Evolution of Merger Antitrust Law

Statutes, Seminal Cases, and Merger Guidelines

Merger Antitrust Law

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Topics

- The statutes
  - Sherman Act (1890)
  - Clayton Act (1914)
  - Celler-Kefauver Act (1950)
  - Hart-Scott-Rodino Act (1976)
- Early seminal horizontal merger cases
  - United States v. E.I. du Pont de Nemours & Co. (1957)
  - Brown Shoe Co. v. United States (1962)
  - United States v. Philadelphia Nat'l Bank (1963)
    - United States v. Aluminum Co. of Am. (1964)
    - United States v. Von's Grocery Co. (1966)
    - United States v. Pabst Brewing Co. (1966)
  - United States v. General Dynamics Corp. (1974)

Topics

- Merger Guidelines
  - 1968 DOJ Merger Guidelines
  - 1982 DOJ Merger Guidelines
  - 1992 DOJ/FTC Horizontal Merger Guidelines
    - 1997 efficiencies revision
  - 2010 DOJ/FTC Horizontal Merger Guidelines

The Statutes

The beginning

- Mergers always a central concern in federal antitrust enforcement
  - Acquisitive tendencies of the Great Trusts in the late 1800s provided a major impetus for the passage of the original antitrust statutes
  - Major concerns
    - Mergers to monopoly
    - Development of holding companies and the secret acquisition of competitors

The Sherman Act

- Enacted in 1890
- Section 1 creates the offense of a "contract, combination . . . or conspiracy, in restraint of trade or commerce"

> Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding $100,000,000 if a corporation, or, if any other person, $1,000,000, or by imprisonment not exceeding 10 years, or by both said punishments, in the discretion of the court.[1]

[1] 15 U.S.C. § 1.

The Sherman Act

- Use in merger antitrust enforcement
  - *E.C. Knight* (1895)[1]
    - First Supreme Court antitrust case
    - Challenged the Sugar Trust's acquisition its four remaining major competitors
    - Dismissed for lack of "in commerce" subject matter jurisdiction
      - Manufacturing is not "commerce" within the meaning of the Interstate Commerce Clause (later overruled)
  - *Northern Securities* (1904)[2]
    - Made Theodore Roosevelt's reputation as a "trust buster"
    - Challenged J.P. Morgan's attempt to consolidate the only two railroad trunk lines serving the northern part of the United States
    - Affirmed lower court injunction against the consolidation
  - *Standard Oil* (1911)[3]
    - Perhaps the most important of all antitrust cases
    - Challenged, among other things, acquisitions by the Standard Oil Trust
    - Found Standard Oil to violate Section 1 and ordered it to be broken up
      - But held that Section 1 only prohibited only *unreasonable* restraints
      - Prior Supreme Court cases had held that *all* restraints of trade were prohibited by Section 1

[1] United States v. E.C. Knight Co., 156 U.S. 1 (1895).
[2] Northern Securities Co. v. United States, 193 U.S. 197 (1904).
[3] Standard Oil Co. of New Jersey v. United States, 221 U.S. 1 (1911).

The Clayton Act

- Enacted in 1914 in reaction to *Standard Oil*
  - Section 7 was directed specifically at prohibiting mergers and acquisitions that were likely to be anticompetitive
    - *Concern*: Congress feared that the courts would not find anticompetitive mergers violated Section 1 of the Sherman Act under the new judicial "rule of reason"
- As originally enacted, Section 7 read in relevant part:

> [N]o corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital of another corporation engaged also in commerce, where the effect of such acquisition may be to substantially lessen competition between the corporation whose stock is so acquired and the corporation making the acquisition, or to restrain such commerce in any section or community, or tend to create a monopoly of any line of commerce.[1]

  - Limitations
    - Limited to "corporations" that are "in commerce"
    - Limited to stock acquisitions
      - Limitation to corporate stock acquisitions was probably intentional: Congress' principal concern was with the activities of holding companies, and specifically with the practice whereby corporations secretly acquired control of their competitors by purchasing the stock of those companies.
    - Widely viewed as limited to horizontal acquisitions[2]

[1] Pub. L. No. 212, ch. 323, §7, 38 Stat. 730, 731-32 (1914) (current version at 15 U.S.C. § 18).
[2] This interpretation of the original act was ultimately but belatedly rejected by the Supreme Court in United States v. E.I. duPont de Nemours & Co., 353 U.S. 586 (1957).

Celler-Kefauver Act[1]

- Enacted in 1950 to amend Section 7 of the Clayton Act
  - Amended Section 7 to—
    - Expand coverage to asset acquisitions
    - Change competitive effects language to current form (except for jurisdictional reach):

      > where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.

  - Supreme Court interpreted the "may be" and "tend to" language in the anticompetitive effects test to mean:
    - Only a *reasonable probability* that the proscribed anticompetitive effect will occur[3]
    - The plaintiff does not have to prove that an actual anticompetitive effect would occur
      - This is called the *incipiency standard*
  - Two significant restrictions remained after the 1950 amendments
    - Applied only to "corporations" that are "in commerce"
    - Anticompetitive effect arguably had to be "in commerce"

[1] Ch. 1184, 64 Stat. 1125 (1950) (amending Section 7 of the Clayton Act).
[2] *See* Brown Shoe Co. v. United States, 370 U.S. 294, 315-23 (1962).
[3] United States v. E.I. duPont de Nemours & Co., 353 U.S. 586, 589 (1957); *accord* Brown Shoe, 370 U.S. at 323 n.39, 325.

Celler-Kefauver Act

- Legislative history aggressively hostile to business combinations
  - This is actually the aspect of the 1950 legislation that most influenced the courts
- 1950 congressional concerns[1]
  - Fear of "the rising tide of economic concentration in the American economy"
  - Loss of opportunity for small business when competing with large enterprises
  - The spread of multistate enterprises and the loss of local control over industry
- Broadly shared macroeconomic concerns at the time
  - Suggested a very restrictive merger antitrust regime
  - Did not require deep microeconomic analysis to implement

[1] *See* Brown Shoe Co. v. United States, 370 U.S. 294, 315-16 (1962) (in reading materials)

Antitrust Procedural Improvements Act of 1980[1]

- Changes to Section 7
  - Eliminated limitation to corporations and made Section 7 applicable to acquisitions by and of any “person”
  - Eliminated requirement that the acquired and acquiring entities must be engaged “in commerce” and as amended reaches entities “engaged in commerce or in any activity affecting commerce”
  - Eliminated requirement that the effect be “in any line of commerce” and expanded it to “any line of commerce or in any activity affecting commerce”
- With the 1980 amendments, the reach of Section 7 is coextensive with the reach of the Commerce Clause
  - Just as with the Sherman Act

[1] Pub. L. 96-349, § 6(a), 94 Stat. 1157 (1980).

Summary of changes to the Clayton Act

	Application	Subject matter jurisdiction	Type of acquisition	Type of transaction
Clayton Act (1914)	Corporations	"In commerce"	Stock	Horizontal
Celler-Kefauver Act (1950)	↓	↓	Stock and assets	All types
APIA (1980)	Persons	"In commerce" or any activity affecting commerce	↓	↓

Clayton Act § 7—Current version

> No person engaged in commerce or in any activity affecting commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no person subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another person engaged also in commerce or in any activity affecting commerce, where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.[1]

- Simple summary: Prohibits transactions that—
  - "may substantially lessen competition or tend to create a monopoly" (anticompetitive "effects" test)
  - "in any line of commerce . . . " (product market)
  - "in any part of the country" (geographic market)

[1] 15 U.S.C. § 18 (in pertinent part).

Hart-Scott-Rodino Act[1]

- Enacted in 1976 and implemented in 1978
  - Designed to alert DOJ/FTC to pending transactions to permit them to investigate—and, if necessary, challenge—a transaction prior to closing
  - *Idea*: Much more effective and efficient to block or fix anticompetitive deal prior to closing than to try to remediate it after closing
- Applies to large mergers, acquisitions and joint ventures
  - In 2017, threshold for prima facie reportability is $80.8 million
- Imposes reporting and waiting period requirements
  - Preclosing reporting to both DOJ and FTC by each transacting party
  - Post-filing waiting period before parties can consummate transaction
    - Normally 30 calendar days after all reporting parties have filed
- Authorizes investigating agency to obtain additional information and documents from reporting parties during waiting period through a "second request"
  - Normally expends waiting period until all parties have responded to their respective second requests + 30 days

[1] Clayton Act § 7A, 15 U.S.C. § 18a.

