THE LAW DEFICIT IN MERGER CASES

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There is a law deficit in American merger cases. Both courts in *AT&T/Time Warner* noted it. As the D.C. Circuit put it, "There is a dearth of modern judicial precedent on vertical mergers." This is especially problematic because, as Judge Rogers noted in the same sentence, there is also "a multiplicity of contemporary viewpoints about how they might optimally be adjudicated and enforced."[2] The Supreme Court decided its last vertical merger case in 1972,[3] and the last case in any circuit came in 1987 in a case by a private plaintiff.[4] *AT&T* was the first vertical case brought by the Justice Department in literally four decades, and the FTC has yet to challenge one in court in modern times. Unfortunately, *AT&T* made no new law. The trial judge held only that the Department had failed to establish the factual predicates for any of its three theories of anticompetitive harm. On appeal, the Department could assert only that the findings on its primary theory were clearly erroneous. The D.C. Circuit held that they were not.[5] Neither court considered whether the Department's theory was valid as a matter of law and, if so, what its elements were nor how they might be established.

The future of serious vertical merger enforcement turns on the answers to these and a host of other questions. Most importantly, must the agencies attempt the same fact intensive showing of likely effects as the Department attempted in *AT&T*? Or can they persuade the courts to accept something more like the *Philadelphia Bank* structural presumption that it still employs to great effect in horizontal merger cases? The most important lesson from *AT&T* is that the agencies are not likely to win many cases if they cannot. The welfare effects of even the largest vertical mergers are ambiguous. Worse, the theories of harm from vertical mergers only show that harm is possible under certain circumstances, but not whether it will actually occur. The same conditions necessary for the raising rivals' cost ("RRC") theory urged in *AT&T*, for example, also support the elimination of double marginalization ("EDM") cited by defendants. Indeed, Carl Shapiro, the government's expert, found both effects in *AT&T*. Quantifying these effects in dollars per annum with any acceptable degree of accuracy, as Dr. Shapiro attempted, proved extremely difficult.[6] Having to bear the ultimate burden of persuasion, vertical cases will be hard for the agencies to win on this theory of harm.

They will also be very expensive and time consuming, as this case illustrates. Even with expedited treatment, the investigation and litigation took over two years. Judge Leon estimated the cost of the case to be "easily in the tens of millions of dollars."[7] This estimate may or may not

2 *United States v. AT&T*, No. 18-5214 (D.C. Cir. Feb. 26., 2019), slip op. at 15.

3 *Ford Motor Co. v. United States*, 405 U.S. 562 (1972).

4 *Alberta Gas Chems. v. E.I. du Pont de Nemours*, 826 F.2d 1235 (3d Cir. 1987), *cert. denied*, 486 U.S. 1059 (1988). The last court of appeals case with an agency plaintiff was *Fruehauf Corp. v. FTC*, 603 F.2d 345 (2d Cir. 1979).

5I agree for the reasons stated in Joshua D. Wright & Jan M. Rybnicek, *United States v. AT&T/Time Warner: A Triumph of Economic Analysis*, 6 J. Antitrust Enforcement 469 (2018).

6 *United States v. AT&T*, 310 F. Supp.3d 161, 225-40 (D.D.C. 2018).

7 *Id.* at 253.

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be accurate, but costs of this magnitude are a serious problem for the agencies in view of their limited resources. The whole point of the *Philadelphia Bank* presumption was to avoid these impediments to effective enforcement, as urged by Derk Bok's famous article,[8] on which Justice Brennan relied in his opinion for the Court.[9]

Unfortunately for the agencies and other proponents of enhanced vertical merger enforcement, there is no equivalent consensus to support a presumption against vertical mergers. Everyone agrees, of course, that vertical integration is efficient in a host of ways, as all economic integration is. In the words of the casebook I use, there are "*literally hundreds of ways* that firms can lower their costs or provide better service by integrating vertically."[10]

