Evolution of the Merger Guidelines

Merger Antitrust Law

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Topics

- The *PNB* presumption
- The 1968 DOJ Merger Guidelines
- *General Dynamics*
- The 1982 DOJ Merger Guidelines
- The 1992 DOJ/FTC Horizontal Merger Guidelines
- The 1997 efficiency revisions
- The 2010 DOJ/FTC Horizontal Merger Guidelines

The *PNB* Presumption

United States v. Philadelphia National Bank

- Background
  - Decided in 1963, during the "restrictive" post-war period of antitrust law between 1946-1973
  - Perhaps the single most important case in merger antitrust law
- Market environment
  - Merger of two banks in the four-country Philadelphia metropolitan area
    - PNB (#1 w/21% total assets) to acquire Girard Corn Exchange Bank (#3 w/16% total assets) → Combined bank (#1 w/36% total assets)
  - Area experienced a trend toward concentration: Since 1950—
    - 7-FCR: 61% → 90%
    - PNB made 9 acquisitions representing 59% of its growth
    - Girard made 6 acquisitions, representing 85% of its growth
  - Acquisition would significantly increase concentration
    - 2-FCR: 44% → 59% (assets)
    - 4-FCR: __% → 78% (assets)[1]

The "*n*-FCR" is the *n-firm concentration ratio*, that is, the sum of the market share of the largest *n* firms in the market.

[1] The opinions do not contain sufficient information to determine the premerger 4-FCR.

United States v. Philadelphia National Bank

- District court
  - E.D. Pa.: Dismissed complaint on merits
    - Section 7 was inapplicable to the transaction
      - Section 7 applies to asset acquisitions only by "corporations subject to the jurisdiction of the Federal Trade Commission"
      - Banks are excluded from FTC jurisdiction under FTC Act § 5
      - The district court deemed the merger to be an asset acquisition for Section 7 purposes
    - But even assuming Section 7 applied, the transaction was not likely to substantially lessen competition because PNB and Girard actively compete in commercial banking with other banks throughout the northeastern United States
  - United States appealed directly to the Supreme Court under the Expediting Act

United States v. Philadelphia National Bank

- Supreme Court: Reversed with instructions to enter an injunction
  - Majority: Brennan for a 6-member majority
    - Created in 1963 as the Court was becoming increasingly restrictive on business
      - Next merger antitrust case after *Brown Shoe*
      - Written by Richard Posner, law clerk to Justice Brennan (who did not like to draft opinions)
    - Section 7 applies to mergers
      - Within the statutory scheme (especially after the 1950 Celler-Kefauver Amendments), mergers are better viewed as stock acquisitions
      - Section 7 reaches any stock acquisition by a corporation (whether or not within the jurisdiction of the FTC)
    - Product market: Commercial banking
    - Geographic market: Four-county Philadelphia metropolitan region

The *PNB* presumption

"This intense congressional concern with the trend toward concentration warrants dispensing, in certain cases, with elaborate proof of market structure, market behavior, or probable anticompetitive effects. Specifically, we think that a merger which **produces a firm controlling an undue percentage share of the relevant market**, and **results in a significant increase in the concentration of firms** in that market is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects."[1]

- Requires—
  - The combined firm to pass some (undefined) threshold of market share, *and*
  - The increase in market concentration caused by the transaction

  NB: The opinion is careful to note that it is not setting a lower bound and that commentators have suggested 20% as a threshold of "undue" market share
- Supposed to reflect the latest in economic thinking in the then prevailing structure-conduct-performance paradigm
  - "[T] the test is fully consonant with economic theory."[2]
  - "[C]ompetition is greatest when there are many sellers, none of which has any significant share."[3]

[1] United States v. Philadelphia National Bank, 374 U.S. 321, 363 (1963).
[2] *Id*. (citing extensively to structure-conduct-performance literature).
[3] *Id*.

The *PNB* presumption

- Application in *Philadelphia National Bank*
  - Combined firm had at least a 30% share in the relevant market
    - Enough for an “undue market share”
  - Share of the two largest banks in the relevant market should increase from 44% to 59%:
    - Enough for a “significant increase” in market concentration
  - *Court’s conclusion*: *PNB* presumption satisfied
  - Nothing in record to rebut presumption
    - District court’s reliance on testimony by competitors that competition was vigorous and would continue to be vigorous post-merger misplaced
      - Problem was too complex
      - Witnesses failed to give “concrete reasons” for conclusions
    - Summarily rejects testimony as sufficient to establish that dissatisfied customers can turn to one of 40 other banks in four-county region
      - Outside of outright monopoly, customer always has alternatives
      - Purpose of statute is to arrest tendency to monopoly in incipiency; purpose ill-served if law could not act until customer choice has largely disappeared
        - *Query*: At what point do you worry?
      - Testimony provided by small bank competitors must treat skeptically
      - Barriers to entry (primarily in government regulation)
      - Government regulation insufficient to ensure competition