Hart-Scott-Rodino Act

- Not jurisdictional: Agencies can review and challenge transactions—
  - Falling below reporting thresholds
  - Exempt from HSR reporting requirements
  - "Cleared" in a HSR merger review—no immunity attaches to a transaction that has successfully gone through a HSR merger review
- Administration
  - The FTC Premerger Notification Office (PNO) is responsible for the procedural administration of the premerger notification program under the HSR Act
  - There is a "clearance process" to allocate HSR filings to the DOJ and FTC for substantive review[2]
  - Once a filing has been "cleared" to an agency for review, the filing is sent to the appropriate investigating section for review, investigation, and possible challenge

[1] Clayton Act § 7A, 15 U.S.C. § 18a.

Early Seminal Cases

United States v. E.I. du Pont de Nemours & Co.[1]

- Background
  - Between 1917 and 1919, du Pont purchased a 23% stock interest in GM
  - GM was a major automobile manufacturer
  - Du Pont was the leading supplier to GM of automotive fabrics and finishes
- DOJ complaint
  - Civil action for injunctive relief, filed in 1949 under Clayton Act § 15
    - Du Pont violated Sherman Act §§ 1-2 in that, by means of its alleged control of GM, du Pont obtained an unlawful preference with respect to GM's purchases of finishes and fabrics
    - Du Pont violated the 1914 Clayton Act § 7 by its purchase of a 23% interest in GM between 1917-1919
      - By its terms, 1950 amendments inapplicable to acquisitions before 1950
  - Prayer: Divestiture
- N.D. Ill. dismissed: Du Pont did not control GM
  - No limitation on GM's freedom to deal with du Pont's competitors
  - After 30 years in which no restraint had resulted ⇒ no basis for finding that there is or has been a reasonable probability of such a restraint

[1] 353 U.S. 586 (1957).

United States v. E.I. du Pont de Nemours & Co.

- Supreme Court
  - Procedure
    - Appealed directly to the Supreme Court under the Expediting Act
  - Majority: Brennan for 4-member majority
    - Application of Clayton Act § 7 (1914 version)
      - *Rule*: Any corporate stock or asset acquisition is within the reach of Section 7 "whenever the reasonable likelihood appears that the acquisition will result in a restraint of commerce or in the creation of a monopoly of any line of commerce."[1]
        - Reaffirms incipiency construction of Section 7 (requires only "reasonable probability" that a lessening of competition will result from the merger)
        - When the above test is satisfied, Section 7 prohibitions the stock or asset acquisition regardless of whether—
          - the acquisition will actually restrain commerce or create a monopoly, or
          - a substantial lessening of competition was intended by the merging parties
      - *Rule*: Applies to all types of corporate stock or assets acquisitions (whether or not horizontal)
        - This was a vertical case
          - Indeed, it was the first application of the original Section 7 to a vertical case
      - *Rule*: Determination of the relevant market an *essential* element of Section 7 violation because:
        - the threatened monopoly must be in some *line of commerce*; and
        - the transaction must threaten to *substantially* lessen competition, and substantiality can be determined only in terms of the market affected

[1] 353 U.S. at 592.

United States v. E.I. du Pont de Nemours & Co.

- Supreme Court (con't)
  - Majority: Brennan for 4-member majority (con't)
    - Application of Clayton Act § 7 (1914 version)
      - "Time of suit" rule
        - *Rule*: "[I]ncipiency . . . denotes not the time the stock was acquired, but any time when the acquisition threatens to ripen into a prohibited effect"[1]
        - Therefore, government may proceed even through the threat did not mature until after the acquisition (assuming that the acquisition gave du Pont the means to lessen competition)
        - *Implication*: There is no limitations period for the government bringing a Section 7 injunctive relief action
    - Merits
      - Relevant market
        - Automotive finishes and fabrics have sufficient "peculiar characteristics and uses" to be in a separate market from other finishes and fabrics
        - No other analysis

[1] 353 U.S. at 597.
[2] *Id*. at 595.

United States v. E.I. du Pont de Nemours & Co.

- Supreme Court
  - Majority: Brennan for 4-member majority (con't)
    - Merits (con't)
      - Competitive effects analysis:
        - *Rule*: In a vertical case, plaintiff must prove a likelihood that competition may be "[1] foreclosed in [2] a substantial share" of the relevant market[2]
        - Here—
          - Foreclosure
            - Du Pont purchased GM stock in part with the intent of securing an outlet for its finishes and fabrics (especially given du Pont's excess capacity after WWI)
            - Du Pont's share ownership gave Du Pont power over GM, especially as Du Pont personnel became the senior managers of GM (who then they set upon securing du Pont as GM's primary supplier)
          - Substantiality
            - GM accounted for roughly 1/2 of the automobile industry's annual sales, so therefore its requirements for automotive finishes and fabrics must represent approximately 1/2 of the relevant market.
            - Du Pont supplied 67% of GM's requirements for finishes in 1947, and 38.5% of its requirements for fabrics.
            - Total GM purchases from du Pont in 1947 = $26.6 million.
            - Since du Pont supplies the largest part of GM requirements (both quantitatively and percentagewise), du Pont has a substantial share of the relevant market
    - *Result*: Reversed and cause remanded for determination of appropriate relief

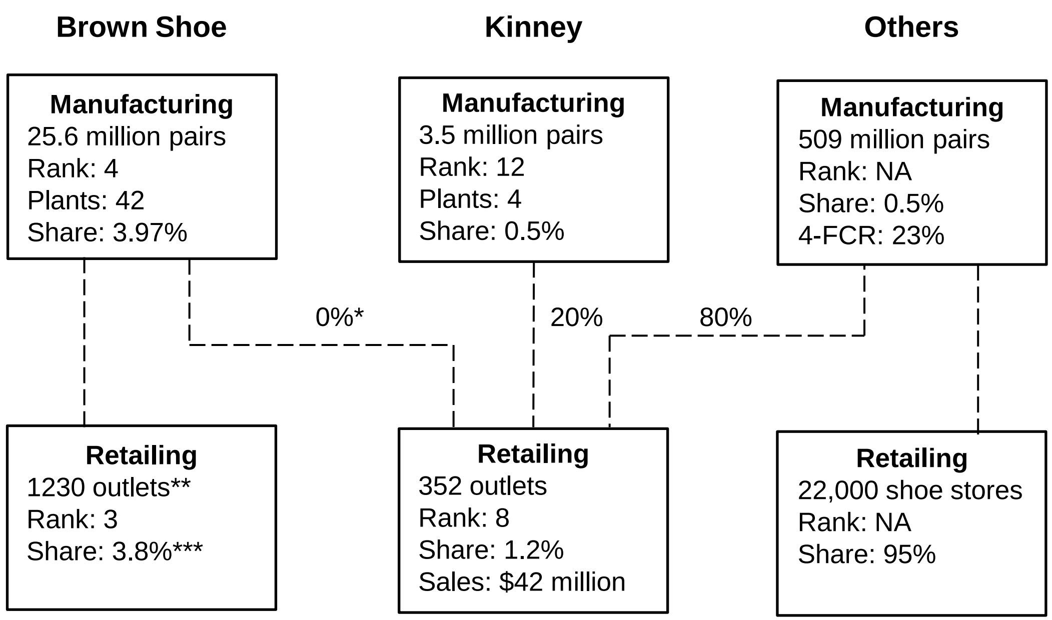
Brown Shoe Co. v. United States[1]

- Background
  - Acquisition by Brown of G.R. Kinney (both national integrated shoe companies)
    - Brown Shoe
      - Manufacturing: #4 w/3.97% share (42 plants)
      - Retailing: #3 w/3.8% share (230 outlets)
    - Kinney
      - Manufacturing: #12 w/0.5% share (4 plants)
      - Retailing: #8 w/1.2% share (352 outlets)—Nation's largest family-style shoe retail chain
    - Combined firm
      - Manufacturing: #3 w/4.5% share (46 plants)
      - Retailing: #__ w/5.0% share (582 outlets)
    - Concentration
      - Manufacturing 4-FCR = 23%
      - Trend toward the decrease of the number of shoe manufacturing plants
      - Trend of shoe manufacturers acquiring shoe retailers

[1] Brown Shoe Co. v. United States, 370 U.S. 294 (1962).