But there is no similar consensus as to whether they cause significant harms justifying more cases like *AT&T*. To use the raising rivals' costs theory urged in *AT&T* as just one example, it is not easy to estimate whether and, if so, how much a newly integrated company can increase its selling cost due to the increased bargaining leverage it obtains. Nor will it be easy to determine how much, if any, of the increased cost to the seller can be passed on to its customers. After all, the proponents of the RRC theory also argue that EDM can be achieved through contracts which in effect split the optimal markup for the final product between the supplier and buyer. Both have the incentive to make such a deal. The key impediment, however, is the split of the surplus created between the parties. The fact that Comcast, for example, may now have to give AT&T a bigger cut of the profit from the distribution of Time Warner content does not mean that the overall margin is higher, just that Comcast now gets less of it. This is only an injury to a competitor, not to competition, and thus no reason to prevent the merger.

There are, of course, other theories of anticompetitive harm from vertical mergers, including the original foreclosure theory of the old Supreme Court cases and the ones in the obsolete 1984 Guidelines. But we still have no useable judicial guidance as to whether these theories continue to justify condemnation under Section 7 and under what conditions.

In particular, we need judicial consideration, preferably from the Supreme Court, on two issues. The first is how to deal with the efficiencies from vertical mergers. The grudging approach to efficiencies in horizontal merger cases makes the supposed "efficiency defense" virtually useless in litigation and reflects a profound misunderstanding of the real world of business. Gains from acquisitions are not "sure things" that can be proved to the dollar. All too often, they are predictions that make sense at the time but unfortunately don't pan out. Uncertainty and risk are integral aspects of business.

The second issue is how to assess markets that are in the midst of rapid change. Both courts in *AT&T* observed the rapid displacement of cable TV by streaming services and by companies like Netflix, Hulu, and Amazon. In such markets, supposedly dominant positions can evaporate quickly. Just ask Blockbuster. AT&T's stated motivation for the deal, to further its data transmission business by encouraging the streaming of video content to its 100 million cellular customers, is highly credible. But the Government's case ignored this obvious motivation, although both Judge Leon and Judge Rogers cited it as a further reason for doubting Professor Shapiro's quantitative model. Certainly, rapidly changing markets pose problems for the static models we typically employ in all of antitrust. This is particularly true with merger cases under Section 7, where prediction is the name of the game.

In my opinion, the present state of knowledge justifies the opposite of *Philadelphia Bank*, a presumption *in favor* of vertical mergers. The plaintiffs should have the burden of demonstrating the likelihood of actual and substantial anticompetitive effects. Whether any lower court would consider such a presumption is questionable. Ultimately, only the Supreme Court can and should frame the basic rules for vertical mergers.

The situation is only marginally better for horizontal mergers. There are a decent number of district court decisions, but only a handful from the courts of appeals, especially outside the D.C. Circuit, and no modern Supreme Court decisions to provide uniformity among the circuits. Very few district court opinions are even appealed. As a result, there is not a lot of controlling precedent even within circuits. The Court's last horizontal merger case was *General Dynamics*, which left many questions unanswered. Without further guidance from the Court, the lower courts answered them, reading *General Dynamics* broadly to support a variety of ways to rebut the *Philadelphia Bank* presumption. Some commentators

8 Derek Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 Harvard L. Rev. 226 (1960).

9 *United States v. Philadelphia, National Bank*, 374 U.S. 321, 362 (1963).

10 E. Thomas Sullivan et al., Antitrust Law, Policy, and Procedure: Cases, Materials, Problems 845 (7th ed. 2014) (emphasis added).

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argue that these cases have gone too far,[11] while others would abolish the structural presumption altogether.[12] The Supreme Court should decide this fundamental issue.

