of different products or suppliers, may be highly relevant, especially when corroborated by other evidence such as historical purchasing patterns and practices. Customers also can provide valuable information about the impact of historical events such as entry by a new supplier.

> The conclusions of well-informed and sophisticated customers on the likely impact of the merger itself can also help the Agencies investigate competitive effects, because customers typically feel the consequences of both competitively beneficial and competitively harmful mergers.\(^3\)

Recent news reports assert that the FTC and the DOJ are investigating an increasing number of deals as a percentage of HSR filings and that merger investigations are taking longer.\(^4\) This creates more opportunities for non-parties to become involved—willingly or not—in merger investi-
gations and litigation, and to remain involved for longer periods of time, at significant expense and management distraction.

Non-parties are typically involved early in a merger investigation. Although not a perfect predictor, if non-parties (and customers, in particular) raise concerns about a proposed transaction, the investigating staff is more likely to issue a Second Request. Regardless of whether the non-party voluntarily cooperates with the investigating agency early in the investigation, the agency may issue some combination of formal document, data, or deposition requests to gather more information to aid in its investigation.

Regardless of whether they support, oppose, or are neutral to a proposed transaction, all of these non-parties have one thing in common: the unexpected expense and management distraction that comes from being a witness in a merger investigation or litigation.

If, after completing its investigation, the investigating agency challenges a proposed merger, non-party witnesses are likely to be pulled into the litigation. Under Federal Rule of Civil Procedure 26(a)(1)(A)(i), the litigants are required to disclose “the name . . . of each individual likely to have discoverable information—along with the subjects of that information—that the disclosing party may use to support its claims or defenses.” Both the FTC and the DOJ have taken the position that Rule 26 requires turning over a list of any non-parties with whom the agency had communications during its investigation. The agencies must also produce non-party documents from their investigations to the merging parties as part of these disclosures. This process immediately shines a spotlight on non-parties and creates potential confidentiality risks for them.

After the agency provides its initial disclosures, the merging parties are likely to issue their own subpoenas to non-parties requesting additional documents, data, or deposition testimony. For example, in the FTC’s recent challenge to the proposed Staples/Office Depot merger, the merging parties sent such requests to over 200 non-parties shortly after receiving the agency’s initial disclosures. Documents produced and testimony taken in the agency’s investigation and during discovery frequently materialize as evidentiary support in court filings and during hearings and trials, meaning that without additional actions, the non-parties’ confidential information could become public.

Moreover, non-parties may be called to put their employees and executives on the stand at trial. In fact, non-parties’ employees can become star witnesses in a merger trial or hearing. In the recent Staples/Office Depot case, the merging parties’ primary defense was that regional office supply vendors and Amazon Business were poised to enter the market or expand in a way that would offset any potential anticompetitive effects. In rejecting those arguments and granting the FTC’s preliminary injunction to block the merger, the court stated that evidence from W.B. Mason, a leading regional supplier, showed that W.B. Mason had abandoned nationwide expansion plans and that it might not be able to compete even after receiving divestiture assets. And the court found that Amazon Business’s testimony and internal analyses indicated that it might not be competitive with the merged entity in the near future because it did not plan to offer the same services as Staples and Office Depot. Similarly, in blocking the proposed Sysco/U.S. Foods merger, the court found that competitor and potential divestiture buyer Performance Food Group’s analyses

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5 See Pls.’ Opp’n toDefs.’ Mot. to Compel at 2, Staples, No. 15-cv-2115 (“Defendants have the entire list of third parties that provided information to [the FTC] . . . .”); Stip. Regarding Scheduling and Case Mgmt. and Proposed Trial Setting and Case Mgmt. Order ¶ 4, AB Electrolux, No. 15-cv-1039 (July 16, 2015) (“The parties will produce . . . all documents, data, information, or transcripts of testimony . . . . that any non-party provided to any party either voluntarily or under compulsory process preceding the filing of this action in the course of the parties’ inquiries into the competitive effects of the proposed acquisition . . . .”).

6 See Pls.’ Opp’n toDefs.’ Mot. to Compel at 2, Staples, No. 15-cv-2115.


8 Id. at *22–24.
showed that it would not be competitive with the merged firm, which would be the only national competitor remaining.\(^9\)

Reflecting on our recent experiences representing non-parties in significant merger challenges by the FTC and the DOJ, in this article we provide practical tips to consider when advising a non-party client in merger investigations or litigation.

**Tip 1: Be Proactive; Not Reactive**

Merging parties would not present information to an investigative agency without a plan; non-parties should not do so either. Regardless of whether the client anticipated receiving that initial call from the investigating agency or if it came out of the blue, the client is now involved in a federal government law enforcement investigation. An initial request from an investigating agency for an informal interview may be the first step in a multi-month process. Non-parties need to be aware of the possibility of a long, time-consuming, and expensive road ahead as a result of that initial call and should plan appropriately. In developing this plan, counsel and clients should consider the following:

- **What is the client’s role in the investigation?** Is the client a customer of the merging parties? A competitor? A supplier? The answer to these questions will help counsel understand what information the investigating staff might want from the client. For example, if the client is a competitor, the investigating staff’s questions may focus around wins and losses against the merging firms and the client’s strength as a competitor in the industry. If the client is a customer or supplier, the inquiry may focus more on the client’s options and whether other firms could compete for the client’s business.

- If the client transacts business with one or both of the merging parties, counsel should consider the client’s relative size compared to other customers or suppliers. If the client is one of only a few customers and accounts for a significant percentage of the merging party’s (or parties’) business or if the merging parties are two of only a few of the client’s purchasers, the investigating staff may pursue the involvement of the client more vigorously than if the client were one of hundreds of similarly situated entities.

- **What is the client’s position on the deal and why?** Prior to the client talking to investigating staff, counsel should gain an understanding of the client’s position on the proposed deal under investigation and the reasons for that position to prepare the client to answer probing questions about its views. For example, staff may be skeptical of a customer’s support of a merger, particularly one that leaves one or few suppliers in the market, and may require deposition or other testimony to unearth the reasons for the view. These reasons can range from benign—for example, that the client has options the agency staff have not considered like sponsoring new entry—to more likely to raise questions, such as that the client received a “sweetheart” deal from the merging parties in exchange for the client’s support. Whatever the rationale, understanding the client’s position is critical to enable counsel to guide the client through the investigation and possible litigation.

- **How involved does the client want to be in the investigation and possible resulting litigation?** Counsel must also understand how involved their client wants to be in the investigation. The product or service on which the merging parties overlap may be a key input in the clients’ own products or services or a key component in the client’s business. Clients may be more willing to be

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involved in agency merger investigations and litigation when the outcome of the process will directly affect their bottom line. And, under these circumstances, clients may proactively contact the reviewing agency to share their views. On the other hand, even if the client could potentially be subject to a price increase if the proposed merger is consummated, if that price increase can be passed through to others or represents only a small fraction of the company’s costs, the client may be less willing to be involved.

Apart from the desire to be involved (or the client’s lack thereof), counsel must also consider how much of a financial commitment the company is willing to dedicate to the agency’s investigation. Deal parties often have budgets relating to their proposed mergers and the ability to plan for their payments to outside counsel and other consultants and advisors. Non-parties may not be afforded this luxury, especially if they are contacted by the investigating agency without warning. Representing non-parties in merger investigations and litigation can impose significant and unexpected costs. Outside counsel legal fees can range from tens of thousands of dollars (for investigatory matters that did not result in document or data production or litigation) to hundreds of thousands of dollars (representing non-parties as witnesses in merger challenges). Even if the client wants to be involved in a merger investigation or challenge, financial constraints are an important factor in determining how to respond to government (and later merging parties’) inquiries.

The client may be able to meet its compulsory process obligations and also lessen this financial burden through discussions with the investigating agency, which is often open to compromise solutions with non-parties. Depending on the client’s importance to the case, these compromises may include prioritizing specific requests and deferring others, limiting the number of custodians searched, or forgoing email searches in favor of production of strategic plans and other “higher level” company documents that are more easily accessible. In addition, in some circumstances, the client may be able to provide a declaration in lieu of participating in a deposition or investigational hearing.10

No matter the client’s level of involvement, these financial burdens may be mitigated if the client has a contractual relationship with one or more of the merging parties. Counsel should consider the extent to which indemnification clauses might provide a basis for the client to seek reimbursement for legal fees and other costs associated with responding to requests related to the merger. If the response costs are not covered by an indemnification clause, the client’s Directors & Officers liability insurance policy may provide for reimbursement depending on the specifics of the policy. Counsel should carefully consider all available options for the client’s recovery of costs incurred.

What do the client’s documents say? Counsel should conduct a mini-investigation prior to opening lines of communication with or beginning document productions to an investigating agency. The level of appropriate inquiry will vary for each merger investigation and client and will be informed by the answers to the above questions. At a minimum, counsel should confer with a

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10 If the agency accepts a declaration in place of (or in addition to) a deposition, agency staff will generally prepare the first draft based on information gathered from informal interviews and document discovery. Counsel for the non-party and the agency may then consult on the draft declaration until they reach agreement on an executable version. At least one court appeared to construe the FTC’s revisions as an attempt to coerce “[a non-party] to say some things that weren’t true,” H’r’g Tr. 834:18-19, Staples, No. 15-cv-2115 (D.D.C. Mar. 24, 2016), although that same court eventually softened that stance. Staples, 2016 WL 2899222, at *24 n.14 (“Although the Court expressed its concern about this process at various times during the hearing, no evidence of an improper motive on the part of the FTC was ever presented.”).
potential witness prior to any telephone discussions with FTC or DOJ staff. This discussion can assist counsel in gaining a general sense of the likely communications between the client and the merging parties that the investigating staff may want to explore. The merging parties are likely producing significantly more documents and emails to the investigating staff than the client will. These documents and emails may include communications to and from the client. Thus, even if the client does not produce a single piece of paper to an investigating agency, the staff likely will have communications involving the client that they may use to question the client’s representative or use as trial exhibits or evidence. In the recent Staples/Office Depot preliminary injunction hearing, the FTC’s opening statement highlighted emails to customers from the merging parties’ files that indicated that Staples and Office Depot were close competitors and the merger would negatively impact prices.11 Non-party counsel should, to the extent possible, understand what documents might be in the merging parties’ files (and, therefore, produced to the reviewing agency) to prepare potential witnesses for discussions with the reviewing agency’s staff.

Tip 2: Protect the Client’s Confidential Materials

Protection of the client’s confidential materials begins with the very first communications with agency staff. In initial discussions, counsel should ensure that they understand what confidentiality protections apply to client materials, and request confidential treatment of every substantive conversation and submission. Requesting confidential treatment in this way can, for example, shield a non-party’s identity and position on the merger in the event that the agency ultimately takes no action or settles the case. This anonymity is particularly important when a non-party opposes a customer’s or supplier’s merger to the reviewing agency but would have ongoing business relationships with one or both of the merging parties regardless of whether the merger is consummated.

The investigating agencies’ confidentiality rules apply strictly to material submitted pursuant to compulsory process during the investigative phase. Under the controlling statutes, such materials submitted to the federal antitrust agencies under the Hart-Scott-Rodino (HSR) Act (investigations of mergers prior to closing) or other authority (all other antitrust investigations) may not be publicly disclosed prior to litigation, except for limited exceptions.12 For example, this information generally may not be disclosed to a deponent (other than the producing party) during an agency’s deposition or investigational hearing.13 The DOJ’s internal Antitrust Division Manual prohibits disclosure to state attorneys general or foreign regulators even though those entities are often involved in large-scale antitrust investigations.14 Thus, investigating staff from the DOJ and the involved states often request “waivers” to permit all investigating agencies to share and discuss information from non-parties.