Brown Shoe Co. v. United States

The Brown Shoe/Kinney Merger
(operations prior to closing)



* 7.9% after merger
** Includes owned stores (470), independently owned franchised stores (570), and independently owned stores under the "Wohl plan" featuring Brown-manufactured shoes (190)
*** Excludes franchised stores

Brown Shoe Co. v. United States

- DOJ complaint
  - Violated Section 7 by—
    1. eliminating actual or potential competition in the production of shoes for the national wholesale shoe market
    2. eliminating actual or potential competition in the sale of shoes at retail in the United States
    3. foreclosing competition from a market represented by Kinney's retail outlets whose annual sales exceed $42,000,000, and
    4. enhancing Brown's competitive advantage over other producers, distributors and sellers of shoes
  - Relief sought: Divestiture
    - District court denied a blocking preliminary injunction and allowed the deal to close subject to a hold separate order

Brown Shoe Co. v. United States

- District court
  - Horizontal (manufacturing)
    - Relevant product market
      - *DOJ*: “Footwear” or, alternatively, men’s, women’s, and children’s shoes separately
      - *Brown*: Narrow markets defined by age, sex, price, quality, customer use
      - *Court*: Men’s, women’s, and children’s shoes separately
        - Distinct uses
        - Recognized as trade classes
        - Separate manufacturing facilities
    - Relevant geographic market: National (not contested)
    - Anticompetitive effects:
      - *DOJ*:
      - *Brown*:
        - Market exhibited healthy competition
        - Competition could not be reduced by merger because Kinney had only a 0.5% share
      - *Court*: No likely anticompetitive effect

Brown Shoe Co. v. United States

- District court
  - Horizontal (retailing)
    - Relevant product market: Party contentions as in manufacturing
      - *Court*: Men's, women's, and children's shoes separately
    - Relevant geographic market
      - *DOJ*:
      - *Brown*: Varies with "economic reality" from the central business district of a large city to a standard metropolitan area (SMA) for a smaller community
      - *Court*: Cities of 10,000 or more population and its immediate and contiguous surrounding area, regardless of name designation, and in which a Kinney store and a Brown (operated, franchise, or plan) store are located.
    - Anticompetitive effects:
      - *DOJ*:
      - *Brown*:
        - Market exhibited healthy competition
        - Competition could not be reduced by merger because Kinney had less than a 2% share
      - *Court*: Violated Section 7

Brown Shoe Co. v. United States

- District court
  - Vertical (foreclosure of other manufactures from Kinney outlets)
    - *Court*: Violates Section 7 in the market for the sale of men's, women's, and children's shoes to Kenny's retail stores (presumably in narrow geographic markets)
      1. Foreclosure of independent manufacturers
         - Trend of shoe manufacturers acquiring shoe retailers
         - "Definite trend" for parent-manufacturers to supply and increasing percentage of shoes to captive retail outlets, (partially) foreclosing third-party manufacturers from these accounts
         - Brown was a moving factor in these trends
           - Example: Wohl (acquired in 1951):
             - Preacquisition: 12.8% requirements from Brown
             - Postacquisition: 32.6%
         - Kinney:
           - Preacquisition: 0% requirements from Brown
           - Postacquisition: 7.9%
      2. Increasing disadvantages of independent retailers
         - In addition, increasing difficult for independent retailers to compete with manufacturer-controlled stores
         - Being affiliated with a manufacturer gives retail store advantages in—
           - Obtaining shoes from the manufacturer-parent
           - Advertising and credit arrangements
           - Insurance

Brown Shoe Co. v. United States

- District court
  - Relief
    - Preliminary injunction denied and transaction permitted to close subject to a hold separate order
    - Permanent injunction entered requiring Brown to divest all of Kinney's stock
- Appeal
  - Direct to Supreme Court under Expediting Act
- Supreme Court
  - Judgment in favor of DOJ affirmed
  - Unanimous on Section 7 merits
    - Opinion by Chief Justice Earl Warren
    - Justice Harlan dissented on jurisdiction under the Expediting Act for lack of a final judgment but concurred in judgment on the Section 7 merits

Brown Shoe Co. v. United States

- Supreme Court
  - Objectives of merger antitrust law (following 1950 amendments)
    - "The dominant theme pervading congressional consideration of the 1950 amendments was a fear of what was considered to be a *rising tide of economic concentration* in the American economy."[1]
    - Retention of local control over businesses
    - Protection of small businesses
  - Section 7 illegality
    - No definite quantitative or qualitative test for whether a merger may tend to substantially lessen competition
    - But
      - —Intended to be more encompassing than Sherman Act § 1 and prohibit anticompetitive mergers in their "incipiency"
      - Mergers are to be "functionally viewed, in the context of its particular industry":

> "That is, whether the consolidation was to take place in an industry that was fragmented rather than concentrated, that had seen a recent trend toward domination by a few leaders or had remained fairly consistent in its distribution of market shares among the participating companies, that had experienced easy access to markets by suppliers and easy access to suppliers by buyers or had witnessed foreclosure of business, that had witnessed the ready entry of new competition or the erection of barriers to prospective entrants, all were aspects, varying in importance with the merger under consideration, which would properly be taken into account."[2]

[1] Brown Shoe Co. v. United States, 370 U.S. 294, 315 (1962).

[2] *Id*. at 322 (internal citation and footnote omitted).

Brown Shoe Co. v. United States

- Supreme Court
  - Vertical aspect of the merger
    - Initial observations
      - Primarily focus of the Court's analysis
      - Primary vice: Foreclosure of competitors:

> "The primary vice of a vertical merger or other arrangement tying a customer to a supplier is that, by foreclosing the competitors of either party from a segment of the market otherwise open to them, the arrangement may act as a 'clog on competition,' which 'deprive(s) . . . rivals of a fair opportunity to compete."[1]

[1] Brown Shoe Co. v. United States, 370 U.S. 294, 323-24 (1962).

Brown Shoe Co. v. United States

- Supreme Court
  - Vertical aspect of the merger
    - Relevant product markets
      - "Outer boundaries" test and "submarkets"

> "The outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it. However, within this broad market, well-defined submarkets may exist which, in themselves, constitute product markets for antitrust purposes. The boundaries of such a submarket may be determined by examining such practical indicia as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors.[1]

        - NB: This is the most important passage in the opinion. It is a foundation of product market definition and continues to be quoted in cases today.
        - NB: Today, courts do not draw distinctions between markets and submarkets
          - *Brown Shoe's* "practical indicia" are treated as types of evidence probative of the boundaries of product markets

[1] Brown Shoe Co. v. United States, 370 U.S. 294, 325 (1962) (internal citation omitted).

Brown Shoe Co. v. United States

- Supreme Court
  - Vertical aspect of the merger
    - Relevant product markets
      - Application here
        - Confirms District Court's finding that men's, women's, and children's shoes are separate relevant product markets
        - *Supporting factors*: Each is recognized by the public, manufactured in separate plants, peculiar in its attributes that makes them noncompetitive with the others, and directed toward a distinct class of customers
        - Price/quality
          - Rejects further subdivision based on price/quality because shoes within each category compete with each other sufficiently to be in the same "line of commerce"
          - However, price/quality differences between the shoes of the two companies may be relevant in assessing the effect on competition
        - Age/sex (especially in children's shoes)
          - Rejects further subdivision on age/sex not because shoes within each category not do compete with one another (a girl's dress shoe does not compete with a boy's dress shoe), but rather because further division does not change the analytics:

> Brown manufactures significant, comparable quantities of virtually every type of nonrubber men's, women's, and children's shoes, and Kinney sells such quantities of virtually every type of men's, women's, and children's shoes. Thus, whether considered separately or together, the picture of this merger is the same. We, therefore, agree with the District Court's conclusion that in the setting of this case to subdivide the shoe market further on the basis of 'age/sex' distinctions would be 'impractical' and 'unwarranted.'"[1]

[1] Brown Shoe Co. v. United States, 370 U.S. 294, 327-28 (1962).

Brown Shoe Co. v. United States

- Supreme Court
  - Vertical aspect of the merger
    - Relevant geographic market
      - Confirms district court's finding that the relevant geographic market is national (not contested)
    - Anticompetitive effect
      - Considerations
        - The share of the market that can be foreclosed
          - Here, "no merger between a manufacturer and an independent retailer could involve a larger potential market foreclosure"[1]
          - NB: Court did not comment on the fact that Kinney sold at most only about 2% of all shoes sold at retail (Brown's total postmerger share of retailing was 7.2%)
        - The nature and purpose of the merger
          - Here, Brown intended to use Kinney retail stores as a primary distribution channel and so "force" Kinney to carry a greater percentage of Brown shoes
        - Trend toward concentration through vertical integration
          - Here, marked trend toward vertical integration by shoe manufacturers into retailing
          - Rejects Brown's argument that the industry remains competitive with a large number of manufacturers and retailers: "But remaining vigor cannot immunize a merger if the trend in that industry is toward oligopoly."[1]
        - Countervailing "competitive, economic, or social advantages"[2]
          - Here, Brown offered none
      - Conclusion: Affirms district court's finding that the vertical aspect of the merger violated Section 7

[1] Brown Shoe Co. v. United States, 370 U.S. 294, 333 (1962). [2] *Id*. at 334

Brown Shoe Co. v. United States

- Supreme Court
  - Retailing (horizontal) aspect of the merger
    - Initial observations
      - "Where the arrangement effects a horizontal merger between companies occupying the same product and geographic market, whatever competition previously may have existed in that market between the parties to the merger is eliminated."[1]
      - But this is not enough generally to violate Section 7: Competition must be threatened in an "economically significant market"
    - Product market
      - District court correctly defined separate product markets for men's, women's, and children's shoes
    - Geographic market
      - The test:

> "The criteria to be used in determining the appropriate geographic market are essentially similar to those used to determine the relevant product market. Moreover, just as a product submarket may have § 7 significance as the proper 'line of commerce,' so may a geographic submarket be considered the appropriate 'section of the country.' Congress prescribed a pragmatic, factual approach to the definition of the relevant market and not a formal, legalistic one. The geographic market selected must, therefore, both 'correspond to the commercial realities' of the industry and be economically significant. Thus, although the geographic market in some instances may encompass the entire Nation, under other circumstances it may be as small as a single metropolitan area."[2]

      - *Court*: Record supports district court's conclusion that the relevant geographic markets are each city with a population exceeding 10,000 and its immediate contiguous surrounding territory in which both Brown and Kinney sold shoes at retail through stores they either owned or controlled

[1] Brown Shoe Co. v. United States, 370 U.S. 294, 335 (1962).