Problems with the *PNB* presumption

- Presumption depends critical on boundaries of the relevant market, but there was no economically sound test for market definition to use when applying the *PNB* presumption
- The "Potter Stewart rule"
  - In the absence of a test, courts generally defer to the government's alleged market definition
  - So if the government gets to define the market, it essentially can ensure that the market shares will trigger the *PNB* presumption of anticompetitive effect

> The sole consistency that I can find is that in litigation under § 7, the Government always wins.[1]

- Although originally created as a rebuttable presumption, soon treated by lower courts as a conclusive presumption—essentially admitted no defenses

[1] United States v. Von's Grocery Store, 384 U.S. 270, 301 (1966) (Stewart, J., dissenting).

Some early Supreme Court precedents

- The Court in the 1960s was very aggressive on the market share thresholds of the *PNB* presumption
  - Brown Shoe/Kinney (1962)
    - Combined share of as little as 5% in an unconcentrated market
  - Von's Grocery/Shopping Bag Food Stores (1966)
    - 4.7% (#3) + 4.2% (#6) → 8.9% (#2) in an unconcentrated market
  - Pabst Brewing/Blatz Brewing (1966)
    - 3.02% (#10) + 1.47% (#18) → 4.49% (#5) in an unconcentrated market
- Implications
  - *Von's* and *Pabst* moved antitrust law away from the economic performance approach of *PNB* and back to the concentration/protection of small business approach of *Brown Shoe*
  - *Bottom line*: Through the 1960s and into the 1970s, antitrust law prevented most significant horizontal mergers and acquisitions

[1] Brown Shoe Co. v. United States, 370 U.S. 294 (1962).
[2] United States v. Von's Grocery Co., 384 U.S. 270 (1966).
[3] United States v. Pabst Brewing Co., 384 U.S. 546 (1966).

1968 DOJ Merger Guidelines

1968 DOJ Merger Guidelines

- First set of merger antitrust guidelines
  - Issued by Donald Turner, a Harvard Law professor specializing in antitrust law with a Ph.D in economics, who was the Assistant Attorney General in charge of the DOJ Antitrust Division from 1965-1968
  - Released on May 30, 1968, the last day of Turner's tenure as AAG
- Animating concern
  - Current interpretation of Section 7 was overly restrictive and was preventing efficiency-enhancing mergers

1968 DOJ Merger Guidelines

- *Solution*: Issue prosecutorial discretion guidelines that—
  1. Reoriented goal of merger antitrust law toward "market structures conducive to competition"[1]
     - The number of substantial firms selling in the market
     - The relative sizes of their respective market shares
     - The existence and magnitude of barriers to the entry of new firms into the market

     NB: This reflected the then-prevailing "structure-conduct-performance" paradigm in industrial organization
  2. Increased *PNB* thresholds above levels the Supreme Court has recognized as sufficient
  3. Gave more credit to efficiencies as a defense
     - The Supreme Court had suggested that efficiencies could be anticompetitive since they can undermine the ability of smaller, less efficient firms to compete
- This is what *Philadelphia National Bank* attempted to do, but subsequent cases (including *Pabst* and *Von's*) had moved the law in a much more restrictive and less economics-based way

[1] U.S. Dep't of Justice, Merger Guidelines § 2 (May 30, 1968).

1968 DOJ Merger Guidelines

- Implicit objectives
  1. Raise the thresholds for the *PNB* presumption to levels somewhat higher than those suggested by *Brown Shoe*, *Pabst Brewing*, and *Von's Grocery*.
     - Thresholds where there is no trend toward concentration

Highly concentrated markets (4FCR: 75% or more)		Less concentrated markets (4FCR: Less than 75%)	
Acquiring firm	Acquired firm	Acquiring firm	Acquired firm
4%	4%	5%	5%
10%	2%	10%	4%
15%	1%	15%	3%
		20%	2%
		25%	1%

     - Thresholds where there is a trend toward concentration
       - Exists when any grouping of the 2 to 8 largest firms increase their aggregate share by at least 7% over any time period from 5 to 10 years prior to the acquisition (credits very weak trends)
       - Will challenge any acquisition by any firm in such a grouping of a firm with more than a 2% share (extremely restrictive)
     - Non-market share standards
       - Acquisition of a disruptive competitor (a "maverick" in today's terminology)
       - Acquisition by a substantial firm of a smaller competitor that possesses "unusual competitive potential"

1968 DOJ Merger Guidelines

- Implicit objectives
  2. Give more credit to efficiencies
     - Supreme Court had indicated that efficiencies from a merger could raise barriers to the entry of new firms and entrench incumbent firms, and hence be anticompetitive
       - In *FTC v. Procter & Gamble Co*., the Supreme Court explicitly held that "[p]ossible economies cannot be used as a defense to illegality" and used the cost efficiencies in advertising resulting from merger to find the merger violated Section 7 because it would "entrench" Clorox's dominant position in the bleach market[1]
       - In *Brown Shoe Co. v. United States*, the Court, noting the congressional intent to use Section 7 to protect small businesses, observed: "Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets. It resolved these competing considerations in favor of decentralization."[2]
     - The 1968 Guidelines opened the possibility of an efficiencies defense in "exceptional circumstances"[3]
       - Although very narrow, given the hostility shown in some of the Warren Court decisions toward efficiencies the idea that they could be considered in any case was remarkable
       - *Query*: If cognizable as a defense, is it a negative defense or an affirmative defense?