The FTC follows a slightly different procedure, and may disclose non-HSR material to other jurisdictions if they make proper requests for access for “law enforcement purposes.”15 The FTC seeks to “limit disclosures as necessary to protect confidential information,”16 including potentially

11 FTC Opening Statement Presentation at 6, Staples, No. 15-cv-2115 (D.D.C. Mar. 21, 2016), https://www.ftc.gov/system/files/documents/cases/160321staplesstatement.pdf (“[I]t is my strong suggestion that [the nonparty] consider any and all program offerings from Staples before [the merger is approved.] [The nonparty] will never get a more competitive offer than right now . . . .”)
13 See U.S. DEPT OF JUSTICE, ANTITRUST DIVISION MANUAL (5th ed. last updated Apr. 2015), ch. 3, at 30, 61; FEDERAL TRADE COMM’N, OPERATING MANUAL, ch. 15, at 64 (showing confidentiality protections available for material to be disclosed in oral testimony).
14 See ANTITRUST DIVISION MANUAL, supra note 13, ch. 3, at 31, 62.
15 FTC OPERATING MANUAL, supra note 13, ch. 15.7.1.
redacting the identity of subpoena recipients.¹⁷ Although depending on the particulars of the state’s request, a “waiver” may still be necessary or advisable, even in FTC investigations. In our experience, both FTC and DOJ investigating staff are very willing to discuss waiver and confidentiality issues with non-parties. Prudent counsel should initiate these discussions with staff as soon as practical after their clients are contacted in investigations.

If representatives from other jurisdictions (foreign antitrust enforcers or state attorneys general) or from other regulators are participating in the investigation, counsel must understand the confidentiality rules that apply in those jurisdictions or to those regulators and whether the participation of other law enforcement agencies constitutes a waiver of the applicable confidentiality protections. Many jurisdictions are prepared for these discussions with non-parties and are willing to provide written assurances regarding confidentiality if the applicable rules or statutes are unclear. Even with these assurances, however, counsel should conduct an independent review of the law to ensure that the basis for non-disclosure under the state Freedom of Information Act (FOIA) or other applicable rules is strong. If it is not, counsel may want to consider requesting that the investigating jurisdiction issue a “friendly” investigative subpoena or other request pursuant to compulsory process in order to be afforded clearer confidentiality protections.

Although information submitted by non-parties during antitrust investigations is generally exempt from FOIA, this exemption does not provide a blanket prohibition on disclosure by the investigating agency.¹⁸ Notably, an investigating agency may disclose non-party confidential information to Congress and the other federal antitrust agency.¹⁹ Moreover, for non-HSR investigations led by the DOJ, information that is submitted voluntarily may also be disclosed.²⁰ This means, for example, that white papers and other advocacy pieces may be subject to disclosure, and it is often advisable for the client to request the DOJ to issue a narrow Civil Investigative Demand or interrogatory requesting the materials.²¹ The FTC’s rules provide that information submitted voluntarily in connection with an investigation of the laws administered by the FTC, even in a non-HSR investigation, is confidential and may not be disclosed.²² Therefore, in FTC investigations, it is unnecessary to request additional compulsory process before submitting a white paper or other information.

If the investigation results in litigation, use of non-party documents in federal court is generally governed by a protective order.²³ Protective orders typically limit the specific individuals who may access non-party materials to the merging parties’ outside counsel and a small number of in-house counsel who are assisting in the defense.²⁴ Counsel for non-parties should enter appearances in merger litigation or otherwise monitor dockets as soon as practicable in order to have

¹⁶ Id. ch. 15.7.3(c).
¹⁷ Id. ch. 15.7.3(a).
¹⁸ Antitrust Division Manual, supra note 13, ch. 3 at 30, 62; FTC Operating Manual, supra note 13, ch. 15.4.3.
²¹ Id.
²³ 15 U.S.C. § 18a(h) (allowing disclosure as “may be relevant to any administrative or judicial action or proceeding”); 15 U.S.C. § 1313(d)(1) (allowing disclosure for “official use in connection with any [] case, grand jury, or proceeding”).
immediate access to court rulings, including proposed changes that may affect non-parties’ confidential documents. For example, in the DOJ’s challenge to the proposed Electrolux/GE Appliances merger, during the week of the Thanksgiving holiday, the merging parties requested that the court modify the protective order to allow GE’s general counsel broad access to non-party material, which went substantially beyond the access the protective order granted to the few previously designated in-house counsel. The court allowed non-parties less than 48 hours to respond. After some non-parties objected to such broad access, the merging parties narrowed their request so that GE’s general counsel would have access only on the same terms as the other in-house counsel, and the court granted the narrowed request.

Even with a protective order, non-parties may need to take additional steps to protect the confidentiality of their documents that are used in court. Trials and hearings are presumptively open to the public. To maintain the confidentiality of material used in these situations, non-parties often are required to file briefs to obtain in camera or sealed treatment of their documents that are designated as potential exhibits by the challenging agency and the merging parties. While each circuit’s law on sealing treatment varies, the key inquiry in most courts is whether the non-party’s interest in confidential treatment outweighs the public’s interest in accessing court documents. This balance may tip one way or the other depending on the content of the material and the reasons for which it was created. For example, a non-party’s internal analysis of the challenged merger may be more prone to public disclosure than the non-party’s internal business sales strategies.

Moreover, just because the client’s documents have been granted sealed treatment initially does not mean that they cannot later be unsealed. In the Electrolux/GE Appliances preliminary injunction proceeding, the court granted motions to seal of every non-party that filed an unopposed motion. But after receiving a letter from certain media outlets criticizing the broad sealing treatment that had been granted to both parties and non-parties in the case, the court imposed a re-review process for any material introduced in court that had previously been sealed. In some instances, the court unsealed documents (or portions of documents) during live testimony and allowed them to be publicly displayed. While this is a difficult issue to predict or prevent, courts may be more willing to maintain sealing treatment if the non-party sought only minimal nondisclosure at the outset, including where appropriate opting for redactions rather than blanket nondisclosure of all potential trial exhibits. If unsealing decisions will be made in open court during a hearing or trial, non-parties should carefully consider whether to have their counsel present to argue in favor of keeping confidential materials sealed.

**Tip 3: Understand and Manage Communications About the Deal**

Non-parties may be contacted soon after a deal is announced. Merging parties often contact cus-

28 See, e.g., Minute Order, FTC v. Staples, No. 15-cv-2115 (D.D.C. Apr. 14, 2016) (instructing that non-parties were required to file motions to seal for documents included in the parties’ findings of fact and conclusions of law); Order, Sysco, No. 15-cv-256 (D.D.C. Apr. 30, 2015) (requiring motions from non-parties to request in camera treatment).
31 H’g Tr. 3826:25-3827:2, AB Electrolux, No. 15-cv-1039 (D.D.C. Dec. 2, 2015) (“Court: I mean, if [the trial exhibit] was presented for [the Association of Home Appliances Manufacturers] to do as they please, why should it be cloaked in confidentiality now?”).
customers, particularly those with whom they have an existing relationship, to garner support for their deal. Additionally, the investigating agencies may contact individual employees of non-party industry participants based on information the investigating agency staff receives from the merging parties or the agency's own estimates of whom to contact. Often these initial contacts are not initiated through the non-party's legal department.

During these calls, it may be tempting for a lower-level employee to express his or her own support for or opposition to a deal. This individual, however, may not represent the position of the company. If this opinion is shared with representatives of one or both of the merging parties via email or otherwise in writing, the merging parties or investigating staff may point to the communication as evidence of the client's position on the deal.

Counsel should proactively reach out to clients likely to be affected by a proposed merger and that are likely to be contacted by either merging parties or a reviewing agency. Counsel should advise business team members on how they should react if they receive a call from either one or both of the merging parties and/or from an investigating agency.

In addition, counsel should assess the likelihood that the client's communications and documents may be produced to a reviewing agency, and, if so, provide appropriate, proactive guidance to their clients' business teams. For example, a client's employees might communicate with each other internally about the deal and its potential effect on the client's business. These internal communications may later be subject to document requests from the investigating agency or requested in post-complaint discovery. Counsel should also seek to identify any written analyses or projections the client may have done relating to the proposed merger. Document requests, including discovery requests after the filing of the complaint, will almost always include a request for this kind of information.

Counsel also should undertake to understand any communications that have already been made to representatives of merging parties about their deal. Conducting short interviews with a small number of employees who would be most likely to comment on or have opinions about the proposed deal may be an easy and efficient way to gather this information. If the topic of the investigation primarily relates to only a discrete business unit, counsel should focus on communications within that unit. For example, in the FTC's investigation of the proposed Staples/Office Depot transaction, for most non-parties, counsel's investigation likely centered on the company's procurement department.

Counsel also should seek to understand who within the company has the authority to determine the company's position on a pending deal and, if there are internal disagreements regarding what the company's position is, counsel should carefully consider how to frame this in discussions with investigating staff. Given the potential importance of non-party testimony to a merger investigation and subsequent litigation, companies should consider advising employees not to communicate about the deal without first discussing the proposed communication with in-house legal counsel. By imposing this requirement, counsel can better understand what communications are being made and also ensure that employees understand their employer's position on the merger to avoid possible inconsistencies between employee communications and other internal company documents. Inconsistencies can, and likely will, be highlighted during depositions, investigational hearings, and trials, and are fertile grounds for pointed questions about the company's apparently wavering position—making the deposition longer and more difficult and contentious than necessary. Moreover, these inconsistencies could impact ongoing business relationships if, for example, the non-party company publicly supports a customer's or supplier’s merger, but its employees express disagreement in their communications. Preparing to address these issues
requires additional outside counsel work and deponent preparation. But understanding and limiting employee communications early can save the company time and money, and it can stave off potential difficult questions as the investigation progresses.

Conclusion

Non-parties in merger investigations and litigation may have varied reactions to being involved. Some may be willing to cooperate or may even voluntarily present information to an investigating agency; others may prefer not to be involved (or to limit their involvement to the extent possible). Counsel for non-parties in merger matters nevertheless must be ready to protect their client’s interests, particularly relating to maintaining the confidentiality of their client’s sensitive business information.
Toward a More Complete Treatment of Efficiencies in Merger Analysis: Lessons from Recent Challenges

Jonathan M. Orszag and Loren K. Smith

Consider an example of a merger of two hypothetical widget companies: In a properly defined relevant market (Market A), the merger is projected to generate harmful competitive effects of $15. But, the merger is expected to generate efficiencies in a second relevant market (Market B), $20 of which would be passed through to customers, and the vast majority of customers buy the products in both Market A and Market B together so customers in Market A would benefit directly from efficiencies in Market B. Should this merger be approved? If the antitrust authority were to block the merger because of the projected harm in Market A, customers in Market A would be worse off (because they would lose the lower prices that would be achieved in Market B if the merger were to be approved). But the Horizontal Merger Guidelines do not explicitly contemplate the effects of such demand-side complementarities in its treatment of efficiencies.1

Consider a second example of a merger between two other widget companies. Again, the merger would generate harmful competitive effects of $15 in Market A. But, the proposed merger also would generate merger-specific, verifiable efficiencies with a 40 percent probability, $50 of which would be passed through to customers. Should this merger be approved? In terms of expected value, the merger would yield a net benefit to customers of $5 and should therefore be cleared.2 But one could also interpret the probability of realizing the efficiencies as less than 50 percent as meaning that they are “unlikely” to be achieved and thus should not be counted at all.3 Under this interpretation of the Guidelines, the antitrust authority would seek to block the merger because consumers would be subject to a harm of $15 in the absence of efficiencies.