[2] *Id*. at 336-37 (internal citations and footnote omitted).

Brown Shoe Co. v. United States

- Supreme Court
  - Retailing (horizontal) aspect of the merger
    - Anticompetitive effect
      - Retailing
        - Affirmed district court's finding that merger would substantially lessen competition
        - Record shows that:
          - In 32 cities, combined Brown/Kinney share of women's shoes would exceed 20%, with 7 cities ranging from 33% to 57%
          - In 32 cities, combined Brown/Kinney share of children's shoes would exceed 20% and in 6 cities would exceed 40%
          - Court indicated that a combined share of 5% would be enough:

            > "In an industry as fragmented as shoe retailing, the control of substantial shares of the trade in a city may have important effects on competition. If a merger achieving 5% control were now approved, we might be required to approve future merger efforts by Brown's competitors seeking similar market shares. The oligopoly Congress sought to avoid would then be furthered and it would be difficult to dissolve the combinations previously approved."[1]

          - Plus there was a trend toward concentration in shoe retailing
          - Brown presented no offsetting factors, such as—
            - Business failure or inadequate resources to continue the business
            - Need to combine in order to better compete with dominant firms

[1] Brown Shoe Co. v. United States, 370 U.S. 294, 343-44 (1962).

Brown Shoe Co. v. United States

- Supreme Court
  - Retailing (horizontal) aspect of the merger
    - Anticompetitive effect
      - Retailing
        - Court also indicated that efficiencies may be "anticompetitive" when they hurt small firms:

> "Of course, some of the results of large integrated or chain operations are beneficial to consumers. Their expansion is not rendered unlawful by the mere fact that small independent stores may be adversely affected. It is competition, not competitors, which the Act protects. But we cannot fail to recognize Congress' desire to promote competition through the protection of viable, small, locally owned business."[2]

  - Manufacturing (horizontal) aspect of the merger
    - Apparently not appealed by the DOJ

[1] Brown Shoe Co. v. United States, 370 U.S. 294, 344 (1962).

United States v. Philadelphia Nat'l Bank[1]

- Background
  - 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] United States v. Philadelphia National Bank, 374 U.S. 321 (1963).

United States v. Philadelphia Nat'l Bank

- Comptroller: Approved merger
  - Acquisition subject to bank regulatory approval by the Comptroller of the Currency
  - Acquisition opposed by Attorney General, the Federal Reserve Board, and the FDIC
    - All found that the merger would have substantial anticompetitive effects in the Philadelphia metropolitan area
  - Comptroller approved anyway: Two grounds—
    - Adequate number of alternative banking sources ⇒ overall no unfavorable competitive effect
    - Merged bank would better serve "convenience and needs of community" by its ability to assist city and state in attracting new industry and retaining existing industry

United States v. Philadelphia Nat'l Bank

- DOJ complaint
  - Day after Controller approval, Justice Department sued
    - Merger not consummated pending resolution of DOJ action
  - Government's case
    - Alleged violations
      - Merger would violate Sherman Act § 1 (seeking blocking injunction under Sherman Act § 4)
      - Merger would violate Clayton Act § 7 (seeking blocking injunction under Clayton Act § 15)
    - Evidence
      - Statistics on market shares, post-merger concentration, and trends toward concentration
      - Not withstanding government regulation, substantial area for free play of market forces
      - Increased concentration of commercial banking inimical to that free play
  - Defendants' case
    - Disputed government evidence
    - Offered business justifications: Resulting bank would—
      - Be better able compete with large out-of-state banks (especially in New York) with its greater prestige and larger lending limit
      - Attract new business to Philadelphia
      - Generally would promote economic development of metropolitan area

United States v. Philadelphia Nat'l Bank

- E.D. Pa.: Dismissed complaint on merits
  - Applicability
    - Bank Merger Act did not repeal by implication the antitrust laws
    - But Section 7 was inapplicable
      - 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
        - D.C. deemed merger to be an asset acquisition
    - But will assume that Section 7 is applicable
  - Markets
    - Relevant product market: Commercial banking (not contested)
    - Relevant geographic market: United States (not four-county Philadelphia metropolitan area)
      - PNB and Girard actively compete with other banks throughout the northeastern United States
  - Anticompetitive effect

United States v. Philadelphia Nat'l Bank

- Supreme Court: Reversed with instructions to enter injunction
  - Majority: Brennan for a 6-member majority
    - Section 7 applies to merger
      - Within the statutory scheme (especially after the 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
      - "We agree with the District Court that the cluster of products (various kinds of credit) and services (such as checking accounts and trust administration) denoted by the term 'commercial banking' composes a distinct line of commerce."[1]
      - No analytics—but then again the dimensions of the product market was not contested by the parties
        - Note the use of a *cluster market* (a grouping of related products that are not substitutes for one another). We will return to this later in the course when we discussed market definition in more detail.
    - Geographic market: Four-county Philadelphia metropolitan region
      - *Test*: The proper question to be asked in this case is not where the parties to the merger do business or even where they compete, but where, within the area of competitive overlap, the effect of the merger on competition will be direct and immediate."[2]
        - Area of effective competition turns on:
          1. where the seller operates, AND
          2. where purchasers can practicably turn for supplies

[1] United States v. Philadelphia National Bank, 374 U.S. 321, 356 (1963) (internal cross-reference omitted).
[2] *Id*. at 357.

United States v. Philadelphia Nat'l Bank

- Supreme Court: Reversed with instructions to enter injunction
  - Majority: Brennan for a 6-member majority
    - Geographic market: Four-county Philadelphia metropolitan region (con't)
      - Banking is essentially local—here, bulk of business originates in four-county area
        - "The factor of inconvenience localizes banking competition as effectively as high transportation costs in other industries."[1]
      - Four-county region represents "workable compromise"
        - Vast bulk of the business of the merging banks originate in this area
        - Although large customers may see New York banks as an alternative, small customers do not
        - Recognized as market for state banking law purposes for branching purposes
        - All three federal banking agencies used region in doing competitive analysis under Bank Merger Act

> "But that in banking the relevant geographical market is a function of each separate customer's economic scale means simply that a workable compromise must be found: some fair intermediate delineation which avoids the indefensible extremes of drawing the market either so expansively as to make the effect of the merger upon competition seem insignificant, because only the very largest bank customers are taken into account in defining the market, or so narrowly as to place appellees in different markets, because only the smallest customers are considered. We think that the four-County Philadelphia metropolitan area, which state law apparently recognizes as a meaningful banking community in allowing Philadelphia banks to branch within it, and which would seem roughly to delineate the area in which bank customers that are neither very large nor very small find it practical to do their banking business, is a more appropriate 'section of the country' in which to appraise the instant merger than any larger or smaller or different area."[2]

[1] United States v. Philadelphia National Bank, 374 U.S. 321, 358 (1963).
[2] *Id*. at 361.

United States v. Philadelphia Nat'l Bank

- Supreme Court: Reversed with instructions to enter injunction
  - Majority: Brennan for a 6-member majority
    - Anticompetitive effects
      - Considerations
        - Statutory language prohibits mergers whose effect "may be substantially to lessen competition" in the relevant market
        - Calls for a prediction since the merger has not yet occurred
        - Normally would require detailed economic inquiry, but data often elusive
        - Operational test needs predictability so that business can anticipate result
        - Test must not subvert congressional intent
          - Dominant concern: "rising tide of economic concentration in the American economy"[1]
      - 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."[2]

        - "[T] the test is fully consonant with economic theory."[3]
          - "[C]ompetition is greatest when there are many sellers, none of which has any significant share."[4]

[1] United States v. Philadelphia National Bank, 374 U.S. 321, 363 (1963) (citing *Brown Shoe*).
[2] *Id*. at 363. [3] *Id*. (citing extensively to structure-conduct-performance literature). [4] *Id*.