[1] 386 U.S. 568, 580 (1967).
[2] 370 U.S. 294, 344 (1962) .
[3] U.S. Dep't of Justice, Merger Guidelines § 10 (May 30, 1968).

General Dynamics

United States v. General Dynamics Corp.

- In the 1970s, the economy took a downturn
  - Significant inflation as a result of the debt financing of the Vietnam war and the Mideast oil shocks
  - Substantial concern about U.S. competitiveness in the world market
- General Dynamics (1974)[1]
  - DOJ action—Filed September 22, 1967
    - DOJ relied on PNB presumption
      - 1959: 15.1% (#1) + 8.1% (#5) → 23.2% (#1) (in Illinois market)
      - 1967: 12.9% (#2) + 8.9% (#6) → 21.8% (#2) (in Illinois market)
      - Increasing concentration
  - Supreme Court—No violation
    - Agreed that DOJ's evidence triggered *PNB* presumption
    - BUT defendants rebutted presumption
      - Since competition was manifested more in rivalry for new long-term contracts, and since the ability to compete for long-term contracts depended on available coal reserves, share of uncommitted reserves a better measure of future competitive significance
      - United Electric's uncommitted reserves very weak → DOJ's prima facie case rebutted
  - There has been no significant merger antitrust case on the merits in the Supreme Court since *General Dynamics* in 1974

[1] United States v. General Dynamics Corp., 415 U.S. 486 (1974).

1982 DOJ Merger Guidelines

1982 DOJ Merger Guidelines[1]

- Origins
  - Issued by AAG William F. Baxter, a former Stanford law professor
  - Very algorithmic:
    - Identified relevant variables (e.g., market shares, market concentration, ease of entry)
    - Indicated enforcement outcomes given the variables associated with the merger
  - FTC refused to join—wanted more flexibility
- Animating concerns
  - Merger antitrust law in 1982 was still structurally oriented and very restrictive
    - 1968 Guidelines and *General Dynamics* had not moved the needle much
  - DOJ and FTC had resisted a more efficiency-oriented approach and were aggressively prosecuting mergers under the *Von's* and *Pabst* standards
  - U.S. businesses needed to become more efficient to compete with non-U.S. firms at home and abroad
  - Supreme Court implicitly recognized the need for antitrust law to protect and promote economic efficiency in *GTE Sylvania*

[1] U.S. Dep't of Justice, Merger Guidelines, 47 Fed. Reg. 28,493 (1982).

1982 DOJ Merger Guidelines

- *Innovation 1*: New explicit focus on market power as the competitive harm
  - Explicitly moved away from preventing increases in concentration as the goal of antitrust law to preventing the creation, enhancement, or facilitation of market power to the harm of consumers:

> *The unifying theme of the Guidelines is that mergers should not be permitted to create or enhance "market power" or to facilitate its exercise.* A sole seller (a "monopolist") of a product with no good substitutes can maintain a selling price that is above the level that would prevail if the market were competitive. Where only a few firms account for most of the sales of a product, those firms can in some circumstances coordinate, explicitly or implicitly, their actions in order to approximate the performance of a monopolist. This ability of one or more firms profitably to maintain prices above competitive levels for a significant period of time is termed "market power." Sellers with market power also may eliminate rivalry on variables other than price. In either case, the result is a transfer of wealth from buyers to sellers and a misallocation of resources.[1]

  - Echoes *PNB* approach → Increasing concentration implies greater likelihood of higher prices through oligopolistic interdependence
  - The importance of this change cannot be overemphasized
    - The Supreme Court was beginning to move in this direction in its 1977 *GTE Sylvania* decision

[1] 1982 DOJ Merger Guidelines § I.

1982 DOJ Merger Guidelines

- *Innovation 2*: Introduced new "hypothetical monopolist" market definition paradigm
  - Rigorous, economics-based standard that linked the market definition test to oligopolistic interdependence
  - *Basic idea*: A merger can threaten to create or facilitate the exercise of market power only with respect to a product/geographic grouping where a hypothetical monopolist could raise prices
  - *Test*: Can the hypothetical monopolist in the provisional (candidate) market raise prices profitably by a "small but significant nontransitory increase in price" (SSNIP) above prevailing levels?
    1. Start with the product of one of the merging firms as the provisional market
    2. Add closest substitute to provisional market and check if SSNIP is profitable
    3. If so, then provisional market is a relevant market. If not, then repeat Step 2 and Step 3 after adding the next closest substitute to the provisional market[1]
  - Comments
    - HMT is entirely demand-side oriented
    - Usual SSNIP is a 5% increase over prevailing market prices
    - Intended to solve the "Potter Stewart problem"

[1] 1982 DOJ Merger Guidelines § II. There will be a separate deck on market definition later in the course.

