Cooley

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# Main take-a-ways from the 2010 Horizontal Merger Guidelines

The revised Guidelines:

- Emphasize direct evidence of competitive effects
- Downplay market definition
- Raise concentration levels at which mergers are said to raise concern
- Highlight economic tools for analyzing unilateral effects from mergers with differentiated products
- Address effects on innovation and partial acquisitions for the first time

The U.S. Department of Justice ("DOJ") and Federal Trade Commission ("FTC") recently issued revised Horizontal Merger Guidelines ("Guidelines") outlining the agencies' enforcement policies with respect to mergers and acquisitions under the federal antitrust laws.

U.S. antitrust authorities have periodically issued Merger Guidelines since 1968. This latest revision is the first full scale revision to the Guidelines, however, since the FTC and DOJ jointly issued guidelines in 1992. (Those Guidelines were updated in 1997 to give greater credence to efficiencies). While not breaking much new ground compared to how the DOJ and FTC have actually been evaluating proposed transactions, this new iteration of Guidelines provides useful insights into how the regulators frame their evaluation of transactions and warrants close attention by companies considering mergers or acquisitions with competitors or potential competitors.

The new Guidelines substantially downplay the importance of defining markets (which were a central feature of earlier Guidelines), focusing instead on direct evidence of anti-competitive effects of proposed transactions. They put substantial weight on the closeness of the merging firms' products and on economic tools including "diversion ratios," "merger simulation," and "critical loss," as well as on the merging firms' profit margins and the potential for price discrimination harming vulnerable customers.

Importantly, the Guidelines explicitly address, for the first time, potential effects on innovation, which should be of particular importance to high-tech firms, and address partial acquisitions, in which only a minority position in a company is acquired.

Given that the Guidelines are, in many ways, a reflection of years of agency practice in evaluating transactions, their tone and content is more evolutionary than revolutionary. Most of the new Guidelines could just as easily have been penned by a Republican administration, though the language does subtly reflect the pro-enforcement tendencies of the Obama Administration. For example, the new Guidelines take care to emphasize the kinds of evidence that may show how transactions lessen competition and express skepticism about too quickly accepting arguments offered by merging parties to defend against antitrust concerns, such as ease of entry.

The bottom line is that the Guidelines are likely to present a slightly higher hurdle for antitrust sensitive deals. They underscore the need to gather more hard data, and sooner in the process, for parties planning a strategy to efficiently overcome antitrust hurdles to closing their transactions.

## Revised Guidelines describe current practice, reflect economic learning, address Court decisions

The revised Guidelines were released August 19 following a nearly year long public review that included written comment, public workshops, and distribution of draft guidelines. DOJ and FTC officials have said their goal was to describe agency practice and to capture advances in economic learning since the 1992 Guidelines were issued, to provide increased transparency.

Parties to transactions and their counsel, however, are not the only intended audience for the Guidelines. Reading between the lines, the Guidelines also appear to be aimed at influencing the courts (this despite a prominent caveat that they are not intended to describe how the agencies will conduct litigation in cases they decide to bring). And, notwithstanding the caveat, antitrust officials, in announcing the revised Guidelines, said they hoped the Guidelines would assist judges as well as private parties.

Even though the Guidelines do not have the force of law, courts have cited and applied previous Guidelines in decisions when the government has challenged mergers. The DOJ and FTC have, however, lost when they have alleged narrow and non-intuitive markets, even when they have had customer support backing up their theories of competitive harm.

Specific language in the new Guidelines appears to respond to cases that the government has lost over the last few years. Thus, the losses in *U.S. v. Sungard* and *U.S. v. Oracle* appear to have led to the new Guidelines' discussion of "product market definition with targeted customers." Losses in *FTC v. Arch Coal* and *FTC v. Western Refinery* appear to have led to the discussion of "information from customers about how they would likely respond to a price increase" and to the Guidelines' giving weight to "the conclusions of well-informed and sophisticated customers."

## Revisions relegate market definition to secondary role

The most significant change in the revised Guidelines is the diminished role of market definition in merger review. Defining product and geographic markets has long been the central focus in merger analysis. Indeed, the Clayton Act condemns only mergers and acquisitions that may substantially lessen competition in a "line of commerce" in a "section of the country" and the Supreme Court has said that "determination of the relevant market is a necessary predicate" to a Clayton Act claim.

The revised Guidelines move away from relying on market definition towards a more flexible, fact-specific inquiry that focuses on actual competitive effects likely to result from the transaction. The 1992/1997 Guidelines set forth a step-by-step framework—market definition, concentration, entry, unilateral and coordinated effects, and efficiencies. The revised Guidelines establish a more holistic, flexible and arguably subjective approach. They treat competitive effects as the central issue in merger analysis. Market definition is relegated to a secondary role, relevant only once the agencies "identify a potential competitive concern."