United States v. Philadelphia Nat'l Bank

- Supreme Court: Reversed with instructions to enter injunction
  - Majority: Brennan for a 6-member majority
    - Anticompetitive effects
      - The *PNB* presumption: Application

> The merger of appellees will result in a single bank's controlling at least 30% of the commercial banking business in the four county Philadelphia metropolitan area. Without attempting to specify the smallest market share which would still be considered to threaten undue concentration, we are clear that 30% presents that threat. Further, whereas presently the two largest banks in the area (First Pennsylvania and PNB) control between them approximately 44% of the area's commercial banking business, the two largest after the merger (PNB Girard and First Pennsylvania) will control 59%. Plainly, we think, this increase of more than 33% in concentration must be regarded as significant."[1]

        - Note the downward shading: The combined bank's market share would be 36%, not 30%
        - But 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
      - Nothing in record to rebut presumption
        - District court misplaced reliance on testimony that competition was vigorous and would continue to be vigorous (problem too complex; witnesses failed to give "concrete reasons" for conclusions)

[1] United States v. Philadelphia National Bank, 374 U.S. 321, 364 (1963) (footnotes omitted).
[2] *Id*. at 363. [3] *Id*. (citing extensively to structure-conduct-performance literature). [4] *Id*.

United States v. Philadelphia Nat'l Bank

- Supreme Court: Reversed with instructions to enter injunction
  - Majority: Brennan for a 6-member majority
    - Anticompetitive effects (con't)
      - Nothing in record to rebut *PNB* presumption
        - District court's reliance on testimony by competitors that competition was vigorous and would continue to be vigorous post-merger misplaced
          - Problem too complex
          - Witnesses failed to give "concrete reasons" for conclusions
          - "The test of a competitive market is not only whether small competitors flourish but also whether consumers are well served. '(C)ongressional concern (was) with the protection of competition, not competitors.' In an oligopolistic market, small companies may be perfectly content to follow the high prices set by the dominant firms, yet the market may be profoundly anticompetitive."[1]
        - Summarily rejects testimony as sufficient to establish that dissatisfied customers can turn to one of other 40 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

[1] United States v. Philadelphia National Bank, 374 U.S. 321, 367 n.43 (1963) (footnotes omitted).

United States v. Philadelphia Nat'l Bank

- Supreme Court: Reversed with instructions to enter injunction
  - Majority: Brennan for a 6-member majority
    - Anticompetitive effects (con't)
      - Also rejects business justifications
        - D.C.: "[O]nly through mergers can banks follow their customers to suburbs":
          - S.Ct.: But could open branch banks in suburbs
        - D.C.: Increased spending limits will permit combined bank to compete with New York banks:
          - S.Ct.: Even if true, anticompetitive consequences in one market cannot be offset by procompetitive effects in another market
        - D.C.: Larger bank will bring business to Philadelphia
          - S.Ct.: Anticompetitive effect not saved by balancing non-competition social benefits
    - Disposition
      - District court's judgment reversed and cause remanded with instructions to enter an injunction blocking the merger
  - Harlan dissent (w/Stewart)
    - Application of antitrust laws inconsistent with bank regulatory scheme
    - Section 7 in particular inapplicable by its terms

More on the *PNB* presumption

- The *PNB* presumption

> Specifically, we think that a merger which produces a firm controlling an undue percentage 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 is must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects.[1]

- 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)
- Originally created as a rebuttable presumption of the requisite anticompetitive effect
  - Required the combined firm to pass some (undefined) thresholds of—
    - Market share of the merged firm, and
    - The increase in market concentration caused by the transaction
  - Suppose to reflect the latest in economic thinking in the then prevailing structure-conduct-performance paradigm

[1] United States v. Philadelphia National Bank, 374 U.S. 321, 363 (1963).

More on the *PNB* presumption

- Problems with the *PNB* presumption
  - No economically sound test for market definition for 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.[2]

  - Although originally created as a rebuttable presumption, soon treated by lower courts as a conclusive presumption—essentially no defenses
    - In 1974, returned to a rebuttable presumption by the Supreme Court *in General Dynamics*[2]

[1] United States v. Von's Grocery Store, 384 U.S. 270, 301 (1966) (Stewart, J., dissenting).
[2] United States v. General Dynamics Corp., 415 U.S. 486 (1974).

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)[1]
    - Combined share of as little as 5% in an unconcentrated market
  - Pabst Brewing/Blatz Brewing (1966)[2]
    - 3.02% (#10) + 1.47% (#18) → 4.49% (#5) in an unconcentrated market
  - Von's Grocery/Shopping Bag Food Stores (1966)[3]
    - 4.7% (#3) + 4.2% (#6) → 8.9% (#2) in an unconcentrated market

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. Pabst Brewing Co., 384 U.S. 546 (1966).
[3] United States v. Von's Grocery Co., 384 U.S. 270 (1966).

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).

Current state of the "law"

- Horizontal transactions
  - The *PNB* presumption remains the primary (if not only) way for plaintiffs to establish the anticompetitive effect element of Section 7 in a horizontal merger in court
  - The thresholds for triggering the presumption have significantly increased
    - No sharp lines
    - The DOJ/FTC provide their view on the thresholds in their Horizontal Merger Guidelines (see below)
    - But courts have not been asked to test the HMG thresholds, since the DOJ and FTC have never brought any cases close to the thresholds
  - Whatever the thresholds, the *PNB* presumption is rebuttable
  - Two general types of rebuttals—
    - Attack the factual predicates of the presumption. For example:
      - The shares and market concentration are different than what the government claims
      - The wrong metric is being used (e.g., total reserves as opposed to uncommitted reserves, as in *General Dynamics*)
    - Advance other factors to show that the presumption does not provide a good prediction of anticompetitive effect in this particular case. For example:
      - Entry, repositioning, or production expansion by other firms are likely and sufficient to offset any anticompetitive effect that the merger might otherwise create
      - Efficiencies resulting from the transaction will make the merger procompetitive rather than anticompetitive

Current state of the "law"

- Two ways to think about the *PNB* presumption
  1. As a presumption grounded in industrial organization economics
     - The citations to the economic literature in *PNB* itself indicate that the majority thought it was grounding the presumption in economics
     - The idea is that as firms become larger and the market becomes more concentrated, there is an increasingly likelihood that the market will exhibit more successful oligopolistic interdependence and higher resulting prices
       - This is sometimes called the *price-concentration hypothesis* or the *profit-concentration hypothesis*
       - This hypothesis was popular among the structure-conduct-performance adherents in the 1950s and 1960s
     - Queries:
       - Is there meaningful support for the price/profit-concentration hypothesis?
       - If so, at what levels of combined share and increased market concentration does oligopolistic interdependence become significantly more successful?
  2. As a burden-shifting device in litigation
     - If the presumption is triggered, it shifts the burden of proof of showing that the presumption is not reliable in the circumstances of the case to the defendants
     - Presumably, the likelihood that the defendants will fail to discharge their burden increases as the case becomes a closer call
     - The effect of the burden shift then is to accept overinclusiveness errors over underinclusiveness errors in close cases

Current state of the "law"

- Bottom line
  - However viewed, the *PNB* presumption remains the point of departure in the litigation of horizontal mergers in the analysis of competitive effects
  - Curiously, the thresholds for triggering the *PNB* presumption have not been litigated
    - Since the early 1980s, the DOJ and FTC—regardless of administration—have only brought actions where the alleged combined market shares and market concentration have been very high.[1]
    - However, conventional wisdom holds that the market shares and market concentration shown in *Rome (Alcoa)/Von's/Pabst* are much too low today to trigger the *PNB* presumption
    - Of course, these shares and market concentration depend on the definition of the relevant market, and the agencies have not always been successful in proving their alleged markets to the satisfaction of the courts

Key questions:

1. What are the tests for product and geographic market definition?
2. What are the thresholds that trigger the *PNB* presumption?
2. What are the factors that can rebut the presumption?

