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Horizontal Merger Guidelines Revision: A Draftsman's Perspective

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Horizontal Merger Guidelines Revision:
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Paul T. Denis[1]

I. INTRODUCTION

When the *Horizontal Merger Guidelines*[2] were revised in 1992, probably no one involved in the drafting process expected that it would be over 17 years before the Department of Justice ("DOJ") and the Federal Trade Commission("FTC") would call for a major revision. The path-breaking *1982 Merger Guidelines* were revised a mere two years after their release. The *1984 Merger Guidelines* that followed lasted only six years before their likely revision was announced. While the *1968 Merger Guidelines* survived 14 years before replacement, they had long before ceased to have any relevance to merger policy. History did not foreshadow a long and prosperous existence for the 1992 Guidelines, certainly not into near adulthood.

But the 1992 Guidelines achieved not only longevity but also considerable influence. Federal Trade Commission Chairman Jon Leibowitz's remarks announcing the Horizontal Merger Guidelines review project referred to the 1992 Guidelines as "one of the most cited documents in modern antitrust." Courts and commentators routinely cite with favor the 1992 Guidelines' framework in merger and non-merger cases alike. Perhaps more significantly, the 1992 Guidelines' framework had enormous global influence, as evident in similar approaches adopted around the world.

The key to this success, I would argue, is that 1992 Guidelines, for the most part, ask the right questions, provide a structured framework in which to ask those questions, maintain a sense of balance rather than trying to tip the table, and avoid the cookbook or check list approach that would have ensured early obsolescence in a continually changing economy. Careful readers of the 1992 Guidelines certainly can point to places where the 1992 Guidelines depart from these principles (the "for the most part" qualification in the prior sentence is there for a reason). Nevertheless, the drafters of the next edition Guidelines would be well advised to adopt these principles to guide the revision process and ensure that the successor version is as long lasting and as influential as its predecessor.

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[2] 1992 HORIZONTAL MERGER GUIDELINES WITH APRIL 8, 1997 REVISIONS TO SECTION 4 ON EFFICIENCIES, U.S. Department of Justice & Federal Trade Commission, (April 8, 1997), *available at* the FTC website page devoted to the Merger Guidelines Review Project, http://www.ftc.gov/bc/workshops/hmg, [hereinafter "1992 GUIDELINES"].

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II. IT IS TIME

As the principal draftsman of the 1992 Guidelines, I developed what might fairly be described as an unusual attachment to the document and its framework. But even from that perspective, I must admit it is time to revise the 1992 Guidelines. In order to provide meaningful guidance, guidelines must reflect actual agency practice. But Agency practice has diverged from the 1992 Guidelines, in some respects for the better and in some respects for the worse. Perhaps the best evidence of this divergence is the *Commentary on the Horizontal Merger Guidelines* ("the Commentary") released by the Federal Trade Commission and the Department of Justice in 2006.[3] The Commentary shows how the agencies, among other things, have de-emphasized market definition and market concentration, devoted greater attention to competitive effects, largely ignored issues of dynamic response, and attempted to break free from the step-wise framework permeating the 1992 Guidelines.[4] This divergence between the 1992 Guidelines and actual agency practice itself is sufficient to warrant revision of the 1992 Guidelines, agency practice—or perhaps both.

III. ASK THE RIGHT QUESTIONS

The next version of merger guidelines should focus the analyst on asking the right questions. But an opaque standard like "the right questions" is much easier to state than it is to apply. What are the right questions as distinguished from the wrong questions?

The 1992 Guidelines hold themselves out as providing the "analytical framework" for antitrust analysis of mergers.[5] The choice of the term "analytical framework" was a considered departure from the language of the 1984 Guidelines which offered the "general principles" that ordinarily would be applied in merger analysis.[6] In reorganizing and revising the 1984 Guidelines, the 1992 Guidelines sought to identify the conditions necessary to establish that a merger was likely to create or enhance market power, or facilitate its exercise. The right questions are the questions that elicit the facts that determine whether those necessary conditions are met. The analytical framework serves as "a methodology for analyzing issues once the necessary facts are available."[7]

The drafters of the next merger guidelines should adopt the same approach of identifying the conditions necessary to establish that a merger is likely to create or enhance market power, or facilitate its exercise. Of course, in doing so the guidelines will then establish the sufficient conditions for the parties to establish that the transaction should be cleared. As

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[3] COMMENTARY ON THE HORIZONTAL MERGER GUIDELINES, U.S. Department of Justice & Federal Trade Commission, (March 2006), *available at* http://www.ftc.gov/bc/workshops/hmg, [hereinafter "Commentary"].