From an economic perspective, one could argue that both of these mergers should be approved by the antitrust agencies because consumers, on an expected value basis, are better off with the mergers. However, a plain reading of the Guidelines would suggest that both of these hypothetical mergers should be blocked.

The issues raised in these two examples are not purely hypothetical—they were part of the economic analysis undertaken by the defendants in two recent merger challenges brought by the agencies: the GE/Electrolux merger4 and the Staples/Office Depot merger.5 Moreover, the substantive issues raised by these examples have not been fully examined by the literature. Indeed, although there is an extensive literature on determining and measuring the competitive effects of a merger—including studies pertaining to market definition, merger simulation, unilateral and coordinated

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2 The expected value of the efficiencies is 40 percent multiplied by $50 or $20. Thus, the net beneficial effect of the merger is $5—the $20 of expected merger-specific efficiencies minus the $15 of projected harm.

3 Guidelines, supra note 1, § 10 (“The Agencies credit only those efficiencies likely to be accomplished with the proposed merger . . . .”).

4 United States v. Electrolux, No. 15-cv-01039-EGS.

5 FTC v. Staples, Inc., No. 15-cv-02115-EGS.
effects, maverick firms, power buyers, and many other issues related directly to analyzing competitive effects—the literature with regard to merger-induced efficiencies is not as well developed.

Such a lack of focus on efficiencies is surprising because the vast majority of mergers are deemed procompetitive by the investigating agencies. For example, the agencies rarely challenge mergers and in 2014 the FTC and DOJ requested additional information only on roughly three percent of all reported mergers. Moreover, retrospective studies of horizontal mergers by agency and academic economists indicate the presence of merger efficiencies.7

Although subsequent changes to the Guidelines have provided more clarity surrounding the treatment of efficiencies by the agencies and arguably have conveyed even more openness to efficiency arguments,8 merger efficiencies still receive far less attention in merger reviews and litigations than do potential merger harms.9

This article takes a step toward a more complete perspective on efficiencies, which will hopefully focus more attention on an often short-changed element of merger analysis. Specifically, we provide more depth and clarification with regard to the definition of “inextricably linked” efficiencies in the Guidelines and then discuss whether the standard that efficiencies must be “likely” is appropriate from an economic perspective.

6 U.S. Dep’t of Justice & Fed. Trade Comm’n, HSR Annual Report (FY 2014) (noting that in fiscal year 2014, 1,663 transactions were report-ed under the HSR Act, 51 transactions received Second Requests, and the agencies brought 33 enforcement actions.)

7 For example, in a retrospective study of mergers and merger enforcement, John Kwoka, Does Merger Control Work? A Retrospective on U.S. Enforcement Actions and Merger Outcomes, 78 ANTITRUST L.J. 619 (2013), Kwoka finds that 13 of 56 transactions studied (12 of 44 where there was no known remedy imposed by antitrust authorities) resulted in price decreases. In recent merger retrospective studies in healthcare, see, e.g., Aileen Thompson, The Effect of Hospital Mergers on Inpatient Prices: A Case Study of the New Hanover-Cape Fear Transaction, 18 INT’L J. ECON. BUS. 1, (2011); and Deborah Haas-Wilson & Christopher Garmon, Hospital Mergers and Competitive Effects: Two Retrospective Studies, 18 INT’L J. ECON. BUS. 1, (2011), and retail, see, e.g., Daniel Hosken, Luke M. Olsen & Loren K. Smith, Do Retail Mergers Affect Competition? Evidence from Grocery Retailing (Fed. Trade Comm’n Bureau of Economics Working Paper No. 313 (2012)), also find a mix of price increases and price decreases following horizontal mergers, indicating that horizontal mergers can create merger efficiencies.


Toward A More Precise Definition of “Inextricably Linked” Efficiencies

The Guidelines focus attention on the impact of a merger on consumer welfare in a relevant market—i.e., one evaluates the opposing effects of upward pricing pressure from the loss of an independent competitor and the downward pricing pressure from merger efficiencies in the relevant market (or relevant markets).  

In many cases, market-by-market evaluation of likely merger harm is practical and appropriate because markets operate independently enough that harm in a particular relevant market can be resolved through a partial divestiture or other remedy that is limited to that relevant market. However, in some cases the realization of merger efficiencies in one market is dependent on a merger being allowed to proceed in another market. The Guidelines provide a cursory footnote about such instances, noting that in some cases, merger efficiencies in other markets should be counted because they are “so inextricably linked with [the relevant market] that a partial divestiture or other remedy could not feasibly eliminate the anticompetitive effect in the relevant market without sacrificing the efficiencies in the other market(s).” In such cases, the appropriate evaluation of merger effects must consider both the anticompetitive effects in the relevant market and the net effects of merger efficiencies in all markets that are inextricably linked.

The limited consideration given to inextricably linked efficiencies in the Guidelines seems mismatched to the potential importance of such efficiencies, particularly for mergers between firms that sell multiple products that are supply-side complements (e.g., are produced using the same technologies or distributed using the same networks) or demand-side complements (e.g., are sold together) or both. That is, the increasing prevalence of multiproduct firms and mergers between them increases the probability incidence of supply-side and demand-side cross-market efficiencies. Recent challenges brought by the DOJ and the FTC against mergers between multiproduct firms, where the competitive effects analysis was limited to relevant markets defined as subsets of products offered by the merging parties, highlight the need to understand how linked merger efficiencies should be counted.

First, if there are supply-side complementarities across products, cost efficiencies on products where there are no merger concerns may depend on links to products where there are merger concerns—and the Guidelines clearly contemplate this possibility. Consider the following example: 

- Firms that produce the same two products—A and B—propose to merge. The merger would generate significant upward pricing pressure on product A but not on product B.  
- Products A and B rely on the same production technology.  
- If the merger is allowed without any divestitures, the combination of the merging parties’ production technologies would reduce production costs on products A and B by $0.10 per unit.
but the merged entity would realize no production efficiencies if there is a divestiture of product A from one of the merging firms. 17

- In the absence of the merger or with a divestiture of product A, a total of 100 units of each product would be sold at $1 each.
- With the merger and the cost improvement of $0.10 per unit, the merged entity would sell 90 units of product A at $1.05 and 120 units of product B at $0.95.

In this example, consumers are better off with the merger because product B is more price elastic than is product A, 18 and thus consumer savings on product B (>100*$0.05) exceed consumer harm on product A (<100*$0.05). 19

Antitrust authorities have, in rare instances, considered supply-side inextricably linked efficiencies. Kolasky and Dick describe a real-world example—a merger of two natural gas gathering and processing companies that were the only two such companies operating in several counties in West Texas. 20 The two companies planned through a horizontal merger to combine underutilized natural gas gathering systems and processing plants—a production efficiency. Investigators determined that these merger efficiencies outweighed any possible anticompetitive harm and that the efficiencies would not be realized fully if a divestiture of assets was required.

Although this is an instance where supply-side inextricably linked efficiencies were given due consideration by the agency, the cursory explanation of inextricably linked efficiencies in the Guidelines makes it unclear to antitrust practitioners and merging parties as to when such efficiencies will be considered inextricably linked to the relevant market and when they will be disregarded completely.

Moreover, the fact that demand-side complementarities—e.g., through purchases of bundled products—can impact the flow of efficiencies realized through a merger has not been given due consideration in merger analysis. Consider the following example:

- Two firms that produce the same two products—A and B—propose to merge. The merger would generate significant upward pricing pressure on product A but not on product B.
- There are 150 total customers, 50 of whom purchase only product A, 50 of whom purchase only product B, and 50 of whom consider products A and B to be perfect complements (i.e., products A and B are only valuable to these customers if purchased together).
- There is a merger efficiency that reduces the production costs of product B by $0.20 but does not affect product A.
- In the absence of the merger a total of 100 units of each product would be sold to the 150 customers; those that purchase either product A or B à la carte pay $1 each; those that purchase a bundle of products A and B pay $1.90 each.
- Assume that with the cost improvement of $0.20 on product B, the merged entity would sell 45 units of product A at $1.05, 60 bundles of products A and B at $1.80 each, and 75 units of product B at $0.85 each.

17 For example, a situation where realization of merger efficiencies requires an investment that only makes financial sense if the merger involves both product A and product B.

18 This scenario is not unlikely—markets that experience more competition are associated with higher price elasticity of demand, all else being equal.

19 This example could be recast to represent a situation where there is only a single product, the anticompetitive harm is limited to a narrow subset of consumers, but the merger-induced efficiencies apply to all buyers. For example, a hospital merger might be evaluated for its potential impact on commercially insured patients, but any efficiencies realized through the merger could benefit patients with government insurance plans as well.

20 Kolasky & Dick, supra note 9, at 231.
In this example, the welfare of purchasers of both products improves because the benefit to those that purchase a bundle of products A and B more than offsets the harm to à la carte purchasers of product A.

The above example is simplistic. The principle that demand-side complementarity among goods offered by multiproduct firms affects the pass-through of merger efficiencies is more general. For example, Sonia Jaffe and E. Glen Weyl show that in a merger of multiproduct firms, the net upward pricing pressure on one firm’s product is a function of diversion ratios from that product to all of the products of its merger partner (multiplied by margins that incorporate merger efficiencies). In other words, the Jaffe-Weyl model shows that in the presence of complementarities, the upward price pressure associated with one product is inextricably linked with the merger-specific variable cost efficiencies of other products. As discussed below, the reason is simple: one product’s cost efficiencies alter the post-merger relative margins of all products, which changes the pricing incentives associated with those products.

The “generalized upward pricing pressure” or “GePP” model presented in Jaffe-Weyl is somewhat technical. However, complex as it is, under the common assumption that firms engage in Bertrand price competition, as with other UPP indices, GePP can be expressed in terms of diversion ratios and price-cost margins. Moreover, the Jaffe-Weyl model is quite general and thus can be simplified to accommodate only the salient complementarities of a particular merger. For example, consider two multiproduct firms that each sell two products—A and B. Individually, the products are substitutes for each other (i.e., each firm’s product A and product B is a substitute for the corresponding product A and product B produced by the other firm.) Moreover, products A and B are complements when produced by the same firm. Under these conditions, the upward pricing pressure on firm 1’s products in the Jaffe-Weyl model are given by:

\[ GePP^A_1 = \frac{1}{1 - D^{AB}_1 D^{BA}_1} \left[ D^{A}_1 \left( P^A_1 - c^A_1 \right) + D^{AB}_1 D^{BA}_1 \left( P^B_2 - c^B_2 \right) \right] \]  (1)

\[ GePP^B_1 = \frac{1}{1 - D^{AB}_1 D^{BA}_1} \left[ D^{B}_1 \left( P^B_1 - c^B_1 \right) + D^{AB}_1 D^{BA}_1 \left( P^A_2 - c^A_2 \right) \right] \]  (2)

where \( D^{A}_1 \) is the diversion ratio from firm 1 to firm 2 on product A, \( D^{AB}_1 \) is the (negative) diversion ratio between firm 1’s product A and firm 1’s product B (i.e., the proportion of firm 1’s lost sales on product A that is also lost on firm 1’s product B because the goods are complements), and \( D^{BA}_1 \) is the (negative) diversion ratio between firm 1’s product B and firm 1’s product A.

As would be expected, equations (1) and (2) show that merger price effects are increasing in the magnitude of diversion ratios between the merging firms’ substitute products. However, the equations also imply that it often will be the case that upward pricing pressure on product A is decreasing in the complementarity of product B with product A (i.e., the magnitude of \( D^{AB}_1 \) and

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22 The diversion ratio from firm 1 to firm 2 for product A is the fraction of product A sales firm 1 would lose to firm 2 were firm 1 to increase prices.