Current state of the "law"

- Vertical transactions
  - But restrictions are of relatively minor significance today
- Conglomerate transactions
  - But no enforcement action since the 1970s
  - There are no operative theories of anticompetitive harm in the U.S. today for conglomerate transactions

Merger Guidelines
A Little History

The role of DOJ/FTC Merger Guidelines

- Judicial assessment of mergers is very infrequent
- Two factors have combined to create an *informal administrative system* of merger antitrust enforcement without judicial involvement:
  - The Hart-Scott-Rodino Act of 1976, which gives the DOJ and FTC—
    - Advance notice of significant transactions
    - A statutorily prescribed "waiting period" following notification during which time the transaction cannot close (and so allows a preclosing investigation)
    - A new investigative tool—colloquially known as a "second request"—that allows the investigating agency to obtain massive amounts of documents and data from the merging companies and tolls the waiting period for (typically) 30 calendar days after all parties have complied with their respective requests
  - A willingness by the DOJ and FTC to negotiate and accept consent decrees that require the parties to "fix" the problematic parts of their transaction and allow the remainder of the transaction to go forward
    - The need for a consent decree and its scope are generally predictable within bounds by experienced counsel and can be taken into account by the parties at the time they are negotiating their deal
    - Almost always better to "fix" than to fight in court, since the investigating agency is likely to seek an injunction that would block the entire deal

The role of DOJ/FTC Merger Guidelines

- *Bottom line*: The fight in a merger investigation is over whether there is a problem and, if so, the scope of the consent decree relief that will fix it.
  - Almost always better to "fix" than to fight in court
    - The investigating agency is likely to seek an injunction that would block the entire deal
    - Deals are unable to withstand the additional delay required to fully litigate a merger case
      - HSR Act investigation is likely to take 6-9 months
      - Pretrial and trial of a merger case can easily take another 6 months or more
      - An appeal adds at least another 6 months
  - With few exceptions, the only deals that are litigated are either
    - Unconsummated deals for which there is no "fix" acceptable to the investigating agency, or
    - Already-consummated deals that the prosecuting agency is seeking to break up
- Significance of DOJ/FTC merger guidelines
  - This informal administrative system of merger antitrust enforcement means that the DOJ/FTC merger guidelines—which presumably inform the analysis of what deals will be challenged and the scope of consent decree relief required—take on great weight, even though they have no legally binding force

1968 DOJ Merger Guidelines

1968 DOJ Merger Guidelines[1]

- Origins
  - 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 then 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
- Express objective
  - "[T]o preserve and promote market structures conducive to competition"[2]
    - Reflected the then-prevailing "structure-conduct-performance" economic paradigm
      - "Market structure is the focus of the Department's merger policy chiefly because the conduct of individual firms in a market tends to be controlled by the structure of that market . . . ."[3]
    - Looked principally to:
      - The number of substantial firms selling in the market
      - The relative sizes of their respective market shares
      - The substantiality of barriers to the entry of new firms into the market

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

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).

1982 DOJ Merger Guidelines

1982 DOJ Merger Guidelines[1]

- Origins
  - Issued by AAG William F. Baxter, a Stanford law professor
  - FTC refused to sign—wanted more flexibility
- Innovations
  - New explicit focus on market power as the competitive harm
    - Primarily through theories of oligopolistic interdependence
    - Echoes PNB approach → Increasing concentration implies greater likelihood of higher prices through oligopolistic interdependence
  - Introduced new "hypothetical monopolist" market definition paradigm
    - Rigorous, economics-based standard that linked the market definition test to oligopolistic interdependence
    - Intended to solve the Potter Stewart problem
  - Increased market share thresholds for the *PNB* presumption
  - Recognized ease of entry as a market power-constraining force
    - Entry to be assessed over a 2-year time period
  - Recognized the efficiency-enhancing aspect of many mergers
    - But still rejected efficiencies as a defense in most cases
  - Created an algorithmic approach to merger analysis

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

1982 DOJ Merger Guidelines

- "Market power"
  - 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]

  - 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

- "Hypothetical monopolist" paradigm for market definition
  - Seeks to identify relevant markets as the smallest collection of products in the tightest geography that would permit a hypothetical monopolist to exercise market power
  - 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*:[1] 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
  - Comments
    - Usual SSNIP is 5%
    - Entirely demand-side oriented

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

1982 DOJ Merger Guidelines

- New concentration measure
  - Retained *PNB* presumption, BUT
  - Replaced n-FCRs with the Herfindahl-Hirschman Index (HHI) as the measure of concentration

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

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 market

- Market shares
  - Normally includes the total sales or capacity of all firms (or plants) that are identified as being in the market
  - BUT include only sales likely to be made (or capacity likely to be used) in the market where sales depend on:
    - Plants are located outside of the market
    - Supply-side substitution
    - Diversion from internal consumption
  - While boundaries of relevant market are determined solely by demand-side considerations, the identification of firms that participate in the market and their market shares may depend on supply-side conditions

1982 DOJ Merger Guidelines

- New concentration thresholds[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

- Ease of entry defense[1]
  - Recognized ease of entry as a means of rebutting the *PNB* presumption
    - "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."
    - Considerations
      - Likelihood and probable magnitude of entry in response to a SSNIP (5%)
      - Two-year time frame
        - 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

- Efficiencies[1]
  - Recognized efficiencies as a feature of many mergers
  - Rejected efficiencies as anticompetitive (as had *Brown Shoe*)
    - 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
  - BUT also 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]

[1] 1982 Merger Guidelines § V.A.
[2] *Id*.

1982 DOJ Merger Guidelines

- Failing firm defense[1]
  - Recognized defense[2]
    - Applies to failing divisions as well as failing firms
  - BUT imposed strict conditions to prevent anticompetitive use:
    - Firm probably would be unable to meet its financial obligations in the near future
    - Firm probably would not be able to reorganize successfully under Chapter 11 of the Bankruptcy Act
    - 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

[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

- Some initial observations
  - Jointly promulgated with the Federal Trade Commission
    - AAG Jim Rill, with major input from economics DAAG Bobby 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[1]
    - 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.[2]

[1] The 1982 Merger Guidelines are sometimes called the 1984 Merger Guidelines, reflecting some minor changes made to the guidelines in 1984.

[2] 1992 DOJ/FTC Merger Guidelines § 0.1.

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
  - Retained market definition as the starting point of analysis
    - But introduced the notion of *price discrimination markets*
  - Changed market share thresholds to "safe harbors"
    - No longer a predictor of prosecutorial decision-making
  - Required explicit explanation of how the merger is anticompetitive
    - 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%
  - Retained entry defense (with original 2-year time frame)
  - Retained a rigid algorithmic approach to prosecutorial decision-making

1992 DOJ/FTC Horizontal Merger Guidelines

- Market definition
  - Retained hypothetical monopolist market definition paradigm

> A market is defined as a product or group of products and a geographic area in which it is produced or sold such that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future producer or seller of those products in that area likely would impose at least a "small but significant and nontransitory" increase in price, assuming the terms of sale of all other products are held constant. A relevant market is a group of products and a geographic area that is no bigger than necessary to satisfy this test. The "small but significant and nontransitory" increase in price is employed solely as a methodological tool for the analysis of mergers: it is not a tolerance level for price increases.[1]

- NB: The 1992 reemphasized that a SSNIP is only a tool for market definition and not "a tolerance level for price increases"[2]

[1] 1992 Merger Guidelines § 1.0 (emphasis added).
[2] *Id*.

1992 DOJ/FTC Horizontal Merger Guidelines

- Market definition
  - Clarified that the paradigm requires that the hypothetical monopolist must find that the SSNIP is in its profit-maximizing interest
    - Not just that a SSNIP is more profitable than not raising prices
  - Clarified that SSNIP should reflect a price increase over what prices would exist going forward in the absence of the merger

> [T]he Agency will use prevailing prices of the products of the merging firms and possible substitutes for such products, unless premerger circumstances are strongly suggestive of coordinated interaction, in which case the Agency will use a price more reflective of the competitive price. However, the Agency may use likely future prices, absent the merger, when changes in the prevailing prices can be predicted with reasonable reliability.[1]

    - So in markets where prices are declining (e.g., computers, microelectronics), the SSNIP would be taken from an expected future that would be lower than the prevailing premerger price

[1] 1992 Merger Guidelines § 1.11.

1992 DOJ/FTC Horizontal Merger Guidelines

- Market definition (con't)
  - Price discrimination markets
    - The 1982 Merger Guidelines required the hypothetical monopolist raise prices in the candidate market uniformly (as a percentage) across all product
    - BUT the 1992 Merger Guidelines allowed for variations in the price increases of products added to the original provisional market:

> [W]here a hypothetical monopolist likely would discriminate in prices charged to different groups of buyers, distinguished, for example, by their uses or locations, the Agency may delineate different relevant markets corresponding to each such buyer group. Competition for sales to each such group may be affected differently by a particular merger and markets are delineated by evaluating the demand response of each such buyer group. A relevant market of this kind is described by a collection of products for sale to a given group of buyers.[1]

[1] 1992 Merger Guidelines § 1.10.