[4] *See* Paul Denis, *The Give and Take of the Commentary on the Horizontal Merger Guidelines*, ANTITRUST 51 (Summer 2006).

[5] *Supra* note 2, GUIDELINES § 0.

[6] 1984 MERGER GUIDELINES §1, *available at* http://www.justice.gov/atr/hmerger/11249.htm, [hereinafter "1984 GUIDELINES"].

[7] *Supra* note 2, GUIDELINES § 0.1.

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was the case in 1992, some will contend that this level of transparency will doom future merger enforcement by making it too easy for the parties to knock out the government's case. But merger enforcement thrived rather than suffered under the 1992 Guidelines framework. The transparency of the analytical framework and its emphasis on asking the right questions gave the 1992 Guidelines a credibility that played a major factor in their longevity. The drafters should maintain this focus.

IV. PROVIDE A STRUCTURED FRAMEWORK

In asking the right questions, the agencies should maintain the structured framework of the 1992 Guidelines, with the analysis moving in a step-wise or linear fashion through the five sections of the 1992 Guidelines framework: (1) market definition, measurement, and concentration; (2) competitive effects; (3) entry; (4) efficiencies; and (5) failing firm/division. As then-AAG James F. Rill said when announcing the issuance of the 1992 Guidelines: "The Guidelines' framework consists of five steps. Each is necessary and together they are sufficient to determine whether a merger is likely to create or enhance market power."[8]

After fourteen years of agency experience in applying the 1992 Guidelines framework, the Commentary took the position that

> Each of the Guidelines' sections identifies a distinct analytical element that the Agencies apply in an integrated approach to merger review. The ordering of these elements in the Guidelines, however, is not itself analytically significant, because the Agencies do not apply the Guidelines as a linear, step-by-step progression that invariably starts with market definition and ends with efficiencies or failing assets.[9]

The first question in the Questions for Public Comment published by the FTC and DOJ at the time the review process was initiated asked

> Should the Guidelines be revised to indicate that the Agency's assessment of whether the merger is likely to reduce competition may not entail following the five steps in the order listed and that not all five steps are needed in all cases?

The answer to the first part of the question most certainly should be "no." This is one area where agency practice should be changed to conform to the Guidelines rather than the other way around. Either of two reasons should be sufficient to resolve this issue:

1. First, each successive step of the Guidelines five step process explicitly relies on the resolution (or at least an assumption as to the worst-case resolution) of the prior step. Any contention that these steps are completely distinct elements is simply incorrect on its face.[10] To make them completely distinct would require a whole scale re-writing of the Guidelines, something the agencies have disclaimed any intention to undertake.

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[8] Interview with AAG James F. Rill, 61 Antitrust L.J. 229, 232 (1992). See also Paul T. Denis, *An Insider's Look at the New Horizontal Merger Guidelines*, ANTITRUST 6 (Summer 1992).

[9] *Supra* note 3, COMMENTARY at 2.

[10] For an explanation of the linkages between the steps, *see Roundtable Discussion, Merger Guidelines Revisited*, ANTITRUST 8, 13-14 (Fall 2009).

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2. Second, the structured framework has had enormous value in teaching merger analysis and in shaping what experienced analysts now assert is their "intuition" while not impeding an integrated or holistic analysis. Calls for abandonment of the step-wise or linear approach of the 1992 Guidelines are perhaps the greatest compliment to the wisdom of this approach. The framework has been so thoroughly assimilated and has become so imbedded in the brains of the leading legal and economic practitioners, both inside the agencies and outside, that they don't even realize that they are applying it.

Experienced practitioners today can and do essentially skip steps in analyzing mergers, making enforcement decisions, and advising clients. But they (at least the good ones) do so with an awareness of what it is that they are skipping and by making worst case assumptions about how those skipped steps might be resolved if fully analyzed. Those who were around at the time the 1992 Guidelines were released will recall that it took a while before the guidelines framework came to be regarded as a shared intuition. The drafters of the next merger guidelines should keep in mind that the framework is learned, not intuitive. Their target audience for the revisions should be not just the antitrust merger analysis cognoscenti, but also the next generation cognoscenti whose DNA does not yet embody the framework, and the occasional user who will need regular reminders. Even the best of practitioners won't be hurt by a reminder of first principles.

Finally, while not dispositive of the issue, it is telling that the Commentary, after a more free form introduction, adopts as its organizing principle the step-wise linear approach of 1992 Guidelines. It remains the best way to structure and organize both merger analysis and discussions of merger analysis. The structured framework should be retained and followed.