We need the Court to address other fundamental merger questions. Apart from the continued role of the structural presumption, the most important is the validity of the hypothetical monopolist method methodology for defining relevant markets. The great virtue of the methodology is that it provides a common market power standard for market definition in lieu of the ad hoc decisions finding markets as broad as flexible packaging and as narrow as frozen dessert pies. But the standard itself, the small but significant nontransitory increase in price ("SSNIP"), is problematical. The ability to raise price 5 percent for one year is hardly the substantial market power of a real monopolist. By contrast, Microsoft was able to price an upgrade to Windows 98 at $89, even though it could have made a profit at $49.[13] The standard should not require that degree of market power, but it should be a substantial amount. By its own terms, the SSNIP test requires only the power to impose "small" price increases, and then for only a short time. It produces unduly narrow markets, just as the submarkets created in *Brown Shoe* do.

The Court needs to address the related concept of unilateral effects, which now accounts for "the clear majority of merger investigations."[14] The original unilateral effect of concern to antitrust was monopoly pricing, not SSNIPs. The market power that every producer of a differentiated product possesses had not previously been the subject of antitrust scrutiny. To be sure, if all else is equal, why not go after even small price increases. But all else may not be equal. Product differentiation provides consumers with more choices and better products, often ones not previously available. Successful differentiations can be copied quickly, especially by larger firms in the same overall market. This is exactly what happened with office superstores. The 1997 *Staples* decision is the poster child for unilateral effects. Yet the really large big box stores, Target, Walmart, Costco and Sam's Club, soon responded by increasing their office supply offerings. And, of course, Amazon carries them, too. So how much good did the *Staples* case really accomplish?

At a more basic level, what's the statutory basis for unilateral effects cases? The original Clayton Act targeted potential monopolies, the "tight combinations" at the heart of the "trust problem." The 1950 amendments broadened the scope to include market concentration falling short of monopoly, but which may create the same effects through actual or tacit collusion. The statutory language easily applies to both monopoly and oligopoly, but not to the slight market power conveyed held by the sellers of most differentiated products. The Supreme Court needs to address whether this is a proper basis for invoking Section 7.

The Court should also examine the consideration of efficiencies in horizontal cases, for the reasons already discussed with regard to vertical cases. Finally, the Court should address entry and potential entry in merger cases. The Court recognized the salutary effects of perceived potential competition in its old conglomerate merger cases, and basic economics counsels that high profits will be competed away if entry is not overly difficult. The 2010 Guidelines recognize the importance of entry, but attempt to place on the parties the burden of establishing that entry will be "timely, likely, and sufficient," a requirement rejected in *Baker Hughes*.[15] One could just as easily argue that a demonstration that entry is difficult should be part of the required showing for the structural presumption. High entry barriers are an integral determinate of market structure.

Unless things change, of course, there will be no Supreme Court consideration of these vital issues, or even a great deal of circuit court attention. Since the passage of the Hart-Scott-Rodino ("HSR") Act, merger enforcement has become very different than the rest of antitrust practice. As Peter Carstensen has noted, with regard to mergers the Justice Department and FTC have become "regulatory agencies subject to modest judicial review."[16] With premerger review, most merger concerns are settled by agreement with divestitures or behavioral remedies. In the rare cases that go court, few go beyond the district court's decision on the agency's motion for a preliminary injunction. The merger parties seldom seek appellate review, and do not appeal to the Supreme Court. It just does not make business sense to wait that long rather than to give in and settle or drop the deal altogether. The agencies, on the other hand, could appeal to the Court even if the courts deny preliminary relief and permit the merger to go forward, as the agencies routinely did before the HSR Act. But they do not.

11 See, e.g. Herbert Hovenkamp & Carl Shapiro, *Horizontal Mergers, Market Structures, and Burdens of Proof*, 127 Yale L.J. 1996, 2010-11 (2018); Peter C. Carstensen, *The Philadelphia National Bank Presumption: Merger Analysis in an Uncertain World*, 80 Antitrust L.J. 219, 236 (2015).

12 Douglas H. Ginsburg & Joshua D. Wright, *Philadelphia National Bank: Bad Economics, Bad Law, Good Riddance*, 80 Antitrust L.J. 377 (2015).