1992 DOJ/FTC Horizontal Merger Guidelines

- Market definition (con't)
  - Price discrimination markets (con't)
    - Example:

> *Example*: Consider a merger of two string bean producers. Assume that a hypothetical monopolist could not profitably raise prices because of diversion to carrots, so that carrots must be included in the provisional market. Assume further that spinach is a close substitute for carrots but not as close a substitute for string beans, and that a hypothetical monopolist could not profitably implement a SSNIP to both string beans and carrots.
>
> Under the usual pre-1992 approach, spinach would be added to the provisional market. But under the new approach of the 1992 guidelines, if the hypothetical monopolist finds it maximally profitably to raise string bean prices by a SSNIP but carrots by something less than the same SSNIP (to avoid diversion to spinach), string beans and carrots would be a relevant market.[2]

[1] 1992 Merger Guidelines § 1.12 (Product Market Definition in the Presence of Price Discrimination).
[2] Janusz A. Ordover & Robert D. Willig, *Economics and the 1992 Merger Guidelines: A Brief Survey*, 8 Rev. Indus. Org. 139, 140-41 (1993).

1992 DOJ/FTC Horizontal Merger Guidelines

- Market definition (con't)
  - Market participants and market shares
    - Includes "uncommitted entrants"
      - Firms that would enter with a one-year SSNIP without significant sunk costs
      - Largely "hit and run" entry
    - Has not proven to be significant in practice[3]

[1] I have found only one opinion that referred to the concept of "uncommitted entrants," and the court rejected the application of the concept on the evidence. *See* United States v. Bazaarvoice, Inc., No. 13-CV-00133-WHO, 2014 WL 203966, at *38 (N.D. Cal. Jan. 8, 2014).

1992 DOJ/FTC Horizontal Merger Guidelines

- Anticompetitive effect
  - Retains HHI and Δ, but only as a "screen" and not an predictor of prosecutorial decision-making[1]

Postmerger HHI	ΔHHI	Guidelines
< 1000		unlikely to have adverse competitive consequences and ordinarily require no further analysis
Between 1000 and 1800	< 100	unlikely to have adverse competitive consequences and ordinarily require no further analysis
	≥ 100	potentially raise significant competitive concerns
> 1800	< 50	unlikely to have adverse competitive consequences and ordinarily require no further analysis
	50-100	potentially raise significant competitive concerns
	≥ 100	likely to create or enhance market power or facilitate its exercise

  - These are the same numerical thresholds as the 1982 Merger Guidelines
    - Although the verbal description of the consequence has been reframed

[1] 1992 Merger Guidelines § 1.51.

1992 DOJ/FTC Horizontal Merger Guidelines

- Anticompetitive effect
  - Added the requirement of a explanation of the anticompetitive mechanism to the *PNB* presumption[1]

    > [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]

    - In other words, for a transaction to be challenged under the guidelines, a "story" must be told as to why the putative anticompetitive are reasonably probable
      - Mere changes in market share statistics are not enough
      - Have to predicate the theory of anticompetitive harm with specific market conditions
  - Two mechanisms
    - "Coordination interaction"—the elimination of market-wide competition through oligopolistic interdependence
    - "Unilateral effects"—the elimination of localized competition between the merging firms

[1] 1992 Merger Guidelines § 2.
[2] *Id.*

1992 DOJ/FTC Horizontal Merger Guidelines

- Anticompetitive effect—Coordinated interaction[1]

> A merger may diminish competition by enabling the firms selling in the relevant market more likely, more successfully, or more completely to engage in coordinated interaction that harms consumers. Coordinated interaction is comprised of actions by a group of firms that are profitable for each of them only as a result of the accommodating reactions of the others. This behavior includes tacit or express collusion, and may or may not be lawful in and of itself.[1]

- Essential characteristics
  - Requires accommodation by non-merging parties to be profitable
  - Merger needs only facilitate coordinated interaction—
    - Proof that actual explicit or tacit collusion would occur is not required
    - No need for coordination to be perfect or complete: Imperfect or incomplete coordination can still hurt consumers
- Essential questions
  - How can a price increase be maintained given possible incentives of some market participants to undercut it?
  - How does the merger change the incentives or abilities of some or all of the firms in the relevant market to coordinate on price or other competitive variables?

[1] 1992 Merger Guidelines § 2.1 (emphasis added). This is often called "coordinated effects."
[2] *Id.*

1992 DOJ/FTC Horizontal Merger Guidelines

- Anticompetitive effect—Coordinated interaction
  - Requirements ("Stigler conditions")—Concentration levels and market conditions must be conducive to:
    - Reaching terms of coordination that are individually profitable to the firms involved
    - Detecting deviations from the coordination rule
    - Punishing deviations from the coordination rule
      - May be nothing more than a permanent or temporary abandonment of the terms of coordination
  - Relation to the merger
    - As a theory of anticompetitive harm for mergers, the merger must make it more likely that a sufficient group of firms in the relevant market will have greater incentives or ability to satisfy the Stigler conditions
      - That is, it is not enough that premerger the market is conducive to coordinated interaction—the merger must reasonably increase the probability that the market will be materially more conducive to coordinated interaction postmerger
    - This means that the merger must make improve the incentives or ability of a sufficient group of firms in the market to satisfy one or more of the Stigler conditions for coordinated interaction
    - A "sufficient group" of firms means a subset of firms that, if coordinating, would create, enhance or facilitate the exercise of market power in the relevant market
      - The set of all firms in the market is a sufficient group (by the hypothetical monopolist test)
      - But a smaller subset may also be sufficient depending on the characteristics of the market
        - Think about a market that can be modeled as a dominant firm with a competitive fringe

1992 DOJ/FTC Horizontal Merger Guidelines

- Anticompetitive effect—Coordinated interaction
  - Some factors to consider
    - Number of competitors in the collusive group
    - Availability of market information
      - Key information may include market conditions, transactions, and competitors
      - Lack of information may make defections from coordination harder to detect and therefore punish
    - Firm heterogeneity
      - Differences in product attributes, location, costs, or vertical integration
      - Significant heterogeneity may make reaching terms of coordination difficult
    - Large buyers/long-term contracts
      - Large, “lumpy” sales or long-term contracts can make defection more profitable
    - Lags in detection or punishment
      - Significant lags makes cheating more profitable
    - Acquisition of a “maverick”
      - The idea of a maverick
        - Have been unusually disruptive historically in the marketplace, or
        - Have attributes that make them particularly likely to deviate from the terms of coordination (e.g., large excess capacity in relation to sales)
      - Acquisition of a maverick can eliminate a disruptive force and make coordination easier
    - Prior actual or attempted collusion
      - Indicates that firms in the market believe that coordination is possible

1992 DOJ/FTC Horizontal Merger Guidelines

- Anticompetitive effect—Unilateral effects[1]

> A merger between firms in a market for differentiated products may diminish competition by enabling the merged firm to profit by unilaterally raising the price of one or both products above the premerger level. Some of the sales loss due to the price rise merely will be diverted to the product of the merger partner and, depending on relative margins, capturing such sales loss through merger may make the price increase profitable even though it would not have been profitable premerger.[2]

  - Essential characteristic
    - Looks to the elimination of "localized" competition between the merging firms
  - Applies primarily in concentrated markets with highly differentiated products
    - The overlapping products of the merging firms must be the first and second choices of buyers in the market (which may be a price discrimination market)
    - Other products in the relevant market must be distant substitutes
    - Repositioning must be difficult to replace the competition lost from the merger
    - Guidelines require that combined share ≥ 35%[3]
      - Intended to make threatened anticompetitive effect "substantial"—No empirical supporting evidence
      - Largely ignored in practice

[1] 1992 Merger Guidelines § 2.2.
[2] *Id.*
[3] There is some debate as to whether this is only a sufficient but not necessary condition.

1992 DOJ/FTC Horizontal Merger Guidelines

- Entry defense[1]
  - Two types of entrants
    - Uncommitted
      - "Hit and run" entry with low sunk costs
      - Included as participants in relevant market and (in theory) assigned market shares
      - Not considered as part of an entry defense
    - Committed
      - Entry entails substantial sunk costs
      - Consequently, entry decision depends on—
        - The entrant staying in the market for a considerable period of time, and
        - An expected trajectory of longer-term prices in the market over this period sufficient to enable the entrant to make a normal profits and recoup its sunk costs

[1] 1992 Merger Guidelines § 3.

1992 DOJ/FTC Horizontal Merger Guidelines

- Committed entry
  - Committed entry as a defense

> A merger is not likely to create or enhance market power or to facilitate its exercise, if entry into the market is so easy that market participants, after the merger, either collectively or unilaterally could not profitably maintain a price increase above premerger levels. Such entry likely will deter an anticompetitive merger in its incipiency, or deter or counteract the competitive effects of concern. Entry is that easy if entry would be timely, likely, and sufficient in its magnitude, character and scope to deter or counteract the competitive effects of concern. In markets where entry is that easy (i.e., where entry passes these tests of timeliness, likelihood, and sufficiency), the merger raises no antitrust concern and ordinarily requires no further analysis.[1]

  - Requirements
    - Timely
      - Must have significant market impact within two years
    - Likely
      - Likely if entry is profitable at premerger prices (including both normal profit and recoupment of sunk costs)
      - *Query*: If profitable, why has entry not already occurred?
    - Sufficient
      - Must deter or counteract the anticompetitive effects of the merger

[1] 1992 Merger Guidelines § 3.