V. MAINTAIN A SENSE OF BALANCE

To ensure the continued acceptance and credibility that benefitted the 1992 Guidelines, the next merger guidelines must maintain the sense of balance struck in the 1992 Guidelines. The 1992 Guidelines had no agenda to increase or retard merger enforcement. The focus was on asking the right questions and letting the facts of the particular transaction determine the outcome.

In the Commentary, there was a noticeable effort to take back some ground lost in litigation of put down markers on points the agencies hoped to establish in the future, something that should be avoided in the guidelines drafting.[11] The agencies should attempt to shape the law. But the process of shaping the law is best left to the Commentary, speeches, and, of course, litigated cases. The next guidelines should reflect the result of that process of shaping the law rather be conscripted into being part of that process.

[11] *See generally* Denis, *supra* note 4.

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VI. AVOID COOKBOOK OR CHECKLIST APPROACHES

Several of the Questions for Public Discussion revolve around whether the next merger guidelines should include discussion of evidence to be considered, tools to be applied, or examples of past deals. They should not.

The inclusion of certain evidence, tools, or examples necessarily implies the exclusion of other evidence, tools, or examples. To remain usable, the next merger guidelines must continue to be limited in length and cannot be exhaustive in the treatment of evidence, tools, and examples. It is better to exclude discussion of evidence, tools, and examples than to include some of each. Those included will be perceived by some readers as being more important than those excluded; those excluded will be perceived as being less important. There is real risk that the items included become a rote checklist that parties feel compelled to address in every deal, not unlike Section 3.4 of the 1984 Guidelines, the amorphous "other factors" section.

Things like natural experiments, critical loss analysis and upward pricing pressure, residual demand estimation, and merger simulation are tools. None of these tools have universal applicability. Each has proven to have some value in different circumstances. The agencies should consider a revised and expanded Commentary to offer greater insights into the possible uses and misuses of these tools.

The 1992 Guidelines are not perfect in avoiding discussion of evidence.[12] The next merger guidelines would do well to avoid repeating this mistake and focus instead on asking the right questions.

VII. EXPAND THE TREATMENT OF UNILATERAL EFFECTS

It is ironic that the inclusion of the unilateral effects section in the 1992 Guidelines was both the most influential and perhaps the least understood change relative to the 1984 Guidelines (the distinction between uncommitted and committed entry may be a close second). Government merger complaints now place reliance on unilateral effect theories at a rate far greater than ever before while volumes are being written trying to understand the underlying principles. The guidelines revision process should address this confusion by expanding the unilateral effects section to break down more clearly the necessary conditions for finding likely unilateral effects from a merger under different modes of competitive interaction.

The unilateral effects section in the 1992 Guidelines stresses that "unilateral competitive effects can arise in a variety of different settings. In each setting particular other factors describing the relevant market affect the likelihood of unilateral competitive effects. The settings differ by the primary characteristics that distinguish firms and shape the nature of their competitive interaction."[13] But there is no effort to detail each of the settings or modes of competitive interaction that might apply. Instead, the 1992 Guidelines focus primarily on the

[12] *See, e.g., supra* note 2, GUIDELINES §§ 1.11 and 1.21 (evidence relevant to market definition), 2.1 (relevance of prior collusive history), and 2.211 n.22 (sources of information relevant to unilateral effects analysis.

[13] *Id.* § 2.2.

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setting in which firms compete based on the characteristics of the products they sell, treating that particular setting like a template that could be extended to other settings.[14]

Less extensive treatment is given to the setting in which firms are differentiated by their capacities.[15] Footnote 21 of the 1992 Guidelines is the only treatment of other settings, briefly mentioning firms competing through individualized negotiations, bidding, or auctions. The drafters of the next merger guidelines would be well advised to build on this footnote, bring it into the text, and explicate more clearly the necessary conditions to establishing the likelihood of adverse unilateral effects under different settings/modes of competitive interaction. The settings/modes noted in the 1992 Guidelines may be insufficient and it may be necessary also to consider other settings or modes of competitive interaction. Some industries are best characterized by a dominant firm model or by spatial/locational competition and those settings/modes of competition may warrant separate explication. But with each, the focus should be on identifying the necessary conditions to establishing the likelihood of the competitive effect of concern.