13 William H. Page & John E. Lopatka, The Microsoft Case: Antitrust, Technology, and Consumer Welfare 231 (2007).

14 Hovenkamp & Shapiro, *supra* note 11, at 2014.

15 *United States v. Baker Hughes, Inc.*, 908 F.2d 981, 983 (D.C. Cir. 1990). See Hillary Greene, *Guideline Institutionalization: The Role of Merger Guidelines in Antitrust Discourse*, 48 William & Mary L. Rev. 771, 799-801 (2006) (Guidelines on efficiency "extremely close" to position rejected in *Baker Hughes*).

16 Carstensen, *supra* note 11, at 236.

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Why should they? Under the current merger regime, they have a more effective way to shape the law in their favor. In the absence of appellate guidance, the district courts resort to the Horizontal Merger Guidelines.[17] As Hillary Greene has shown, courts frequently rely on the Guidelines in a precedent-like manner, i.e., applying them uncritically. She notes that courts switched from the concentration ration ("CR") measures of concentration used in the Supreme Court's merger precedents to the then-controversial HHI after its use in the 1982 Guidelines. For a short transition period, courts used both measures. While one would have expected some judicial weighing of the two measures, especially in light of the lack of a consensus among economists at the time that the HHI was superior, Professor Greene found only one case with such a discussion. This lack of legal engagement with the issue, she concludes, "allowed the HHI measure … to reframe the legal analysis without meaningful debate."[18]

This story has been repeated on almost every important merger issue: the hypothetical market test, the use of the SSNIP, the legal validity of the unilateral effects theory, and the stringent requirements for efficiencies, especially that they be passed on to consumers. The Guidelines position on each has been accepted with little or no judicial discussion. In one case, the Guidelines have seemingly reversed a court of appeals. As mentioned above, the Guidelines' requirement that entry be "timely, likely, and sufficient" is almost identical to the standard that the D.C. Circuit rejected in *Baker Hughes*. Yet, as Professor Greene found, this new standard subsequently met with judicial approval, even among district courts in the D.C. Circuit.[19]

In short, the Guidelines now receive *Chevron*-like guidance, even though Congress never authorized either agency to make antitrust law in the way it has authorized agencies like the EPA and OSHA to make legislative rules with binding legal effect. In administrative law terms, the Guidelines are merely policy statements. They have no legally binding effect, and are not entitled to *Chevron* deference. Instead, as every administrative law student knows, they receive only *Skidmore* deference, i.e., only to the discretionary extent that they have the "power to persuade, if lacking the power to control."[20] But before according policy statements this persuasive power, courts are supposed to consider a set of factors, including the thoroughness of their consideration, the power of their reasoning, their consistency with earlier and later pronouncements, and anything else that recommends them.[21] But as Professor Greene has shown, the district courts do not do this.

This is the worst of all administrative law worlds. The procedural requirements of the Administrative Procedure Act bind agencies that have actually been authorized to make policy either by rulemaking or in agency adjudications. Their decisions are subject to "hard look" review by the courts. The antitrust agencies, by contrast, are not authorized to make merger law and do not engage in notice and comment rulemaking. Their guidelines are certainly not getting "hard look" review.

Rather clearly, this is a serious problem. Appropriate administrative procedure, including effective judicial review, is essential to the legitimacy of the modern administrative state. The procedural protections of the Administrative Procedure Act as applied by the federal courts provide a substitute for the Constitution's system of checks and balances that obtains outside the administrative sphere. It is hard to see why the regulation of mergers by the Antitrust Division and the FTC should be an exception. No other economic regulation is.

The thesis of this short article is that we need a solution to this problem. Here are some ideas of the shape a possible solution could take.