At the same time, the new Guidelines raise the market concentration thresholds at which a merger is said to "raise significant competitive concerns" or is "presumed to be likely to enhance market power." Highly concentrated markets are now said to be those with a Herfindahl-Hirschman Index (HHI, measured by summing the squares of individual firms' market shares) above 2500, rather than 1800. Moderately concentrated markets are said to be those with an HHI between 1500 and 2500, rather than 1200 and 1800. And even in highly concentrated markets, only mergers that raise the HHI more than 200 points are presumed anticompetitive, up from 100 in the earlier guidelines.

The HHI thresholds, however, no longer provide safe harbors to merging parties, since market definition is now only one "type of evidence" considered by the agencies.

## Evidence of adverse competitive effects

The agencies have inserted an entirely new section into the Merger Guidelines, entitled "Evidence of Competitive Effects." While taking the position that the agencies consider any reasonably available and reliable evidence, the section identifies categories and sources of evidence that has been found to be most informative. Those include: evidence of post-merger price increases; evidence from recent mergers, expansion and entry (so-called "natural experiments"); evidence of head-to-head competition between the merging firms; and whether the merger may eliminate a disruptive or "maverick" firm.

The revised Guidelines also identify the sources of "available and reliable" evidence which they consider, giving substantial weight to "documents created in the normal course," business decisions taken by the merging firms, and evidence that the merging parties intend to raise price, reduce output or capacity, reduce product quality or variety, withdraw products or delay their introduction, or curtail research and development efforts after the merger. The Guidelines specifically credit "the conclusions of well informed and sophisticated customers on the likely impact of the merger."

Among the most significant changes to the Guidelines is an expanded discussion of how mergers involving differentiated products —which are pervasive and have been the focus of most challenges in recent years—may lead to unilateral anticompetitive effects. The Guidelines describe a range of economic tools to determine if the merging firms are close competitors, placing heavy reliance on win/loss reports, discount approvals, customer switching patterns, customer surveys, and pre-merger margins. Consideration of "diversion ratios," "upward pricing pressure," and "merger simulation" in the analysis will likely require greater use of economists early in the review process by parties seeking antitrust approval for their transactions. In fact, one FTC Commissioner wrote separately upon issuance of the revised Guidelines to condemn the "overemphasis on economic formulae and models based on price theory." Others have expressed concern that the economic models almost always predict a price increase.

## Innovation and other non-price effects

The revised Guidelines introduce theories of harm based on reductions in innovation for the first time, although the agencies have been alleging such theories for at least 15 years.

The 1992 Guidelines recognized, but only in a footnote, that "sellers with market power … may lessen competition on dimensions other than price, such as product quality, service and innovation." Those Guidelines, however, analyzed only on adverse affects on price.

The new Guidelines note that the agencies consider whether a merger is likely to "diminish innovation competition by encouraging the merged firm to curtail its innovative efforts." The Guidelines articulate two different theories of innovation related harm.

First, they suggest that where a firm is engaged in efforts to introduce new products that would capture substantial revenues from the other merging firm, incentives to continue with existing product development may diminish.

Second, they suggest that where a merger may combine two of a very few firms with the strongest capabilities to successfully innovate in a specific direction, there could be a reduced incentive to initiate development of new products.

The Guidelines also acknowledge that mergers may enable innovation that would not otherwise take place, by bringing together complementary capabilities.

Articulation of these innovation theories, which are likely to be of most relevance to firms in high-tech industries, are certain to play a more prominent role in merger challenges over the coming years. Firms must plan for that possibility as they consider potential mergers and acquisitions.

In addition to innovation, the new Guidelines also focus on possible reductions in product variety, considering whether a merger is likely to give the merged firm an incentive to cease offering products offered by one of the merging parties. The Guidelines recognize that consolidation of products may be efficient, but suggest that withdrawal of a product that a significant number of customers strongly prefer can constitute harm to customers.

## Partial acquisitions

As noted, the new Guidelines also address, for the first time, partial acquisitions, in which a buyer acquires a minority interest in a competitor.

The Guidelines explain that acquisitions that do not result in control may nonetheless affect competition by (1) giving the acquiring firm the ability to influence the conduct of the target firm, by for example appointing board members, (2) reducing the incentive of the acquiring firm to compete, because it shares in losses inflicted, or (3) by giving the acquiring firm access to competitively sensitive information of the target firm. Although these are well-worn theories of the potential for anticompetitive harm posed by some minority acquisitions, their inclusion in the Guidelines suggests that the antitrust enforcers will have such acquisitions on their enforcement radar far more than they have in the past.

## Conclusion

Ultimately, as it was with the 1992 Merger Guidelines, the new Guidelines' full impact will only be felt years after their issuance—when not only the general concepts but also the specific framework they set forth has been fully absorbed by private practitioners, courts, and regulators in how they analyze transactions and evaluate the arguments proposed in support or against particular transactions. And so, while the Guidelines reflect what is, at most, an incremental change from existing practice, their role in setting down the specific words that will frame discussions for years to come marks their place as an extremely significant document.

If you have questions about this *Alert,* please contact one of our antitrust attorneys or your regular Cooley contact.



# Key Contacts


| | |
|---|---|
| Howard Morse<br>Washington, DC | hmorse@cooley.com<br>+1 202 842 7852 |