1982 DOJ Merger Guidelines

- *Innovation 3*. Introduced new market concentration measure
  - Retained *PNB* presumption, BUT
  - Replaced *n*-FCRs with the Herfindahl-Hirschman Index (HHI) as the measure of concentration

$$\text{HHI} = \sum_{i=1}^{N} s_i^2$$

where there are a total of N firms in the relevant market, and s_i is the market share of the ith firm

In other words, the HHI is the sum of the squares of the market shares of *all* of the firms in the relevant market

1982 DOJ Merger Guidelines

- *Innovation 4*. Increased market share thresholds for the *PNB* presumption[1]
  - Raised thresholds for what constitutes significant postmerger concentration (HHI)
  - Raised thresholds for what constitutes an "undue increase" in concentration ("delta" or ΔHHI)

Postmerger HHI	ΔHHI	Guidelines
< 1000		"Because implicit coordination among firms is likely to be difficult and because the prohibitions of section 1 of the Sherman Act are usually an adequate response to any explicit collusion that might occur, the Department is unlikely to challenge mergers falling in this region."
Between 1000 and 1800	< 100	"unlikely to challenge"
	≥ 100	"more likely than not to challenge"
> 1800	< 50	"unlikely to challenge"
	50-100	Could be problematic
	≥ 100	"likely to challenge"

[1] 1982 DOJ Merger Guidelines § III.A.

1982 DOJ Merger Guidelines

- *Innovation 5*. Recognized ease of entry as a market power-constraining force

> "If entry into a market is so easy that existing competitors could not succeed in raising price for any significant period of time, the Department is unlikely to challenge mergers in that market."[1]

  - Look at likelihood and probable magnitude of entry in response to a SSNIP (5%)
  - May be used to rebut the *PNB* presumption
  - Entry to be assessed over a 2-year time period
    - This two-year time frame suggested that the merger could have an anticompetitive effect in the first two years after consummation as long as this anticompetitive effect was eliminated by entry by the end of two years

[1] 1982 Merger Guidelines § III.B.

1982 DOJ Merger Guidelines

- *Innovation 6*. Recognized the efficiency-enhancing aspect of many mergers
  - Implied by the change of objective—
    - from preventing increased concentration and preserving small businesses
    - to preventing the creation of market power or the facilitation in its exercise
  - Recognized efficiencies as a feature of many mergers
  - Rejected notion that efficiencies were anticompetitive
    - *Brown Shoe* had indicated that efficiencies were anticompetitive because they reduced the competitiveness of smaller, less efficient firms
  - But still rejected efficiencies as a defense in most cases

> Except in extraordinary cases, the Department will not consider a claim of specific efficiencies as a mitigating factor for a merger that would otherwise be challenged. Plausible efficiencies are far easier to allege than to prove. Moreover, even if the existence of efficiencies were clear, their magnitudes would be extremely difficult to determine.[2]

- *Innovation 7*. Created an algorithmic approach to merger analysis

1982 DOJ Merger Guidelines

- *Innovation 7*. Formalized the failing company defense[1]
  - Basic idea:
    - If a firm is failing and will exit the market absent an acquisition, the acquisition cannot be anticompetitive (looked at from a going-forward perspective)
  - Recognized defense[2]
    - Applies to failing divisions as well as failing firms
  - BUT imposed strict conditions to prevent improper use:
    1. Firm probably would be unable to meet its financial obligations in the near future
    2. Firm probably would not be able to reorganize successfully under Chapter 11 of the Bankruptcy Act
    3. Firm has made unsuccessful good faith efforts to elicit reasonable alternative offers of acquisition that would both
       - keep the firm in the market, and
       - pose a less severe danger to competition than would the proposed merger
- *Innovation 8*. Created an algorithmic approach to merger analysis

[1] 1982 Merger Guidelines § V.B.
[2] The Supreme Court first recognized in the defense in 1930. *See* International Shoe Co. v. FTC, 280 U.S. 291 (1930).