Under the 1903 Expediting Act either party could appeal directly to the Supreme Court from a district court decision in a Justice Department merger challenge. The Expediting Act was modified in 1974 to route *almost all* of these appeals to the courts of appeal before they could go to the Court. The revision, however, still permits direct review by the Court if, on application of either party, the district court enters an order stating that "immediate consideration" by the Supreme Court is "of public importance in the administration of justice." The Court can then either

17 Antitrust courts also rely heavily on the Areeda & Hovenkamp treatise in merger cases, as they do in all antitrust matters. See Hillary Greene & D. Daniel Sokol, *Judicial Treatment of the Antitrust Treatise*, 100 Iowa L. Rev. 2039 (2015). See also Rebecca Haw Allensworth, *The Influence of the Areeda-Hovenkamp Treatise in the Lower Courts and What It Means for Institutional Reform in Antitrust*, 100 Iowa L. Rev. 1919 (1996). But no treatise, no matter how excellent — and it is truly excellent — can provide binding precedent that governs throughout the country. Only the Supreme Court can do that. See Herbert Hovenkamp, The Antitrust Enterprise: Principle and Execution 4 ("Lack of Supreme Court supervision has led to many divisions among the federal courts of appeal") (2005).

18 Greene, *supra* note 17, at 791.

19 *Id.* at 790-91.

20 *Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944).

21 *Id.*

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hear the case or remand it to the court of appeals for decision in the usual manner.[22] The provision does not apply to preliminary injunctions, only to final judgments, and it doesn't apply to cases brought by the FTC.[23] Even so, this section could provide a vehicle for at least some Supreme Court review of Justice Department cases. To be sure, the typical case formally seeks only preliminary relief. But the parties to a preliminary injunction hearing can agree to make it on the merits, which is what these cases already are de facto, if not de jure. It is hard to imagine how a trial on the merits in *AT&T* would have differed from a conventional trial on the merits.

A better solution would be an amendment to this provision that would cover, in merger cases only, appeals from preliminary injunction proceedings brought by either agency. The primary vice of the Enabling Act was its complete elimination of court of appeals review in virtually every civil case brought by the Department under the Sherman or Clayton Acts. The current provision, either as is or with my suggested amendments, lets the district court decide in the first instance whether there is an important issue in need of resolution by the Supreme Court. If, for example, the district court in *AT&T* had enjoined the merger, it could have found that immediate Supreme Court review of AT&T's was appropriate in view of the need for useable precedent in vertical merger cases. The Court itself would have had the final say, of course, just as it does with petitions for certiorari in other antitrust appeals.

Other legislative solutions are available. Congress could create a special court of appeals, modeled on the Federal Circuit, for mergers or even for all antitrust cases. Alternatively, as it did with the Nixon and Ford price control regimes, Congress could provide for a special court of appeals staffed by sitting appeals judges selected for limited periods by the Chief Justice.[24]

Finally, Congress could amend the HSR Act to provide a more fundamental change that reflects the regulatory function of the agencies in merger cases. It could provide for merger challenges to be resolved in administrative adjudications under the APA, at either the FTC or a new agency in the Justice Department. What is now a second request under HSR could be the commencement of a formal investigation, as it already is under Part II of the FTC's Rules of Practice.[25] Instead of seeking a preliminary injunction, the agency could proceed to an administrative adjudication, as the FTC does in other antitrust matters. To deal with the special timing problems of merger regulation, the amendment could provide for expedited proceedings at the agency and expedited judicial review.

I would not recommend that the FTC or a new agency have the power to promulgate legislative rules for mergers. Instead, I would limit it to making policy in adjudications, as some other agencies do, with judicial review in the courts of appeals or in a special court like the ones mentioned above, or even, in special cases, at the Supreme Court under a provision like the special review provision of the revised Expediting Act.

I repeat, however, that my thesis is that we need some solution to the law deficit problem in mergers, not that one of the ideas I have briefly sketched here is the best solution. I am sure that others could provide better fixes. But it is time for the agencies and the rest of the antitrust community to start looking for them.

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22 5 U.S.C. § 529(b).

23 Section (a) provides that interlocutory orders can only be reviewed in the courts of appeals. Like the original Expediting Act, section 529 does not apply to the FTC.

24 See Federal Judicial Center, *Temporary Emergency Court of Appeals, 1971-1992*, https://www.fjc.gov/history/courts/temporary-emergency-court-appeals-1971-1992.

25 16 C.F.R. § 2.20.

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