23 Although stylized, this example is not so difficult to imagine. For example, in the appliance industry some customers prefer to buy washers and dryers that are of the same brand.

24 These equations can be derived from the multiproduct UPP formula given in Jaffe-Weyl, supra note 21, § II.D (under the heading “Bertrand” on p. 195). See the Appendix, infra, for this derivation.
Intuitively, firm 1 raising the price of product A decreases the sales of firm 1’s complementary product B, decreasing upward pricing pressure. Importantly, when this is the case, the presence of merger efficiencies on firm 2’s product B decreases $GePP^A_1$, a factor that should be considered when weighing an enforcement action involving product A.

The discussion and examples provided above demonstrate the potential importance of efficiencies that are “inextricably linked” across products through either supply-side or demand-side complementarities. In our experience, linked efficiencies are given little, if any, consideration in antitrust investigations and enforcement actions. Multiproduct firms produce and market complementary goods and services, and thus ignoring linked efficiencies potentially causes antitrust agencies to thwart procompetitive mergers. And, although complex, models like that of Jaffe-Weyl provide useful starting points from which the agencies can develop first-order approaches to better fit the particular features of horizontal mergers of multiproduct firms.

**Treatment of Expected Merger Efficiencies in the Context of Merger Litigation**

As noted above, the vast majority of horizontal mergers do not raise significant antitrust concerns. However, when a merger is between close substitutes in a concentrated industry, merging parties typically are required to demonstrate that merger-specific efficiencies will enhance the merged entity’s incentive and ability to compete (to the benefit of consumers). Generally, it is the burden of the merging parties to provide evidence that merger efficiencies will be realized.

Placing responsibility on the merging parties for demonstrating merger efficiencies is reasonable, particularly during the investigation stage of a potential merger challenge. After all, as explained in the Guidelines: “[I]nformation relating to efficiencies is uniquely in the possession of the merging firms.”

Cognizable efficiencies are defined in the Guidelines as those that are both merger-specific and verified. Assume potential merger efficiencies are merger specific. “Verified” is an interesting word to use in the context of a prospective merger evaluation because none of the outcomes of the merger, including any potential merger efficiencies, can be “verified” until after the merger has occurred. Merger investigations typically involve assessments of inherently uncertain events, e.g., expected merger price increases. Yet the Guidelines seem to imply that merging parties are held to a higher standard of certainty with regard to merger efficiencies. For example, the Guidelines state: “Efficiency claims will not be considered if they are vague, speculative, or otherwise cannot be verified by reasonable means.” Such language, as well as standard practices, indicates that merger efficiencies are often evaluated as though it were possible to demonstrate both merger specificity and verifiability before the merger occurs. That is, estimated merger efficiencies are either deemed to be cognizable and credited fully or considered to be not cognizable and given zero credit.

Of course, no efficiencies are 100 percent guaranteed, especially before a merger is consummated. Put another way, each claimed merger efficiency will occur with some positive probability. Hence, a more appropriate treatment of likely merger efficiencies would be to estimate the

$$D_1^{(AB)}.$$  
Mathematically, the upward pricing pressure of, for example, firm 1’s product A is decreasing in the complementarity between firm 1’s products A and B if the derivative of $GePP^A_1$ with respect to the diversion ratio between firm 1’s products A and B ($D_1^{AB}$) is positive. In the case of the $GePP^A_1$ in equation (1),

$$\frac{\partial GePP^A_1}{\partial D_1^{AB}} = \frac{D_1^{AB}(P_B^2-c_B^2)+D_1^{BA}(P_A^2-c_A^2)}{(1-D_1^{AB})^2} > 0.$$  

26 Guidelines, supra note 1, § 10.

27 Id.

28 Id. (emphasis added).
expected value of each claimed merger efficiency, much the same way that investigators currently evaluate the likely price effects of a merger. That is, assume the investigator has been convinced by the merging parties that a $100 efficiency will be realized if a merger is consummated but thinks that another claimed $70 efficiency is somewhat unlikely. Rather than crediting the merging parties with just the $100 efficiency, it would be more appropriate to estimate the expected value of the sum of the two efficiencies—which could be greater than or less than $100.\(^{29}\)

The deterministic treatment of merger efficiencies as counting or not counting as opposed to using a probabilistic approach could lead to undesirable outcomes. For example, consider two proposed mergers. For simplicity, assume that each merger is between firms that produce products with identical prices (equal to 1) and percentage margins (equal to 0.5), with symmetric diversion ratios (equal to 0.2). Hence, each merger has a GUPPI of 0.1 for each firm’s product.\(^{30}\)

Merger 1 would realize marginal cost efficiencies of 0.3 on each firm’s product with probability 0.7, while Merger 2 would realize marginal cost efficiencies of 0.6 on each firm’s product with probability 0.5. Under a coarse count/do not count standard for efficiencies, the agencies would allow Merger 1 but block Merger 2—which is precisely the wrong outcome from a consumer welfare standpoint.\(^{31}\)

Refining merger efficiencies to probabilistic outcomes is likely an unnecessary step for most merger investigations, especially those that are not close calls. Moreover, calculations of probability-weighted merger efficiencies would place a significant burden on merging parties and the antitrust authorities during the investigation phase of a merger review. Hence, it would be pragmatic and appropriate for preliminary merger reviews to consider claimed merger efficiencies as is done currently—by either counting such efficiencies fully or not counting them at all.

As part of merger litigations, however, using probability-weighted measures of merger efficiencies, instead of the coarse count/do not count standard suggested by the Guidelines, would be a more effective approach to produce the correct outcome for consumer welfare. Indeed, all elements of a merger evaluation—market definition, competitive effects analysis, etc.—typically are reevaluated and sharpened for presentation to the court, so reevaluating efficiencies should not impose any additional burden.

Perhaps even more importantly, our recommended approach for the final stages of a merger investigation and in the litigation phase of merger challenges would harmonize the economic analysis of upward price pressure resulting from the loss of an independent competitor with the economic analysis of merger-specific efficiencies. When one analyzes the potential effects of the merger on prices, there is always some uncertainty regarding the precise point estimate of the potential merger effect. Yet, lawyers and economists usually accept the best point estimate as the

\(^{29}\) We are not the first to suggest that merger efficiencies should be credited according to expected values. See, e.g., Daniel A. Crane, Rethinking Merger Efficiencies, 110 Mich. L. Rev. 347–92 (2011); J.J. Simons & Daniel A. Crane, Unified Merger Analysis: Integrating Anticompetitive Effects and Efficiencies, and Emphasizing First Principles, HMG Review Project—Comment, Project No. P092900 (2009).

\(^{30}\) The GUPPI for firm 1 in a merger with firm 2 can be expressed as \(GUPPI_1 = D_{12} \times M_2 \times \frac{P_2}{P_1}\). The subscripts in the equation index firms, \(D\) is diversion ratio, \(M\) is percent margin, and \(P\) is price. Under the stated assumptions, the GUPPI for each firm is the same, say \(GUPPI = D \times M\).

\(^{31}\) In expectation, Merger 1 would realize efficiencies of 0.21, which is less than \(\frac{GUPPI}{(1-D)(1-M)} = \frac{0.1}{0.8 \times 0.5} = 0.25\), whereas Merger 2 would realize efficiencies of 0.30, which is greater than this expression. Hence, in expectation, Merger 1 would lead to a price increase because \(\frac{GUPPI}{(1-D)(1-M)}\) exceeds expected realized efficiencies (i.e., 0.25 > 0.21), while Merger 2 would result in a price decline because \(\frac{GUPPI}{(1-D)(1-M)}\) is less than expected realized efficiencies (i.e., 0.30 > 0.25). For a derivation and explanation of this test for weighing merger efficiencies against upward pricing pressure, see Farrell & Shapiro, supra note 21, at 12–13.
best available measure of the merger price effect. The approach we recommend for merger litigations puts efficiencies on the same playing field as price effects: We would use the best point estimate of efficiencies, taking into account uncertainties about the potential outcomes.

**Conclusion**

For too long, efficiencies—the primary motivator for the vast majority of mergers—have been short-changed in merger analysis. This article helps to provide a deeper understanding of the appropriate framework for considering merger-specific efficiencies. But the research into efficiencies, given their importance in difficult merger decisions, cannot end here. We must continue to investigate and refine how the treatment of efficiencies can be improved going forward.
Appendix: Derivation of $2 \times 2$ Multiproduct UPP for Bertrand Competition

The multiproduct UPP formula for Bertrand competition is given by:

$$ GePP_i = - \left( \frac{\partial Q_i}{\partial P_i} \right)^{-1} \left( \frac{\partial Q_j}{\partial P_i} \right)^T (P_j - c_j), $$

where $GePP_i(P)$ is a vector of $GePP$ for the products sold by firm $i$, and $j$ indexes firm $i$’s merger partner.\(^3\)

Assume merging parties, indexed by 1 and 2, each produce products A and B. Then the multiproduct UPP for firm 1 is given by:

$$ GePP_1 = \begin{bmatrix} GePP_{1A} \\ GePP_{1B} \end{bmatrix} = - \left( \begin{bmatrix} \frac{\partial Q_1^A}{\partial P_1^A} & \frac{\partial Q_1^A}{\partial P_1^B} \\ \frac{\partial Q_1^B}{\partial P_1^A} & \frac{\partial Q_1^B}{\partial P_1^B} \end{bmatrix} \right)^{-1} \begin{bmatrix} \frac{\partial Q_2^A}{\partial P_1^A} & \frac{\partial Q_2^A}{\partial P_1^B} \\ \frac{\partial Q_2^B}{\partial P_1^A} & \frac{\partial Q_2^B}{\partial P_1^B} \end{bmatrix} \begin{bmatrix} (P_2^A - c_2^A) \\ (P_2^B - c_2^B) \end{bmatrix}. $$

Given the assumption that products A and B are complements only when produced by the same firm, $\frac{\partial Q_2^A}{\partial P_1^B} = \frac{\partial Q_2^B}{\partial P_1^A} = 0$, and thus $GePP_1$ can be rewritten:

$$ GePP_1 = \frac{1}{\frac{\partial Q_1^A}{\partial P_1^A} \frac{\partial Q_1^B}{\partial P_1^B} - \frac{\partial Q_1^A}{\partial P_1^B} \frac{\partial Q_1^B}{\partial P_1^A}} \begin{bmatrix} \frac{\partial Q_1^B}{\partial P_1^A} \frac{\partial Q_1^A}{\partial P_1^B} (P_2^A - c_2^A) + \frac{\partial Q_1^B}{\partial P_1^A} \frac{\partial Q_2^B}{\partial P_1^B} (P_2^B - c_2^B) \\ -\frac{\partial Q_1^A}{\partial P_1^A} \frac{\partial Q_2^A}{\partial P_1^B} (P_2^A - c_2^A) + \frac{\partial Q_1^A}{\partial P_1^A} \frac{\partial Q_2^B}{\partial P_1^B} (P_2^B - c_2^B) \end{bmatrix}. $$

\(^3\) See Jaffe & Weyl, supra note 21, § II.D.
Finally, dividing the numerator and the denominator of $GePP_1$ by $\frac{\partial Q^A_1}{\partial P^A_1} \frac{\partial Q^B_1}{\partial P^B_1}$ and multiplying through gives:

$$GePP^A_1 = \frac{1}{1 - D^{AB}_1 D^{BA}_1} [D^{A}_{12} (P^A_2 - c^A_2) + D^{AB}_1 D^{B}_{12} (P^B_2 - c^B_2)]$$

and

$$GePP^B_1 = \frac{1}{1 - D^{AB}_1 D^{BA}_1} [D^{B}_{12} (P^B_2 - c^B_2) + D^{BA}_1 D^{A}_{12} (P^A_2 - c^A_2)],$$

where $D^{X}_{12} = -\frac{\partial Q^X_1}{\partial p^X_2}$ is the diversion ratio from firm 1 to firm 2 for product $X = A, B$, and

$$D^{AB}_1 = -\frac{\partial Q^B_1}{\partial p^A_1} \quad \text{and} \quad D^{BA}_1 = -\frac{\partial Q^A_1}{\partial p^B_1}$$

are the diversion ratios between firm 1’s products A and B.
Brexit: Merger Review Implications and Recommendations

Jay Modrall and Ian Giles

The United Kingdom’s June 23, 2016 vote to leave the European Union, known as Brexit, triggered a political and economic earthquake. Some immediate consequences were dramatic, including the replacement of the Conservative Prime Minister, leadership struggles in the Labour party, a sharp drop in the value of the pound against other major currencies, and fluctuations in the UK and global stock markets. The new Prime Minister, Theresa May, has committed to triggering the Article 50 process to start Brexit negotiations by March 2017, with indications that she will seek a “hard Brexit”—involving a clean break from the European Union and loss of access to the single market. However, the backlash to this approach is gathering steam and EU leaders are suggesting they will not grant the United Kingdom any advantageous deal involving the benefits of EU membership without the related obligations. In reality, the long-term consequences of Brexit will not become clear for many years, and certainly not before the process of negotiating the United Kingdom’s exit from the EU and the post-exit relationship between the United Kingdom and the European Union begins.