1992 DOJ/FTC Horizontal Merger Guidelines

1992 DOJ/FTC Horizontal Merger Guidelines

- Some initial observations
  - Jointly promulgated with the Federal Trade Commission
    - AAG James Rill, with major input from economics DAAG Robert D. Willig
    - FTC Chairwoman Janet Steiger

      NB: Recall that the FTC did not join in the prior 1982 DOJ Merger Guidelines
  - Addressed only horizontal mergers
    - DOJ and FTC could not agree on guidelines for nonhorizontal mergers
  - Much more economically rigorous document than the 1982 DOJ Merger Guidelines
  - Retained the focus of the 1982 guidelines on market power:

> The unifying theme of the Guidelines is that mergers should not be permitted to create or enhance market power or to facilitate its exercise. Market power to a seller is the ability profitably to maintain prices above competitive levels for a significant period of time.[1]

1992 DOJ/FTC Horizontal Merger Guidelines

- Five-step analytical approach
  1. *Market concentration*: Will the merger would significantly increase concentration and result in a concentrated market?
  2. *Potential adverse effects*: Will the merger, in light of market concentration and other factors that characterize the market, raises concern about potential adverse competitive effects?
  3. *Entry*: Will entry would be timely, likely and sufficient either to deter or to counteract the competitive effects of concern?
  4. *Efficiencies*: Will any efficiency gains that reasonably cannot be achieved by the parties through other means?
  5. *Failure*: Will, but for the merger, either party to the transaction would be likely to fail, causing its assets to exit the market.

> The process of assessing market concentration, potential adverse competitive effects, entry, efficiency and failure is a tool that allows the Agency to answer the ultimate inquiry in merger analysis: whether the merger is likely to create or enhance market power or to facilitate its exercise.[1]

[1] 1992 DOJ/FTC Merger Guidelines § 0.2.

1992 DOJ/FTC Horizontal Merger Guidelines

- Innovations
  1. Retained market definition as the starting point of analysis
     - But introduced the notion of *price discrimination markets*
  2. Changed market share thresholds to "safe harbors"
     - Did not change the numbers—just the interpretation
     - No longer a predictor of prosecutorial decision-making
  3. Required explicit explanation of how the merger is anticompetitive

     > [M]arket share and concentration data provide only the starting point for analyzing the competitive impact of a merger. Before determining whether to challenge a merger, the Agency also will assess the other market factors that pertain to competitive effects, as well as entry, efficiencies and failure.[2]

     - Oligopolistic interdependence ("coordinated interaction" or "coordinated effects")
     - Introduced new "unilateral effects" theory of anticompetitive harm:
       - Products of merging firms must be the first and second choice of customers in the relevant market
       - Combined market share must be at least 35%
  4. Retained entry defense (with original 2-year time frame)
  5. Retained a rigid algorithmic approach to prosecutorial decision-making

[1] 1992 DOJ/FTC Merger Guidelines § 2.0.

1997 Efficiency Revisions

1997 Efficiency Revisions

- Amended the efficiency section of the 1992 Merger Guidelines
  - Issued under—
    - AAG Joel Klein
    - FTC Chairman Robert Pitofsky (former Dean, Georgetown University Law Center)
  - Recognized that efficiencies can have offsetting procompetitive effects and result in—
    - Lower prices
    - Improved quality
    - Enhanced service
    - New products

1997 Efficiency Revisions

- *Innovation*: Imposed demanding proof requirements for efficiencies to be considered ("cognizable efficiencies")
  1. *Merger specific*, so that they cannot be achievable without the merger
  2. *Verifiable* as to likelihood and magnitude
  3. *Sufficient* to negate the otherwise anticompetitive effect of the merger
  4. *Not anticompetitive*, so that they cannot arise from an anticompetitive reduction in output or service
- Negative defense
- Practical consequences
  - Essentially limited cognizable efficiencies to—
    - marginal cost reductions
    - that are passed on to customers
  - Implicitly rejected fixed cost reduction as cognizable efficiencies
  - Burden of proof elements can be interpreted very differently by different administrations

2010 DOJ/FTC Horizontal Merger Guidelines

2010 DOJ/FTC Horizontal Merger Guidelines

- *Animating concerns*: DOJ/FTC believed that the 1992 Guidelines were—
  - No longer reflected how the agencies analyzed mergers (true)
  - Too rigid and missed too many anticompetitive transactions (not very true)
  - Being used effectively against agencies in court (true)
- Two problems in particular
  - Courts over time adopted a simplified version of the “hypothetical monopolist” market definition test, but in application often reached results different than the market definitions alleged by the DOJ/FTC in the litigation
    - *Result*: DOJ/FTC lost in those cases for failure to establish an essential element of the prima facie case
    - By far the biggest problem the DOJ and FTC faced in their merger challenges
  - While courts had not completely embraced the unilateral effects theory, when considering the theory courts could hold the DOJ/FTC strictly to the Guidelines’ requirements (uniquely next best substitutes and a combined market share ≥ 35%)
    - *Result*: When the DOJ/FTC depart from the Guidelines’ requirements, one court rejected the application of the unilateral effects theory and the agencies feared that other courts would follow[1]

[1] *See* FTC v. CCC Holdings Inc., 605 F. Supp. 2d 26 (D.D.C. 2009).