VIII. ELIMINATE PRESUMPTIONS

One concept that should not be found in the next merger guidelines is the structural presumption. In investigative practice today (as distinguished from litigation), the agencies do not infer presumptions from structural evidence, nor should they. Rather, structural evidence is used as a screening device or safe harbor. Transactions with minimal impact on concentration or resulting in post-merger concentration below some critical level (most likely a level above the HHI 1800 threshold stated in the 1992 Guidelines) are allowed to proceed without detailed review. On this point, the next merger guidelines should conform to agency practice, not the other way around.

The structural presumption made its way into the 1992 Guidelines as an alternative to language in the 1984 Guidelines suggesting that the agencies were "likely to challenge" transactions based solely on structural evidence.[16] The "likely to challenge" language was incorrect both as a matter of theory and as a statement of agency practice and had to be removed if the Guidelines were to have any chance at attaining credibility. In investigative practice, concentration had become, as it is today, at most a screening tool. But given the weight the agencies continued to place in litigation on structural presumption as articulated in *Philadelphia National Bank*, there would be no way to achieve a consensus for drafting the Guidelines to describe what was actually happening at the agencies.

The compromise was to adopt as an alternative to the "likely to challenge" language the structural presumption, incorporating the learning of Baker Hughes where then Judge (now Justice) Thomas explained that presumptions merely were of evidentiary not substantive

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[14] *Id*. § 2.21. Those interested in the theoretical underpinnings should *see* Robert D. Willig, *Merger Analysis, Industrial Organization Theory, and Merger Guidelines*, BROOKINGS PAPERS ON ECONOMIC ACTIVITY. MICROECONOMICS, VOL. 1991, pp. 281-332, (1991) *available at* http://www.jstor.org/pss/2534795.

[15] *Supra* note 2, GUIDELINES § 2.22

[16] *Supra* note 6, 1984 GUIDELINES § 3.11.

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significance. Once the government established the structural presumption, the burden of coming forward with evidence to rebut the presumption shifted to the merging parties, but the overall burden of persuasion remained at all times with the government. Obviously, the incorporation of the structural presumption was at odds with the notion that the Guidelines should be burden neutral,[17] but necessity of compromise won out over internal consistency.

Since the 1992 Guidelines were adopted, there has been a continued erosion of the *Philadelphia National Bank* structural presumption, a fact conceded even by senior agency officials.[18] Whereas it was once thought that if the structural presumption was established that adverse competitive effects from the transaction were likely, it is now widely understood that a host of other market characteristics are relevant and there is no necessary relationship between market concentration and competitive effects. The next guidelines should make this recognition official and remove the structural presumption. Alternatively, if misplaced concerns about litigation advantage continue to dominate, the next guidelines should make clear that the agencies view the presumption as merely of evidentiary, and not substantive, significance; perhaps shifting the burden of coming forward with evidence but not creating an independent basis for concluding that a transaction is likely to have adverse competitive effects.

At a minimum, the drafters should remove the second presumption embedded into the Guidelines in the unilateral effects section.[19] Unlike the basic structural presumption incorporated into Section 1.5 of the 1992 Guidelines, this second presumption has no foundation in the case law or theory. It started out as an effort to create a safe harbor that would ensure that unilateral effects analysis would not be misused to go after transactions with, at best, very small welfare effects. The thirty-five percent figure was chosen because it was part of the "leading firm proviso," the closest thing to unilateral effects found in the 1984 Guidelines.[20] Fears that the safe harbor approach might infect Section 1.5 of the Guidelines and lead to the demise of the structural presumption led to the conversion of the safe harbor into a presumption, albeit one that is phrased in such a way as to defy its application (market share in differentiated products markets rarely, if ever, reflects a product's relative appeal as a second choice which thereby negates a condition necessary for application of the presumption).[21]

IX. CONCLUSION

The 1992 Guidelines have had a really good run, longer and more influential than anyone could have expected when they were released. But the time has come to update the 1992 Guidelines to more closely reflect actual agency practice and more clearly explicate important issues, such as unilateral effects analysis. If the drafters of the next guidelines can maintain the

[17] *Supra* note 2, GUIDELINES § 0.1,

[18] *See*, e.g., Carl Shapiro, Updating the Merger Guidelines: Issues for the Upcoming Workshops, Address before the Fall Forum, Antitrust Section, American Bar Association (Nov. 12, 2009).

[19] *Supra* note 2, GUIDELINES § 2.211.

[20] *Supra* note 6, 1984 GUIDELINES § 3.12.

[21] *Supra* note 2, GUIDELINES § 2.211.

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focus on asking the right questions and maintain the structured framework in which to ask those questions, we could have an equally influential document and might go more than another 17 years before revisiting these issues.

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