While the detailed terms of the new relationship will take time, some of Brexit’s main implications for competition law are already reasonably clear. For example, the United Kingdom’s rules on restrictive agreements and abuses of dominant positions, which are based on EU law, are unlikely to change in the short term. Likewise, in areas where the United Kingdom’s antitrust laws already diverge from the laws in other EU Member States or the European Union as a whole, like the United Kingdom’s regime for private antitrust enforcement and criminal sanctions for individuals in cartel cases, those divergences will likely remain post-Brexit.

One area in which Brexit can be expected to have significant implications for EU and UK authorities and for companies operating in Europe is merger control. Many observers have noted that, after Brexit, the “one-stop-shop” of the European Union’s Regulation 139/2004 on the control of concentrations among undertakings (EUMR)\(^1\) will probably cease to apply to the United Kingdom. This will likely result in more UK merger notifications, a significant increase in the Competition and Markets Authority’s (CMA’s) workload, and increased burdens for companies engaged in mergers or acquisitions who may have to make parallel filings in Brussels and London. Under the current system, jurisdiction of the Commission precludes the need to file in the United Kingdom.

In this article, we explore the merger control implications of Brexit in more detail and offer some preliminary suggestions of ways to mitigate the burden on competition authorities and business.

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Brexit Background

The basic mechanism for an EU Member State to leave the European Union is set out in Article 50 of the Treaty on the European Union (TEU), but the language of this article is very general. The Article 50 process is triggered by a notice from the leaving Member State to the European Council. Article 50 TEU does not define the conditions or procedure for giving such a notice, which depend on Member State law. Even in the United Kingdom, there is some uncertainty about this, and a number of lawsuits are ongoing to test whether the Government can trigger Article 50 without support of the UK Parliament (with a large majority of Parliamentarians having opposed Brexit), and questions as to whether devolved assemblies in Scotland or Northern Ireland could frustrate the Brexit process.

Once the Article 50 notice is given, the leaving Member State and the European Union have two years to negotiate an exit agreement (unless an extension is mutually agreed), failing which the Member State’s exit becomes effective two years after the notice date. After much posturing on whether and if so when the United Kingdom would deliver the Article 50 TEU notice, Prime Minister Theresa May has confirmed she plans to deliver the Article 50 notice before the end of March 2017 and in the meantime is seeking informal discussions on the new agreement. EU officials, in contrast, are refusing to enter any discussions ahead of Article 50 being triggered. Because there is no way for the European Union to start the process, refusing to negotiate until the United Kingdom gives notice under Article 50 TEU is seen as the only leverage the European Union has to accelerate the process, and perhaps to push the United Kingdom into a more conciliatory approach.

Once the Article 50 TEU notice has been given, the complexity of the issues involved makes it highly unlikely that an agreement can be reached in less than two years. Therefore, the earliest effective date for the United Kingdom’s exit from the European Union will be sometime in early 2019.

The substantive terms of the future relationship between the United Kingdom and the European Union will not be clear for years. On the one hand, it seems unlikely that the United Kingdom will agree to any arrangement in which it must abide by EU law, like the members of the European Economic Area (the EEA—consisting of Norway, Iceland, and Liechtenstein), given the sovereignty-related concerns motivating the UK vote. Specifically, to accept the EUMR in a post-Brexit world would mean the United Kingdom ceding jurisdiction to Brussels with respect to large transactions with potentially significant impacts on UK markets. This would be at odds both with the desire for sovereignty (“taking back control”), which was a major theme of the “leave” campaign, and also with Prime Minister Theresa May’s stated intention to pursue a “proper industrial strategy.” Moreover, the recent comments regarding the United Kingdom favoring a “hard Brexit” suggest such an approach is unlikely. For purposes of this article, therefore, we assume that EU law, including the EUMR, will cease to apply in the United Kingdom after Brexit.

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2 An arrangement, for example, whereby the United Kingdom would be bound by the competition provisions of the EEA Agreement, which stem from the EU provisions (Articles 53 to 60 (Chapter 1, Rules Applicable To Undertakings), Annex XIV (which contains specific provisions giving effect to the principles set out in Articles 53, 54, 57, and 59) and Protocols 21 to 24 of the EEA Agreement). Decisions of the EEA Joint Committee transpose all EU Regulations and Directives. In addition, EU acts, like Notices, Communications, and Guidelines are usually re-adopted for the European Free Trade Association (EFTA) or EEA States by the EFTA Surveillance Authority.

3 See, e.g., William James, PM May Resurrects Industrial Policy as Britain Prepares for Brexit, Reuters (Aug. 2, 2016), http://uk.reuters.com/article/us-britain-eu-industry-idUKKC110C3CR.
On the other hand, it also seems unlikely that the United Kingdom will immediately change its existing competition laws, given (among other things) the huge amount of work required to review and update UK legislation to reflect Brexit and the need to negotiate new trade agreements with other countries to replace the EU agreements that currently cover the United Kingdom. In particular, it seems reasonable to assume that wholesale change to the existing UK merger control regime will not be a high priority.

**EUMR vs. UK Review**

Before discussing merger control in the post-Brexit world, it is worth summarizing the main similarities and differences between the European Commission’s and the UK CMA’s merger review processes.

In many ways, the Commission’s and the CMA’s approaches to merger control are similar. Both are sophisticated authorities, and they apply similar substantive tests. While the Commission blocks or remedies mergers that would lead to a “significant impediment to effective competition,” and the CMA looks for a “substantial lessening of competition,” the theories of harm and underlying economic theory are essentially identical (although do not necessarily lead to identical outcomes). The CMA’s and the Commission’s notification requirements are similar, requiring detailed information and supporting documents. Both apply similar tests for establishing the relevant market (which the Commission refers to as its “small but significant and non-transitory increase in price” test (SSNIP), and the CMA as its “hypothetical monopolist” test), and understand that market definition is not completely distinct from the assessment of competitive effects. Both are more concerned with horizontal than with vertical or conglomerate mergers, and both look at possible unilateral and coordinated effects. Both use a two-phase process, where more problematic mergers are subjected to a more in-depth assessment, commonly referred to as “Phase 2.”

The key difference between the EU and UK systems lies in which mergers are caught in the first place. The UK system captures “relevant merger situations” where the target has turnover above £70 million or the combined market share of the parties on any plausible market definition is 25 percent or more. In those situations, because notification is voluntary, parties can decide whether or not to notify the CMA. In practice, however, parties that meet the test are well-advised to inform the CMA, even if by an informal letter explaining why the parties do not intend to notify formally. The CMA can, wherever a relevant merger situation occurs, call in a merger for review (subject to a 4-month deadline for opening an in-depth investigation from the time the deal completes or becomes public). By contrast, if a deal meets the EU notification thresholds—which are entirely turnover-based—an EU notification is mandatory. Moreover, the parties cannot close a deal until EU clearance has been obtained: in the United Kingdom, it is legal to close a deal qualifying as a relevant merger situation, although the CMA will likely require the parties in a case that the CMA is investigating to hold their businesses separate until a decision has been reached.

The differences between the thresholds affect the types of mergers reviewed by each authority. For example, the Commission reviews a large number of “full function joint ventures,” where a new joint venture has been set up by large multinational firms. Though the joint venture itself may be small scale and have minimal—or no—market presence in the European Union (sometimes in markets in which the parents themselves are not active), the deal will still fall to be reviewed by

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6 See, for example, the outcome of the SeaFrance case, infra note 17.

7 EUMR, supra note 2, arts 1(2) & (3).
the Commission if the joint venture partners meet the turnover tests. For example, a deal struck by Maersk, a Danish shipping company, and Statoil, a Norwegian energy company, to buy a tugboat operator in the Bahamas was notifiable in Brussels. Cases of this nature are not caught under the UK rules where cases involving no substantive competitive overlap are not typically notified to the CMA.

These structural differences are reflected in the outcomes of cases reviewed under the UK and EU systems. The CMA’s long-term average of cases that are subjected to an in-depth investigation is currently 36 percent. The Commission has gone to Phase 2 just 242 times out of 6239 cases—approximately 4 percent of cases. This reflects the fact that the CMA’s caseload includes a larger number of difficult cases, with routine cases presenting no serious issues cases typically not notified under the CMA’s voluntary system. Similarly, a far larger proportion of CMA decisions require remedies or commitments to resolve competition concerns than is the case in Brussels, again reflecting the fact that the CMA’s caseload is made up of a higher proportion of more challenging transactions. Because the CMA’s cases are more difficult, on the whole, the CMA has a number of different processes from the Commission:

● The CMA can fast-track cases straight to the in-depth Phase 2 review when it is clear that the deal could not be cleared in Phase 1.

● The CMA has no “short form” notification procedure. At the EU level, parties to deals that on their face raise no concerns can use the less onerous “Short Form CO,” an abbreviated version of the full Form CO used for notifying transactions under the EUMR. Indeed, the Commission even exempts notifying parties from complying with all aspects of the Short Form CO in the most straightforward cases. (The CMA might expect no notification or a simple informal letter in such “no issues” deals.)

● The CMA’s Phase 1 review lasts 40 working days, compared to the Commission’s 25. The CMA’s longer review period may be offset, however, by the Commission’s practice of engaging in (sometimes lengthy) pre-notification discussions, which take place before the Commission accepts the notification as complete. While the CMA also has a pre-notification period that can last several weeks—or months—on more complex deals, in the authors’ experience, this pre-notification period is typically longer in Brussels than in London. In essence, the pre-notification procedures allow the Commission to extend the review process outside the statutory timetable.

Finally, the Commission does not have any discretion to apply non-competition factors in its assessment of notified transactions. The United Kingdom retains an (admittedly narrow) role for public interest factors, such as national security, plurality of the media, and preserving stability of financial markets. It is possible that Theresa May’s renewed focus on “industrial strategy” will lead to more interventions on such grounds—or potentially a relaxation of rules to support consolidation creating “national champions”—but, by contrast, the EU regime carves out public interest factors as an issue for Member States and so there is, at least in theory, no scope for policy issues to intrude on EUMR reviews.