2010 DOJ/FTC Horizontal Merger Guidelines

- *Solution*: Completely rewrite the Guidelines
  1. Create a new, flexible (nonpredictive) approach to analyzing mergers
  2. Adopt a new emphasis on non-price dimensions of anticompetitive harm
  3. Deemphasize market definition (but increase *PNB* thresholds)
  4. Increase emphasis on unilateral effects and on targeted customers
  5. Eliminate the unilateral effects structural requirements in the 1992 Guidelines
     - The overlapping products of the merging firms need not be each other's closest demand-side substitutes
     - Combined share need not be greater than 35% in the relevant market
  6. Increase emphasis on "direct" evidence
  7. Raise the bar on entry and repositioning defenses
     - Eliminated the two-year period for evaluating entry and repositioning
     - Now must be "rapid enough" to ensure no anticompetitive effect ever arises
  8. Maintain a high bar on efficiency defenses

1. New flexible approach to analyzing mergers

- The 2010 Guidelines are explicitly “flexible” in their approach
  - Hold that there is no one right way to do merger analysis
    - Eliminate the programmatic approach of the 1992 guidelines
    - Any way the agencies deem reliable can be used
    - But prevention of the creation or enhancement of market power remains the objective
  - Eliminate the numerical “safe harbor” thresholds of the 1992 Guidelines
  - Are intentionally very fuzzy
    - Provide enforcement agency with wide discretion in analyzing mergers
    - Do not predict enforcement outcomes
    - Preclude courts and defendants from saying that the agency misapplied the Guidelines

2. Non-price dimensions of anticompetitive harm

- The 2010 Guidelines identify the following types of harm in addition to price increases that may result from an anticompetitive merger:
  - Reduced product quality
  - Reduced service
  - Diminished innovation
  - Reduced product variety
  - Other effects that "harm customers as a result of diminished competitive constraints or incentives"
- Observation
  - None of these potential types of anticompetitive harm are necessarily harmful
    - Since most involve reducing costs, it is possible that the net effect in the circumstances of a particular case of a reduction in product quality, service, innovation, and especially product variety could be competitively neutral or even procompetitive

[1] 2010 Merger Guidelines § 1.

3. Deemphasis of market definition

- Eliminated market definition as an essential element of the violation
  - Unnecessary where there is other sufficient evidence of a likely anticompetitive effect
  - Compare 1982 and 1992 Guidelines, which held that market definition was the starting point of any antitrust merger analysis
- Eliminated "safe harbors" based on market definition
  - HHI thresholds in 1992 Guidelines say when mergers would not be challenged
  - HHI thresholds in 2010 Guidelines only say when mergers are likely to be challenged
- Modified "hypothetical monopolist" test
  - Any set of products that can support a profitable price increase can be a relevant market
  - Relevant markets are no longer unique—2010 Guidelines eliminates "smallest market" principle of 1982 and 1992 Guidelines as a strict requirement
    - But courts continue to use the smallest market principle in defining markets[1]
  - Can produce very small markets and exclude large but close substitutes
    - See Example 7 in the 2010 Merger Guidelines—Motorcycles, cars and the similarity test

[1] *See, e.g.*, FTC v. Sysco Corp., 113 F.Supp.3d 1, 26 (D.D.C. 2015).

3. Deemphasis of market definition

- Anticompetitive effect in defined markets
  - Increase the thresholds for the *PNB* presumption, but use the presumption only as one more type of evidence that the reviewing agency will consider[1]

Postmerger HHI	ΔHHI	Guidelines
	< 100	"unlikely to have adverse competitive consequences and ordinarily require no further analysis"
< 1500	--	"unlikely to have adverse competitive consequences and ordinarily require no further analysis"
Between 1500 and 2500	≥ 100	"potentially raise significant competitive concerns and often warrant scrutiny"
> 2500	100-200	"potentially raise significant competitive concerns and often warrant scrutiny"
	≥ 200	"will be presumed to be likely to enhance market power. The presumption may be rebutted by persuasive evidence showing that the merger is unlikely to enhance market power."

[1] "The purpose of these thresholds is not to provide a rigid screen to separate competitively benign mergers from anticompetitive ones, although high levels of concentration do raise concerns. Rather, they provide one way to identify some mergers unlikely to raise competitive concerns and some others for which it is particularly important to examine whether other competitive factors confirm, reinforce, or counteract the potentially harmful effects of increased concentration." 2010 Merger Guidelines § 5.3.