1992 DOJ/FTC Horizontal Merger Guidelines

- 1997 efficiency amendment[1]
  - 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

[1] 1992 Merger Guidelines § 4.

1992 DOJ/FTC Horizontal Merger Guidelines

- 1997 efficiency amendment
  - BUT materially narrowed efficiency defense
  - Essentially limited cognizable efficiencies to—
    - marginal cost reductions
    - that are passed on to customers

Recall that, in the standard neoclassical economics model, firms set price so that marginal revenue equals marginal cost. Consequently, in the context of this model any downward pressure on price from merger efficiencies must come from a reduction in marginal cost. A reduction in fixed costs (such as eliminating corporate overhead redundancies) will not have any effect on price.

More formally, recall that profits are equal to revenues (*pq*) minus fixed costs (*f*) minus total variable costs (*c*(*q*)):

(1)
$$\pi = pq - f - c(q).$$

The first order condition for a profit maximum is

(2)
$$\frac{d\pi}{dq} = p + q\frac{dp}{dq} - \frac{dc}{dq} = 0.$$

Since Equation 2 is unaffected by changes fixed costs *f*, prices remain constant even if fixed costs decline as a result of the merger. Since changes in *f* do not affect prices, reductions in fixed costs will have no offsetting effect on upward pricing pressure resulting from any postmerger loss of competition.

Query: Is this the right model to use in merger analysis for assessing the role of efficiencies? (It is very static.)

1992 DOJ/FTC Horizontal Merger Guidelines

- 1997 efficiency amendment
  - ALSO imposed demanding proof requirements for efficiencies to be considered (“cognizable efficiencies”)
    1. *Merger specific*: Efficiencies cannot be achievable without the merger
       - Does this mean that the projected efficiencies *could* not be achieved without the merger or *would* not be achieved (there can be a big difference)
    2. *Verifiable*: Efficiencies must be reasonably verifiable as to likelihood and magnitude
    3. *Not anticompetitive*: Efficiencies cannot arise from an anticompetitive reduction in output or service
  - Negative defense
    - Merger must not be anticompetitive in any relevant market after taking cognizable efficiencies into account
    - Best used in defense of mergers where the anticompetitive tendencies are small
    - Almost never accepted as a defense to a merger to monopoly or near-monopoly

1992 DOJ/FTC Horizontal Merger Guidelines

- Failure and exiting assets
  - General idea

    > [A] merger is not likely to create or enhance market power or to facilitate its exercise, if imminent failure, as defined below, of one of the merging firms would cause the assets of that firm to exit the relevant market. In such circumstances, post-merger performance in the relevant market may be no worse than market performance had the merger been blocked and the assets left the market.[1]

  - Failing firm
    - Four requirements—
      1. The allegedly failing firm would be unable to meet its financial obligations in the near future
      2. The allegedly failing firm would not be able to reorganize successfully under Chapter ll of the Bankruptcy Act.
      3. The allegedly failing firm has made unsuccessful good-faith efforts to elicit reasonable alternative offers of acquisition of the assets of the failing firm that would both keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger
      4. Absent the acquisition, the assets of the failing firm would exit the relevant market
    - Success as a defense
      - There is a footnote to Requirement 3: "Any offer to purchase the assets of the failing firm for a price above the liquidation value of those assets—the highest valued use outside the relevant market or equivalent offer to purchase the stock of the failing firm—will be regarded as a reasonable alternative offer.
      - Defendants almost never can prove Requirement 3 when liquidation value is the price floor

[1] 1992 Merger Guidelines § 5.0.

1992 DOJ/FTC Horizontal Merger Guidelines

- Failure and exiting assets
  - Failing division
    - The defense also applies to failing divisions
    - Three requirements—
      1. Upon applying appropriate cost allocation rules, the division must have a negative cash flow on an operating basis.
      2. Absent the acquisition, the assets of the division would exit the relevant market in the near future if not sold.
         1. Due to the ability of the parent firm to allocate costs, revenues, and intracompany transactions among itself and its subsidiaries and divisions, the Agency will require evidence, not based solely on management plans that could be prepared solely for the purpose of demonstrating negative cash flow or the prospect of exit from the relevant market.
      3. The owner of the failing division also must have complied with the competitively-preferable purchaser requirement of Requirement 3 for failing firms
    - Success as a defense
      - Nonexistent—Defendants almost never (if ever) can prove Requirements 2 and 3

[1] 1992 Merger Guidelines § 5.0.

Merger Guidelines

The 2010 Revisions

Impetus for change

- Agencies 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).

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
4. Increase emphasis on unilateral effects and on targeted customers
5. Increase emphasis on "direct" evidence
6. Raise the bar on entry and repositioning defenses
7. 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 procompetive

[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
  - Retains HHI and Δ, but 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

- 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.").

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).

4. Increased emphasis on unilateral effects

- 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

4. Increased emphasis on unilateral effects

- 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:

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

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.

4. Increased emphasis on unilateral effects

- 2010 Guidelines—Upward pricing pressure (UPP)
  - Likely price-increasing influence of merger on merging Firm A can be determined by looking only at:
    - Diversion ratio D_{AB}
    - times the gross margin of Firm B to which some sales are lost $(P_B - C_B)$
  - The resulting statistic is known as *Upward Pricing Pressure* on Firm A (UPP_{AB})

$$UPP_{AB} = D_{AB} \times (P_B - C_B)$$

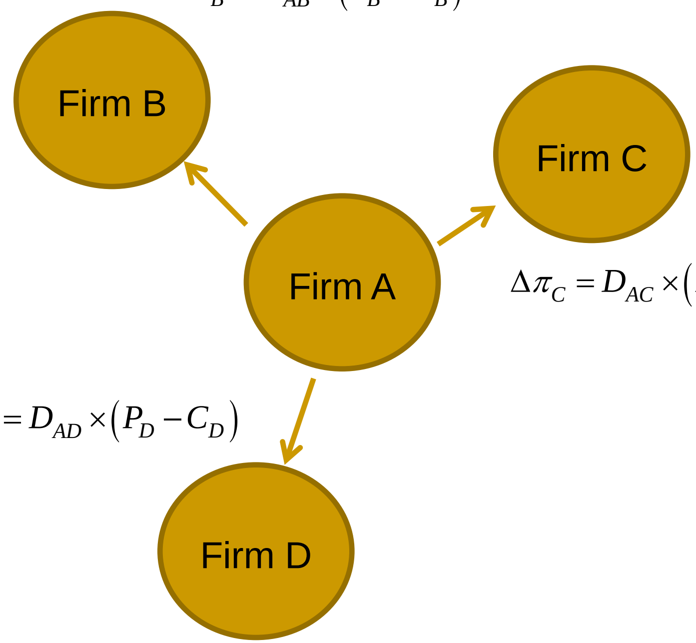
which is the additional profit Firm A earns when it loses a sale but owns Firm B

  - Implications of the Guidelines UPP model
    - A positive diversion ratio and a positive gross margin *always* yield upward pricing pressure
      - Consistent with the standard result in a Cournot oligopoly model
    - Better interpretation: Gives *relative* influence of the price pressure on Firm A exerted by competitors B and C:
      - If $UPP_{AB} > UPP_{AC}$, then B exerts more pricing pressure on A than does C, even if C has a higher cross-elasticity of demand

4. Increased emphasis on unilateral effects

- 2010 Guidelines—Upward pricing pressure (UPP)

$$\Delta\pi_B = D_{AB} \times (P_B - C_B)$$



$$\Delta\pi_C = D_{AC} \times (P_C - C_C)$$

$$\Delta\pi_D = D_{AD} \times (P_D - C_D)$$

Profit gains to Firms B,C, and D as a result of Firm A's price increase

When Firm A acquires Firm B, it recoups $\Delta\pi_B$. This reduces Firm A's marginal revenue loss from the price increase and so incentivizes A to further raise its price.

Convention: Diversion ratios are technically negative numbers for substitute products, since a loss in q_1 means a negative Δq_1 and a positive Δq_2. The convention, however, is to express diversion ratios as positive numbers (i.e., their absolute values), so that a high diversion ratio means that Firm B captures a higher percentage of the loss from Firm A

5. 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

5. 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

5. 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

Rebutting the predictions of the UPP model

- Anticompetitive predictions of UPP models can be rebutted by evidence of sufficient—
  - New entry
  - Repositioning by incumbent firms
  - Efficiencies

6. 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

$$\text{Percentage gross margin} \equiv \frac{P - C}{P}$$

    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

7. 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

- 2010 merger guidelines only address horizontal mergers

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