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8 Case COMP/M.5783—Statoil/Svitzer/FTTS (JV), Comm’n Decision, 2010 O.J. (C 30).
Commission/CMA Staff

The Commission’s competition team (DG Comp) has more than 700 members, including more than 450 higher level officials who “play a key role”\(^\text{12}\) in the Commission’s activities.\(^\text{13}\) Unlike cartels and state aid, there is no specific “mergers” unit in DG Comp. Instead, for each of five sector-focused units, there is a mergers team. In addition, there is a mergers case support and policy team within the Policy and Strategy Unit, and a mergers unit within the Chief Economist’s team. Altogether, around 75–100 individuals focus on mergers at any one time within DG Comp.

Similarly, the CMA employs around 700 people, although the CMA’s team includes its legal service, whereas the Commission has a standalone Legal Service.\(^\text{14}\) The CMA has a specific “Markets and Mergers” directorate, with a Senior Director responsible for mergers and three Directors who oversee merger control enforcement in the United Kingdom. Below this level however, staff work across mergers, market studies, and enforcement cases.\(^\text{15}\) This means there is more flexibility at the CMA to allocate staff to merger review in times when M&A activities are higher. In recent years, the CMA has allocated significant resources to market investigations of particular sectors—notably banking and energy—but the individuals involved in those investigations could be redeployed to deal with a greater volume of merger notifications. Thus, the CMA likely has the scope and resources to take on a higher volume of merger reviews than at present.

Brexit Consequences for Merger Control

Having set out some of the key similarities and differences in the existing regimes, we now turn to focus on the future.

**Increased Number of UK Filings and Greater Burden on Business.** As noted, the most immediate consequence of Brexit from a merger control perspective is that merger filings to the European Commission under the EUMR will no longer cover the United Kingdom. This change can be expected to lead to a significant increase in the number of UK filings post-Brexit and possibly to a much more modest reduction in the number of EU filings, in particular as UK turnover will no longer count towards EU turnover.

As regards UK filings, many transactions that meet the EU thresholds are also likely to meet the UK thresholds. Following Brexit, therefore, many transactions currently notifiable to the Commission will likely also qualify for review before the CMA (although transactions clearly raising no competition issues, like many private equity transactions, will probably not need to be notified in the United Kingdom). Moreover, some transactions having a “Union dimension”\(^\text{16}\) under the EUMR

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\(^{13}\) European Comm’n, Statistical Bulletin on 01/02/2016, Officials and Temporary Staff by Directorate-General and Gender (Feb. 26, 2016), http://ec.europa.eu/civil_service/docs/ebcr_sp2_bs_cat-sexe_x_dg_en.pdf.


\(^{16}\) A concentration will have a “Union dimension” where: (i) the combined aggregate worldwide turnover of all the undertakings concerned is more than €5000 million; and (ii) the aggregate Community-wide turnover of each of at least two of the undertakings concerned is more than €250 million, unless each of the undertakings concerned achieves more than two-thirds of its aggregate Community-wide turnover within one and the same Member State.

A concentration will alternatively have a “Union dimension” where: (i) the combined aggregate worldwide turnover of all undertakings concerned is more than €2.5 billion; (ii) the aggregate EU-wide turnover of each of at least two of the undertakings concerned is more than €100 million; (iii) the combined aggregate turnover of all undertakings concerned is more than €100 million in each of at least three Member States; and (iv) in each of at least three of these Member States, the aggregate turnover of each of at least two of the undertakings concerned is more than €25 million, unless each of the undertakings concerned achieves more than two-thirds of its aggregate EU-wide turnover within one and the same Member State. EUMR, arts. 1(2) & (3).
may not meet the UK test. For instance, joint ventures that meet the EU turnover thresholds by virtue of the parents’ turnover are unlikely to be captured under the UK rules. In addition, many deals that meet the EU thresholds will not trigger the UK thresholds because the target does not have more than £70m in UK turnover and the transaction does not involve the creation or increase of a 25 percent share of supply in the United Kingdom.

In short, while not all transactions notifiable under the EUMR will also have to be notified in the United Kingdom, it seems likely that many horizontal and even vertical combinations will need to be notified in both jurisdictions. This duplication will lead to a significant increase in the CMA’s workload. As discussed above, however, the CMA is likely to have sufficient staff to deal with such an increase—and this increased workload may even have the positive benefit of streamlining the UK review process and reducing the currently onerous focus the CMA places on smaller transactions. From the business perspective, though, the requirement of an additional UK notification will increase the cost of obtaining required antitrust approvals and the complexity of managing the approval process.

Reduction in the Number of EU Filings. Conversely, Brexit may lead to a reduction in the number of EU filings. Many companies derive a significant portion of their EU turnover in the United Kingdom (as the EU's second largest economy). Some transactions that would currently be notifiable under the EUMR will therefore likely not meet the turnover thresholds for mandatory filing when the United Kingdom is excluded.

Post-Brexit, the impact on the number of EU filings made pursuant to a voluntary referral request could also be affected. Under the EUMR, parties acquiring control in transactions that would otherwise be notifiable in three or more Member States can request that the transaction be referred to the Commission for review. The United Kingdom's jurisdictional thresholds are broad, and it is not uncommon for the United Kingdom to count as one of the jurisdictions that can be used to trigger a referral request. The parties to transactions that would be subject to review in only three EU Member States, one of which is the United Kingdom, would no longer be able to take advantage of the referral process. Overall, while it is not possible to predict with any accuracy the likely effect on the number of EU merger filings based on data published by the Commission, it seems likely that Brexit will result in a small but noticeable drop in the number of filings to Brussels.

Divergent Outcomes and Resulting Burden on Businesses. One theoretical possibility that would raise material concerns for business is the increased prospect of concurrent reviews in London and Brussels leading to divergent outcomes (i.e., one authority clearing a merger and the other blocking it) and/or of differing, inconsistent remedies. A recent example of such divergent outcomes involved Eurotunnel’s acquisition of the bankrupt SeaFrance ferry operation, which was approved by the French authorities but blocked by the United Kingdom.17

Currently, Section 60 of the UK Competition Act 1998 contains a “convergence clause” to ensure the compatibility of UK competition law with EU competition law. Post-Brexit, there will be no legal need for such a clause, and it might be removed from UK law. Removal of the convergence clause would increase the likelihood of the CMA’s approach diverging from the Commission’s in specific cases, although both authorities will presumably strive to avoid such divergent outcomes. Moreover, the UK Government has indicated it will favor a “grandfathering” approach

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to Brexit, which would mean existing EU law remains in force in the United Kingdom until specifically repealed. This should help ensure consistency of approach, at least in the medium term.

**Exit from the European Competition Network.** Another significant consequence of Brexit for competition policy within the European Union would be the removal of the CMA from the European Competition Network (ECN), which includes the Commission and EU Member State competition authorities. Two notable advantages of the ECN are (1) close cooperation and consistency among national competition authorities such as the CMA and (2) a flexible and informal case allocation system. Leaving the ECN will mean this close cooperation and consistency will be lost, with, importantly, both the CMA and the other national authorities losing out. The outgoing head of the CMA, Alex Chisholm, who has been vocal in warning that Brexit would be an “unfavourable outcome” for the United Kingdom, commented in *The Financial Times* on January 18, 2016, that “from a competition regime perspective, we’re very interconnected through the ECN. So there’s a high level of consistency in the way in which competition law is enforced in every one of the 27 countries.” The United Kingdom will need to seek some alternative method to cooperate with the Commission and EU national authorities, but whatever is agreed will be less effective than the integrated ECN framework.

Many would also argue that the loss of the CMA’s voice from the ECN and from consultations with the Commission could lead to adverse outcomes for business. The CMA was influential (along with the German authority), for instance, in leading the European Commission to shelve, at least for the time being, its proposal to expand the EUMR mandatory notification regime to include minority investments in which the acquirer does not enjoy veto rights conferring “joint control.” The Commission currently lacks power to review such transactions but, although the CMA has a power to review transactions where a company acquires “material influence”—a lower threshold than control—this has rarely been used. This lower control threshold has been effective on occasion—for example, it allowed the CMA to intervene to block Ryanair’s minority stake in its rival Aer Lingus, which ultimately led to the acquisition of Aer Lingus by British Airways’ parent company, IAG. The Commission proposed to broaden its jurisdiction to cover certain non-controlling minority shareholdings, but with a mandatory notification regime instead of the United Kingdom’s voluntary one. The CMA argued that the burden on business of having to notify acquisitions of minority shareholdings on a mandatory basis was disproportionate and highlighted how seldom it had in fact used its powers to investigate cases involving levels of control below “joint control.”

In summary, Brexit may somewhat reduce the number of EU filings and thereby alleviate the burden on the Commission staff, but Brexit will likely lead to a significant increase in the number of UK notifications. This increase may strain the CMA’s resources, although as noted the CMA probably has flexibility to deal with a higher case load. The duplication of work and the risk of divergent timetables and (potentially) outcomes will impose significant additional costs on businesses and (in some cases) increase legal uncertainty for business.

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Mitigating the “Brexit Tax” in Merger Review

There are some concrete steps that could be taken to mitigate these negative consequences. Some of these steps are discussed below.

One key step that the Commission and the CMA can and, in our view, should take is to create an ad hoc framework for cooperation in merger cases. This framework should provide for close cooperation between the Commission and the CMA in cases notified to both jurisdictions, beginning well before the Commission’s existing procedures for consulting EU Member State authorities on proposed merger decisions. To reduce the duplication of effort for themselves and for businesses, for example, the Commission and the CMA could consult on the information to be included in a complete notification. The CMA could also agree that it would accept EU notifications (with some supplemental UK-specific information) for UK purposes. The Swiss competition authority already follows such an approach with respect to transactions that have also been filed in Brussels.

Similarly, the Commission and the CMA could cooperate in the collection of evidence with the approach governed through a formal cooperation agreement. For instance, they could prepare common questionnaires, cooperate in interviews with customers and competitors, and conduct site visits and state-of-play meetings jointly. The U.S. and Canadian authorities embrace such practices to facilitate their parallel merger reviews. Parties would be encouraged to grant waivers to allow the CMA and EU agencies to exchange evidence from their respective files to support collaborative approaches—much as currently occurs between the EU and U.S. agencies. In each of these cases, the parties’ rights of defense would need to be protected, but merging parties would benefit from close cooperation in many if not most cases.

In the relatively small percentage of cases raising substantive issues, cooperation may be more challenging, but may offer even greater potential for efficiencies. If the recipients of an EU statement of objections wished to exercise their right to an oral hearing, for example, the hearing could be coordinated with the CMA—or, perhaps more realistically, the CMA could consult closely with the Commission and adjust its review timelines to allow the EU and UK processes to move forward in parallel and align key decision points. As noted, the current UK process is 40 working days in Phase 1 in comparison to 25 working days in Brussels, which will mean the Commission may have had to conclude whether to open a Phase 2 investigation before the CMA has reached the same point. It would be in the interest of all parties if such decision making could be better coordinated—including synchronizing the end of pre-notification periods to allow formal review periods to be aligned (a concern which already exists with respect to the larger global transactions facing divergent merger review timelines between the United States, European Union, China, and elsewhere).

Where the parties wish or are required to submit remedies to obtain merger clearance, the Commission and the CMA could agree to accept remedy proposals in the same format, if and to the extent the issues are the same. The Commission and the CMA could also agree to cooperate in the market testing of proposed remedies. Similarly, in remedy implementation the Commission and the CMA could agree to accept the same forms and otherwise avoid duplication. For example, in many cases only one monitoring or divestiture trustee should be required for both the EU and UK processes.21

In many cases, we anticipate that it would make sense for the CMA to rely on the Commission’s existing precedents and procedures. A useful model might be the existing arrangements under

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which the Canadian Competition Bureau sometimes relies on remedies negotiated by the U.S. agencies based on a side letter, without the need for a complete separate remedy process in Canada.\textsuperscript{22} The United Kingdom’s proposed “grandfathering” approach should be helpful in this respect.