3. Deemphasis of market definition

- Practical consequence
  - Very little prosecutorially, since the 1992 thresholds were never close to being binding
  - Some courts appear to have accepted a 2500 point postmerger HHI and a 200 point Δ as sufficient to trigger the *Philadelphia National Bank* presumption[1]

[1] *See, e.g.*, United States v. Aetna Inc., 240 F. Supp. 3d 1, 42 (D.D.C. 2017) ("Courts have adopted these thresholds in determining whether a merger is presumptively unlawful."); FTC v. Staples, Inc., 190 F. Supp. 3d 100, 128 (D.D.C. 2016) (but finding that the postmerger HHI was 6265 and the delta was "nearly 3000" and would result in a "dominant firm with a competitive fringe"); Saint Alphonsus Med. Ctr.-Nampa, Inc. v. St. Luke's Health Sys., Ltd., No. 1:12-CV-00560-BLW, 2014 WL 407446, at *8 (D. Idaho Jan. 24, 2014), ("A market is considered highly concentrated if the HHI is above 2500, and a merger that increases the HHI by more than 200 points will be presumed to be likely to enhance market power."), *aff'd sub nom.* Saint Alphonsus Med. Ctr.-Nampa Inc. v. St. Luke's Health Sys., Ltd., 778 F.3d 775, 786 (9th Cir. 2015) (noting thresholds but not explicitly endorsing them as *PNB* triggers); *see also* United States v. Anthem, Inc., 855 F.3d 345, 349 (D.C. Cir. 2017) ("Although, as the Justice Department acknowledges, the court is not bound by, and owes no particular deference to, the Guidelines, this court considers them a helpful tool, in view of the many years of thoughtful analysis they represent, for analyzing proposed mergers."). For other cases noting the 2500/200 threshold but not explicitly endorsing it because the HHI in the case far surpassed them, see, for example, FTC v. Penn State Hershey Med. Ctr., 838 F.3d 327, 347 (3d Cir. 2016); ProMedica Health Sys., Inc. v. FTC, 749 F.3d 559, 568 (6th Cir. 2014); United States v. Energy Solutions, Inc., No. Civ. No. 16-1056-SLR, 2017 WL 2991799, at *17 (D. Del. July 13, 2017); FTC v. Advocate Health Care, No. 15 C 11473, 2017 WL 1022015, at *7 (N.D. Ill. Mar. 16, 2017); United States v. Anthem, Inc., 236 F. Supp. 3d 171, 207 (D.D.C. 2017); FTC v. Sysco Corp., 113 F. Supp. 3d 1, 52 (D.D.C. 2015); United States v. Bazaarvoice, Inc., No. 13-CV-00133-WHO, 2014 WL 203966, at *36 (N.D. Cal. Jan. 8, 2014); FTC v. OSF Healthcare Sys., 852 F. Supp. 2d 1069, 1079 (N.D. Ill. 2012); United States v. H & R Block, Inc., 833 F. Supp. 2d 36, 71 (D.D.C. 2011).

3. Deemphasis of market definition

- Anticompetitive effect
  - Acceptance by courts
    - Some courts appear to have accepted a 2500 point postmerger HHI and a 200 point Δ as sufficient to trigger the *Philadelphia National Bank* presumption

[1] *See, e.g.*, United States v. Aetna Inc., 240 F. Supp. 3d 1, 42 (D.D.C. 2017) ("Courts have adopted these thresholds in determining whether a merger is presumptively unlawful."); FTC v. Staples, Inc., 190 F. Supp. 3d 100, 128 (D.D.C. 2016) (but finding that the postmerger HHI was 6265 and the delta was "nearly 3000" and would result in a "dominant firm with a competitive fringe"); Saint Alphonsus Med. Ctr.-Nampa, Inc. v. St. Luke's Health Sys., Ltd., No. 1:12-CV-00560-BLW, 2014 WL 407446, at *8 (D. Idaho Jan. 24, 2014), ("A market is considered highly concentrated if the HHI is above 2500, and a merger that increases the HHI by more than 200 points will be presumed to be likely to enhance market power."), *aff'd sub nom.* Saint Alphonsus Med. Ctr.-Nampa Inc. v. St. Luke's Health Sys., Ltd., 778 F.3d 775, 786 (9th Cir. 2015) (noting thresholds but not explicitly endorsing them as *PNB* triggers); *see also* United States v. Anthem, Inc., 855 F.3d 345, 349 (D.C. Cir. 2017) ("Although, as the Justice Department acknowledges, the court is not bound by, and owes no particular deference to, the Guidelines, this court considers them a helpful tool, in view of the many years of thoughtful analysis they represent, for analyzing proposed mergers.").