Procedural cooperation and convergence between the United Kingdom and the European Union are clearly desirable post-Brexit, but it remains to be seen how far the CMA will be prepared to accept the Commission as the “lead authority” on European competition matters. The CMA may be less willing to allow another agency to take a leading role than the Swiss and Canadian authorities have been. If that turns out to be the case, a looser structure in which the Commission and the CMA could agree on a case-by-case basis which authority is best placed to take the leading role may be preferable—and it is to be hoped that this would not result in political stalemate, duplication, and an increased burden on the notifying parties. The level of cooperation in the transitional period as Brexit takes effect may be a useful indicator for the future: will the CMA allow the Commission to assert jurisdiction on deals notified just before Brexit takes effect? Will any transitional rules be agreed?

In summary, Brexit will likely lead to parallel EU and UK notifications in many transactions that meet the EUMR thresholds. The additional notification requirements may put a strain on the CMA’s resources and will very likely lead to increased costs and complexity for business. With creativity and good will, however, the Commission and the CMA could do much to mitigate these burdens. In many cases, the Commission and the CMA could potentially make significant improvements through bilateral agreements without the need for new legislation. Although the structure and contents of the broader Brexit negotiations are likely to be unclear for some time, we encourage the Commission and the CMA to consider potential steps and to set up working groups to discuss these initiatives in parallel with or potentially even before the commencement of the broader negotiations.

\textsuperscript{22} Canada Competition Bureau, Information Bulletin on Merger Remedies in Canada para 7 (Sept. 22, 2006), \url{http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/02170.html#PartVII}. 
Practical Advice for Avoiding Hub-and-Spoke Liability

Rachel S. Brass and Caeli A. Higney

It is axiomatic that the federal and state antitrust laws prohibit unreasonable agreements in restraint of trade. Most often, such agreements take one of two forms: (1) horizontal agreements made between competitors and (2) vertical agreements made up and down a supply chain, like those between a supplier and its distributors. Certain horizontal agreements, like agreements among competitors to fix prices or divide markets, and certain forms of group boycott agreements, are deemed per se illegal. In those circumstances, once the agreement’s existence is established, no further inquiry into the parties’ intentions or the practice’s actual impact on the market is necessary to establish a violation. Vertical agreements, by contrast, are analyzed under the rule of reason, which involves an examination of the particular context in which the restraint was adopted, including its effect on the relevant product market and any procompetitive justifications for the restraint. Sometimes, however, “the line between horizontal and vertical constraints can blur.”

In particular, companies and their counsel must be on the watch for so-called hub-and-spoke agreements, which by their nature combine elements of both horizontal and vertical restraints. In the typical “hub-and-spoke” case, a dominant purchaser or supplier in a relevant market (the “hub”) is alleged to have entered into a series of vertical agreements with its distributors or suppliers (the “spokes”). Considered alone, these agreements might be lawful, vertical restrictions. For example, Distributor A, at the behest of its customer, Supplier A, might agree to forgo doing business with Supplier B. A firm generally has the unrestricted right to choose with whom it deals. Thus, such a restraint would normally be evaluated under the rule of reason. However, the analysis may change, and greater scrutiny afforded, if Supplier A has also secured similar agreements from Distributors B, C, and D. With evidence of a “rim”—that is, an agreement between Distributors A, B, C, and D to accede to Supplier A’s demand and essentially boycott Supplier B—all participants could potentially be found per se liable for participating in an unlawful hub-and-spoke conspiracy.

Recent years have seen an increased invocation of hub-and-spoke theories of liability by both government enforcement agencies and private plaintiffs, some of which have caught traction with the courts. Plaintiffs have a strong incentive—the promise of potential per se liability—to plead hub-and-spoke conspiracies. Establishing that a rim exists is often a dispositive hurdle in these cases because, absent a rim, the conspiracy will be evaluated as a series of vertical arrange-

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1. In re Musical Instruments & Equip. Antitrust Litig., 798 F.3d 1186, 1192 (9th Cir. 2015).
2. United States v. Colgate & Co., 250 U.S. 300, 307 (1919) (“In the absence of any purpose to create or maintain a monopoly, the [Sherman] Act does not restrict the long recognized right of trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal . . . .”).
4. In re Musical Instruments, 798 F.3d at 1192–93 n.3 (“The prospect of establishing a violation per se is much more appealing to plaintiffs than the potential difficult and costliness of proving a § 1 claim under the rule of reason.”).
ments, which plaintiffs will have to prove unreasonable under the rule of reason. In a small number of cases, a rim is readily established through direct evidence of an explicit agreement between the spokes. More often, it must be inferred from circumstantial evidence.

Thus, an important question facing both antitrust practitioners and their clients is: Absent direct evidence of an agreement among the alleged spokes, what suffices to establish a rim in a hub-and-spoke conspiracy? And, equally important, what steps should business entities take to avoid creating the incorrect appearance of a tacit agreement to join a hub-and-spoke agreement?

Distinguishing a Series of Independent Agreements from a Hub-and-Spoke Conspiracy

Consider the following scenario: A dominant manufacturer sends a letter to its suppliers, which outlines two prerequisites to continued distribution of the manufacturer’s products. The suppliers, competitors of one another, are all copied on the same letter. The conditions, viewed independently, might be lawful vertical restrictions, provided they enhance competition. But is the letter an invitation to collude? Do the suppliers risk being labeled as part of a hub-and-spoke conspiracy and held per se liable for violating Section 1 of the Sherman Act if they all agree to the requirements? What if the competing suppliers never explicitly agree amongst themselves to accede to the manufacturer’s conditions?

In Interstate Circuit, Inc. v. United States, the Supreme Court affirmed a decision holding a number of horizontal competitors liable for participating in a conspiracy with a common distributor under similar circumstances. There, the manager of the two dominant movie theater operators across a number of cities sent a letter to eight representatives of movie distributors, all of which were in active competition with one another to distribute films for first-run showings. In the letter, on which all eight distributors were copied, the movie theater operator asked the distributors to comply with two demands: a minimum price for first-run theaters and a policy against evening double features. There was no direct evidence of an agreement between the distributors, but the Court found that “[i]t was enough that, knowing that concerted action was contemplated and invited, the distributors gave their adherence to the scheme and participated in it.”

A closer look at that case, as well as an examination of subsequent case law, demonstrates that mere knowledge that rivals may be adopting similar policies at the request of a distributor or manufacturer is probably not sufficient to alone establish liability. But that knowledge, combined with parallel action on the part of the competitors and other “plus” factors, may lead a court to infer a conspiracy among horizontal actors who enter into vertical agreements with a common hub. These plus factors can include action that would be against a participant’s independent business interests, conditioning an agreement on the participation of other competitors, and action that reflects a marked departure from previous business practices.

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5 Some courts have spoken of “rimless” hub-and-spoke conspiracies. See Elder-Beerman Stores Corp. v. Federated Dept’ Stores, Inc., 459 F.2d 138, 146 (6th Cir. 1972). Most courts, however, have adopted an approach more consistent with general antitrust principles and rejected the application of the hub-and-spoke theory to such cases, noting that “without the rim of the wheel to enclose the spokes,” a single, wheel conspiracy cannot exist but instead is a series of multiple conspiracies between the common defendant and each of the other defendants.” United States v. Swafford, 512 F.3d 833, 842 (6th Cir. 2008) (quoting Kottekos v. United States, 328 U.S. 750, 755 (1946)); see also United States v. Bustamante, 493 F.3d 879, 885 (7th Cir. 2007) (“For a hub and spoke conspiracy to function as a single unit, a rim must connect the spokes together, for otherwise the conspiracy is not one but many.”); In re Musical Instruments, 798 F.3d at 1192 (describing a hub-and-spoke theory as one in which “the rim of the wheel . . . consists of horizontal agreements among the spokes”).


7 Id. at 226.
In *FTC v. Toys “R” Us*, the FTC successfully defended a verdict against Toys “R” Us and a number of toy manufacturers for participating in a hub-and-spoke conspiracy. The Seventh Circuit upheld a finding that Toys “R” Us acted as the hub and coordinated a horizontal agreement among the toy manufacturers through a network of vertical agreements in which each toy manufacturer agreed with Toys “R” Us to restrict the distribution of its products to low-priced warehouse club stores on the condition that other manufacturers would do the same. In *United States v. Apple*, the Second Circuit upheld the district court’s finding of a per se violation of the antitrust laws by Apple, where it had entered into a series of vertical agency agreements with e-book publishers. In a 2–1 decision, the Second Circuit concluded that, through its vertical conduct, Apple “orchestrated” an agreement among publishers to raise e-book prices and that the district court did not err in characterizing this agreement as a horizontal price fixing-conspiracy subject to per se liability.

The Ninth Circuit, however, recently rejected plaintiffs’ allegations of a hub-and-spoke conspiracy in *In re Musical Instruments & Equipment Antitrust Litigation*, where individual guitar manufacturers had agreed to adopt minimum advertised price (MAP) policies at the request of Guitar Center, a large musical-instrument retailer. The court found “ample independent business reasons why each of the manufacturers adopted and enforced MAP policies even absent an agreement among the defendant manufacturers” and thus found that their “decisions to heed similar demands made by a common, important customer do not suggest conspiracy or collusion.”

A few common threads run through the cases in which courts have found either allegations or evidence sufficient to infer a horizontal agreement between competitors from circumstantial evidence. From those decisions, common principles can be extracted to assist in analyzing proposed business opportunities for competition risk.

The easiest way to prove a horizontal agreement in a hub-and-spoke conspiracy is the same as in any Section 1 case: through direct evidence of an express agreement. That, of course, turns what is termed a rim into a plain vanilla horizontal agreement. But what do courts do absent such express evidence? They turn to the allegations or evidence that is most suggestive that such an agreement was tacitly reached: evidence of direct communications between horizontal competitors.

1. **Are there communications between the horizontal competitors or, at the very least, knowledge that other competitors are entering into similar agreements?** Most cases in which courts have either imposed per se liability on horizontal competitors for engaging in a hub-and-spoke conspiracy or allowed such claims to proceed past a pleadings challenge have involved evidence of communications between the competitors or, at the very least, evidence that competitors were

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8 221 F.3d 928 (7th Cir. 2000).
9 Id. at 930.
10 United States v. Apple Inc., 791 F. 3d 290, 314 (2015), cert. denied, 136 S. Ct. 1376 (2016). The Second Circuit did not affirm the district court's finding that a rule of reason violation had also been established; the two-judge majority split on that issue.
11 But see, Leegin Creative Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 893 (2007) (holding that a rule of reason analysis would apply to a vertical agreement "entered upon to facilitate . . . [a] cartel . . ."); see also Toledo Mack Sales & Service, Inc. v. Mack Trucks, Inc., 530 F.3d 204, 225 (3d Cir. 2008) (holding that "[t]he rule of reason analysis applies even when . . . the plaintiff alleges that the purpose of the vertical agreement between a manufacturer and its dealers is to support illegal horizontal agreements between multiple dealers.").
12 798 F.3d 1186.
13 Id. at 1195.
aware of common communications with the hub about similar terms.\textsuperscript{14} Conclusory allegations that the spokes had mere knowledge of one another’s participation in an alleged conspiratorial scheme, by contrast, are not sufficient even to withstand a motion to dismiss—“there must be factual allegations to plausibly suggest as much.”\textsuperscript{15}