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4. Increased emphasis on unilateral effects

- Basic idea: Unilateral effects theory
  - Looks to the elimination of "localized" competition between the merging firms
  - *Overinclusiveness problem*: In the absence of repositioning, entry, or efficiencies, a wide variety of economic models predict a price increase to at least to some subset of customers whenever two firms with a positive cross-elasticity of demand combine
- 1992 Guidelines—Tried to cabin the theory to avoid overinclusiveness by adding two additional requirements:
  - The overlapping products of the merging firms must be each other's closest demand-side substitutes
    - Other products in the relevant market must be distant substitutes
  - Combined share ≥ 35% in the relevant market

5. Eliminate the unilateral effects preconditions

- 2010 Guidelines—Unilateral effects unleashed
  - Eliminated requirement that merging firms be each other's closest substitutes
    - Sufficient if they are close substitutes (as measured by the *diversion ratio*)
    - The "diversion ratio" ("D_{AB}") is the percentage of sales lost by Firm A to the other merging company (Firm B) whenever sales are lost (presumably for competitive reasons)
  - Eliminated requirement that products of other firms be distant substitutes
    - Allows for other firms to be even closer substitutes to one merging firm than the other merging firm
  - Eliminated the 35% combined share requirement
    - Indeed, no need for market definition at all

More on the diversion ratio:

$$D_{12} \equiv \frac{\%\text{ change in } q_2}{\%\text{ change in } q_1} = \frac{\dfrac{\Delta q_2}{q_2}}{\dfrac{\Delta q_1}{q_1}} = \left(\frac{\dfrac{\Delta q_2}{q_2}}{\dfrac{\cancel{\Delta p_1}}{\cancel{p_1}}}\right)\left(\frac{\dfrac{\cancel{\Delta p_1}}{\cancel{p_1}}}{\dfrac{\Delta q_1}{q_1}}\right) = \frac{\varepsilon_{12}}{\varepsilon_1}$$

Definition

Cross-elasticity of product 1 with product 2

Own-elasticity of product 1

So the diversion ratio D12 is equal to the cross-elasticity of product 1 with product 2 divided by the own-elasticity of product 1.

6. Increased emphasis on direct evidence

- The 2010 Guidelines place heavy emphasis on direct evidence of a likely anticompetitive effect
  - *Direct evidence* is evidence that is probative without the need to draw inferences
  - Contrast this with *circumstantial evidence*, which requires an inference to be probative
- Agencies look for evidence that indicates the transaction is likely to cause an–
  - Increase in price
  - Decrease in aggregate output
  - Decrease in product or service quality
  - Decrease in product variety
  - Decrease in the rate of technological innovation or product improvement

6. Increased emphasis on direct evidence

- Sources of direct evidence
  - Indications in the documents of the parties
  - Financial terms of transaction that indicate the transaction will be profitable to the buyer only if the transaction is anticompetitive
  - Interviews with knowledgeable customers that reveal concern that they will be harmed by the transaction
  - Interviews with competitors that provide a plausible, testable theory of anticompetitive harm
  - “Natural” experiments that indicate harm has occurred in similar situations
    - Impact of recent mergers, entry, expansion, or exit
    - Comparisons across similar markets
  - Implications of economic theory
    - Especially unilateral effects and upward pricing pressure

6. Increased emphasis on direct evidence

- Agencies will still consider significant circumstantial evidence
  - Market shares and concentration in a relevant market
  - Indications that merger will eliminate–
    - Substantial head-to-head competition
    - A “disruptive” market influence

7. Entry and repositioning defenses

- Tone of the 2010 Guidelines toward entry and repositioning defenses even more difficult to prove than under 1992 Guidelines
  - Introduced two new notions
    1. If the existing percentage gross margin failed to induce entry or repositioning to compete down prices premerger, the investigating agency should be skeptical that a higher postmerger margin due to a small but significant price increase will induce entry

$$\text{Percentage gross margin} \equiv \frac{p - mc}{p}$$

    2. Eliminated the 1992 Guidelines two-year time period for entry to occur
       - Now must be “rapid enough” to ensure no anticompetitive effect ever arises
       - With the ability to insist on short deadlines for entry, these defenses can almost always be rejected
  - *Bottom line*: The skepticism that small changes in the margin will induce entry and the requirement that entry has to ensure that no anticompetitive effect ever occurs as a practical matter eliminates entry as a viable defense
    - Guidelines also explicitly apply entry-style analysis to repositioning, making a repositioning defense as hard to prove as an entry defense

8. Maintaining a high bar on efficiency defenses

- 2010 Guidelines continue hostility toward efficiency defenses
- Require efficiencies to—
  1. Be merger-specific
  2. Be reasonably verifiable as to likelihood and magnitude
  3. Offset merger's anticompetitive tendency and leave customers unharmed
- Much greater burden of proof on the merging parties
  - Merging parties bear the bear of proof
  - Agencies assert that most efficiencies can be achieved outside of the merger through contracting or more limited joint ventures, negating merger specificity
  - Agencies hold parties to a very high standard of proof in showing verifiability
    - Requires a detailed explanation as to how the efficiencies will be achieved
    - Usually reject efficiency projections generated outside of the usual business planning process
    - Helpful where there are historical instances where similar efficiencies have been achieved
  - Parties also required to show that entry will prevent any anticompetitive effect from ever arising
    - Imposes requirements on timing, likelihood, and magnitude that are almost impossible to satisfy

Other theories of anticompetitive harm

- The 2010 merger guidelines only address horizontal mergers

We will examine theories of harm for nonhorizontal mergers later in the course