In \textit{Interstate Circuit}, there was no evidence of direct communications or agreement among the competitors, but all were copied on the same correspondence from the hub and acted in parallel to the requests therein—facts the Court found sufficient to demonstrate implicit agreement. The Court found that an inference of agreement was “supported and strengthened” by the defendants’ failure to offer the testimony “of any officer or agent of a distributor who knew, or was in a position to know, whether in fact an agreement had been reached among them for concerted action.”\textsuperscript{16} Silence, in that circumstance, was tantamount to a concession. And \textit{Toys “R” Us} included the “direct evidence of communications that was missing in \textit{Interstate Circuit}.”\textsuperscript{17} In that case, \textit{Toys “R” Us}, acting as the hub, communicated the message that “‘I’ll stop if they stop’ from manufacturer to manufacturer,” resulting in an essential boycott of the club stores by almost all major toy manufacturers.\textsuperscript{18}

\textbf{Practice tip:} \textit{Communications with competitors about dealings with a mutual supplier or buyer create heightened risks. The fact that a firm does not speak directly with competitors about an agreement will not allow it to avoid liability if there is evidence that it used the hub or another third party as a conduit to communicate with competitors.}

2. \textbf{Would the contemplated action be in your independent interest regardless of whether or not competitors take a similar action?} A key factor in many courts’ analyses of whether indirect evidence supports a finding of a hub-and-spoke conspiracy is whether the agreement is in the individual participant’s independent business interest. In \textit{Monsanto Co. v. Spray-Rite Service Corp.}, the Supreme Court held that “antitrust law limits the range of permissible inferences from ambiguous evidence in a § 1 case.”\textsuperscript{19} Accordingly, under this standard, conduct that is “as consistent with permissible competition as with illegal conspiracy does not, standing alone, support an inference of antitrust conspiracy.”\textsuperscript{20}

In \textit{Interstate Circuit}, the Supreme Court explained that the cooperation of all the horizontal players was “essential” to the success of the planned change in cinema practices.\textsuperscript{21} Each competitor theater operator knew that if the others did not adopt the requested restrictions on a market-wide basis, it stood to lose substantial business and good will. And at the same time, each knew that if all the competitors did adopt the restrictions, then they all faced the prospect of increased

\begin{itemize}
\item \textsuperscript{14} Compare \textit{Toys “R” Us}, 221 F.3d at 935 (noting “direct evidence of communications”) \textit{with In re Pool Products Distrib. Market Antitrust Litig.}, 940 F. Supp. 2d 367, 393 (E.D. La. 2013) (dismissing a horizontal and/or hub-and-spoke claim where “complaint does not specifically allege any contacts among or between manufacturers”) (citing Bell Atl. Corp. v. Twombly, 550 U.S. 544, 564–70 (2007)).
\item \textsuperscript{15} \textit{Howard Hess Dental Labs, Inc. v. Dentsply Int’l, Inc.}, 602 F.3d 237, 255 (3d Cir. 2010) (citing \textit{Twombly}, 550 U.S. at 564).
\item \textsuperscript{16} \textit{Interstate Circuit}, 306 U.S. at 225.
\item \textsuperscript{17} 221 F.3d at 935.
\item \textsuperscript{18} \textit{id.} at 932.
\item \textsuperscript{20} \textit{Matsushita}, 475 U.S. at 588 (citing \textit{Monsanto}, 465 U.S. at 764).
\item \textsuperscript{21} 306 U.S. at 226.
\end{itemize}
profits. Likewise, in *Toys “R” Us*, the Seventh Circuit found that “the sudden adoption of measures under which [toy manufacturers] decreased sales to the clubs ran against their independent economic self-interest.” The court cited evidence demonstrating that “each manufacturer was afraid to curb its sales to the warehouse clubs alone, because it was afraid its rivals would cheat and gain a special advantage in that popular new market niche.”

The Ninth Circuit, in *In re Musical Instruments & Equipment Antitrust Litigation*, distinguished cases in which action reflective of “market interdependence giving rise to conscious parallelism” occurs from cases “where individual action would be so perilous in the absence of advance agreement that no reasonable firm would make the challenged move without such an agreement,” finding that the latter “may suggest a prior agreement” among competitors. On their face, the MAP policies central to the alleged conspiracy might be against a given manufacturer’s self-interest insofar as they restrict the degree to which retailers could discount and thus increase sales of its products. The court, however, declined to find this suggestive of conspiracy in the circumstances where the complaint also “provide[d] ample independent business reasons why each of the manufacturers adopted and enforced MAP policies even absent an agreement the defendant manufacturers.”

**Practice tip:** A firm should avoid agreeing to adopt a restriction or enter into an agreement that runs contrary to its individual interests, such that it would only consider doing so if it knew its competitors were doing the same.

3. **Is your agreement to a course of conduct conditioned on the agreement of your horizontal competitors to that same course of conduct?** This question is closely linked to an assessment of whether the contemplated conduct would be in a firm’s independent business interest. The fact that a firm feels that it must condition its agreement to certain terms upon the agreement of its competitors to those same terms can suggest that the terms are not in its independent interests. In *Toys “R” Us*, testimony from both toy company executives and Toys “R” Us “to the effect that the only condition on which each toy manufacturer would agree to Toys “R” Us’ demands was if it could be sure its competitors were doing the same thing” weighed heavily in the court’s finding that a horizontal agreement existed among the “spokes.” And, as noted above, in *Interstate Circuit*, the failure of the distributors to offer any testimony or evidence suggesting that the companies had, in fact, acted independently was viewed as dispositive of the fact of agreement.

**Practice tip:** Seeking assurances from a counterparty that competitors are entering into similar agreements may serve as evidence that a given course of conduct is not in the firm’s independent business interests and thus support a finding of an agreement among the alleged firms. Adherence to agreements should be a truly unilateral business decision.

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22 Id. at 222.
23 *Toys “R” Us*, 221 F.3d at 932.
24 Id. at 936.
25 798 F.3d at 1195.
26 Id.; see also *Howard Hess Dental Labs. Inc. v. Dentsply Intl., Inc.*, 602 F.3d 237, 255 (3d Cir. 2010) ("[S]imply because each Dealer, on its own, might have been economically motivated to exert efforts to keep Dentsply’s business and charge the elevated prices Dentsply imposed does not give rise to a plausible inference of an agreement among the Dealers themselves.").
27 *Toys “R” Us*, 221 F.3d at 928.
4. Does the contemplated action represent a significant departure from previous business practices? A recent decision by the Fifth Circuit highlights the importance of this factor in avoiding an inference of agreement. In *MM Steel, L.P. v. JSW Steel (USA) Inc.*, the court affirmed the liability of a steel manufacturer that allegedly participated in a conspiracy with steel distributors to exclude a new steel distributor from the market where the manufacturer abruptly changed its course of dealing with that new entrant following threats it received from the distributors.28 Pointing to this “abrupt decision” to no longer deal with the new entrant, as well as statements made by the manufacturer regarding that decision, the court found that a reasonable juror could have concluded that the evidence “tended to exclude the possibility of conduct that was independent of the distributors’ conspiracy.”29 The court, however, reversed judgment as to another steel manufacturer, where it found that defendant’s decision not to deal with the new entrant “was either consistent with its incumbency practice, or at most, consistent with a vertical agreement with [a] long-standing customer.”30

This follows other hub-and-spoke cases in which liability has been established without direct evidence of an agreement. In *Interstate Circuit*, the Supreme Court noted that the distributors’ agreement with the manufacturer’s proposal involved a “radical departure from the previous business practices of the industry” and a “drastic increase in . . . prices.”31 Similarly, in *Toys “R” Us*, the court described the manufacturers’ decision to stop dealing with the club stores “an abrupt shift from the past.”32

**Practice tip:** An abrupt decision to change a course of dealing with a supplier, buyer, or competitor at the request of another supplier, buyer, or competitor carries heightened risk of the inference of a conspiracy. In such circumstances, adhering to best antitrust risk practices is paramount.

**A Special Case: Collaborative Industry Initiatives**

Dangers arise and risk increases where firms face particular unilateral issues (e.g., how to deal with the increase of the price of labor or how to deal with a particularly troublesome supplier) and then discuss them—or have the opportunity to discuss them—with other industry participants. Collaborative industry initiatives that include actual or potential competitors, especially where they involve exchanges of competitively sensitive information, can attract the attention and scrutiny of competition law enforcers. Moreover, private plaintiffs can try to use evidence of such meetings to establish communications between or a meeting of the minds among the rim of an alleged hub-and-spoke conspiracy.

For example, before the plaintiffs filed their complaints in *In re Musical Instruments Antitrust Litigation*, the FTC had initiated an investigation into possible price fixing in the music products industry, alleging that the National Association of Music Merchants (NAMM) organized various meetings and events at which “competitors discussed the adoption, implementation, and enforcement of minimum advertised price policies; the details and workings of such policies; appropri-

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29 Id. at 845.
30 Id. at 846.
31 306 U.S. at 222.
32 221 F.3d at 935.
ate and optimal retail prices and margins; and other competitively sensitive issues.”33 The FTC’s complaint was resolved through a consent decree that included no admission of liability. Plaintiffs, however, seized upon these allegations and the defendants’ attendance at NAMM meetings as supporting an inference of horizontal agreement between the guitar manufacturers to adopt MAP policies.34

The Ninth Circuit majority rejected such an inference, noting that “mere participation in trade-organization meetings where information is exchanged and strategies are advocated does not suggest an illegal agreement.”35 The three judge panel, however, was not in agreement on this point. In a strongly worded dissent, Judge Pregerson argued that the fact that the FTC had alleged that the trade association’s meeting “had the purpose, tendency, and capacity to facilitate collusion,” made it “more plausible” that an illegal agreement was reached and that “discussions at NAMM-sponsored events of specific mutually agreeable terms are a ‘circumstance pointing toward a meeting of the minds . . . .’”36

Accordingly, a firm’s participation in joint industry collaborations can give rise, at the very least, to an opportunity for the suggestion of collusion. When participating in industry collaborations, such as trade associations or standards-setting bodies, it is critical to remember that competitors should avoid discussing or sharing competitively sensitive information, especially information regarding pricing, costs, or market share data. Competitors should also avoid discussing plans for current or future commercial activities. It is the case that both vertical players and horizontal competitors may participate in joint standard-setting activities—providing a fertile ground for hub-and-spoke allegations to arise absent caution. In such cases, it is important to remember that any standards adopted should be supported by legitimate, pro-competitive business justifications. Examples of such justifications include enhancing the industry’s reputation, deterring undesirable conduct, assuring quality products, and promoting innovation. Participants should be cautious about applying standards to companies that are not participating in the meeting, or using standards as an exclusionary tool. Standards should not restrict any participant’s freedom to make independent business decisions. Finally, trade association meetings should always be guided by an agenda and discussions should adhere to that agenda, so that any allegations of conspiratorial purpose can be rebutted.

**Practice tip:** To minimize risk when meeting with competitors, an agenda should be prepared in advance of the meeting and reviewed by counsel. All discussions should adhere to that agenda. Minutes should be kept and reviewed after the meeting. Consider inviting antitrust counsel to participate in the meeting.

**Looking Toward the Future of Hub-and-Spoke Liability**

This area of law remains a developing one, with often unique factual situations that can leave companies, their counsel, and courts wading through arguably ambiguous territory between per se liability and lawful, vertical agreements. As more plaintiffs invoke hub-and-spoke theories, one hopes that the courts will continue to refine and harmonize the answer to what evidence suffices to support an inference of conspiracy among horizontal competitors who entered into similar vertical agreements with a common supplier or distributor. In the meantime, companies and their counsel should remain watchful for circumstances that could arguably give rise to such liability.

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33 In re Musical Instruments, 798 F.3d at 1190.
34 See id. at 1196.
35 Id.
36 Id. at 1199–1200 (quoting Twombly, 550 U.S. at 557).