MERGER ANTITRUST LAW

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Georgetown University Law Center
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READING GUIDANCE

Class 3 (September 4): Presumptions and Merger Guidelines (Unit 3)

> *The materials for this unit cover a great deal of material. Read them with some care but do not obsess over it. The overall picture (gestalt) is what is important; we will address the details as the course proceeds. There is an optional case study but no homework assignment for this unit.*

On Tuesday, we will examine synergies (the business term), which are known to antitrust lawyers as efficiencies. You should review the reading materials (Unit 2 slides 37-52 and reading materials pp. 88-95). We will also spend a few minutes on the Class 2 homework assignment looking at what preliminary questions TranDigm you might ask at the beginning of the analysis in order to quickly uncover the areas that the DOJ ultimately concluded were problematic.

Next, we will continue exploring substantive merger antitrust risk by examining the use of the *Philadelphia National Bank* presumption to make a prima facie showing of anticompetitive effect under Section 7 and how the DOJ and FTC have operationalized the *PNB* presumption over time in the various iterations of the Merger Guidelines. To get started, first read the class notes on setting the stage (slides 3-6).

The PNB presumption (slides 7-16 and reading pp. 4-8). In 1963 in *United States v. Philadelphia National Bank*,[1] the Supreme Court provided an approach to answering one of the fundamental questions of merger antitrust law. The Court held that the plaintiff can make a prima facie showing of the requisite anticompetitive effect under Section 7 of a horizontal merger through an evidentiary presumption where the combined share of the merging firms and the increase in market concentration due to the merger are sufficiently high:

> [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 must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects.[2]

The *PNB* presumption, which was not suggested in the briefs of the parties, was based on the price-concentration hypothesis of the structure-conduct-performance paradigm, which at the time was the theory of dominant industrial organization. The idea was that the structure of the market determined the market's performance and that markets performed less efficiently and exhibited higher prices as they became more concentrated (at least past some threshold). In this light, the

1. 374 U.S. 321 (1963).

2. *Id*. at 363.

PNB presumption was (implicitly) an effort to stop mergers that would impair economic efficiency and result in higher prices.[3]

On the facts of the case, the Court held that the presumption was triggered where the merged firm would hold over 30% of a relevant market and the combined share of the largest two firms in the market (the "two-firm concentration ratio" of 2-FCR) would increase from 44% to 59%.[4]

The *Philadelphia National Bank* Court, however, did not fix any minimum numerical thresholds for invoking the presumption. The Court only said that the combined market share and increase in market concentration in the case were sufficient to trigger the presumption, but held open the possibility that much lower numbers could also predicate the presumption. *Philadelphia National Bank* was decided in one of the most restrictive periods in U.S. antitrust history, and that prospect quickly came to pass.

In 1966, in one of the more infamous cases in antitrust law, the Supreme Court held that the acquisition by Von's Grocery of Shopping Bag Food Stores satisfied the *PNB* presumption.[5] The merging firms were the third and sixth largest grocery store chains in Los Angeles, although they had market shares of only 4.7% and 4.2%, respectively. While the merger produced the second largest firm in the Los Angeles retail grocery store market with a market share of 8.9%, the market was relatively unconcentrated with the largest four chains accounting for only 24.4% of total market sales premerger. In applying the presumption, the Court gave short shrift to the low concentration as measured by the four-firm concentration ratio. Instead, the Court relied heavily on the facts that the number of owners operating single stores in the Los Angeles retail grocery market had decreased from 5,365 in 1950 to 3,818 in 1961, while during roughly the same period the number of chains with two or more grocery stores increased from 96 to 150, and that both Von's and Shopping Bag were successful firms that had been growing largely through acquisitions. The Court reversed the district court's dismissal of the complaint and remanded the case to the district court with instructions to "order divestiture without delay."

The next month, the Court held that the combination of Pabst Brewing and Blatz Brewing triggered the *PNB* presumption with even lower market shares.[6] The merger combined the tenth and eighteenth largest brewers in the country, with national market shares of 3.02% and 1.47%, respectively, and produced the country's fifth largest brewer with a share of 4.49%.[7] Again, the

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3 Recall from Unit 1 that in 1962 the Supreme Court in *Brown Shoe* had interpreted Section 7 in light of the legislative history of the Celler-Kefauver Amendments to be a guard against "the rising tide of economic concentration in the American economy," the loss of opportunity for small business when competing with large enterprises, and the spread of multistate enterprises and the loss of local control over industry. These are somewhat different concerns than the loss of economic efficiency and higher prices that concentrative mergers may cause under the price-concentration hypothesis. On the other hand, since the *PNB* presumption was—at least at the time of its creation—only a sufficient but not necessary means of proving a prima facie case of anticompetitive effect under Section 7, the fact that the *PNB* presumption was more narrowly based may not have been significant.

4. *Id*. at 364.

5. United States v. Von's Grocery Co., 384 U.S. 270 (1966). Richard Posner, who was then in the Solicitor General's office, successfully argued the case for the United States. For a more detailed summary of the case than the slides provide, see Seminal Cases of the 1960s, at 37 (in the supplemental materials).

6. United States v. Pabst Brewing Co., 384 U.S. 546 (1966). For a more detailed summary of the case than the slides provide, see Seminal Cases of the 1960s, at 40.

7. *Id*. at 550-51. The Court also examined shares and market concentration in a three-state area of Wisconsin, Illinois, and Michigan, and the single state of Wisconsin alone. The shares and market concentration were higher in

market overall was unconcentrated but the number of breweries operating in the United States declined from 714 in 1934 to 229 in 1961 and the total number of different competitors selling beer had fallen from 206 in 1957 to 162 in 1961—a "steady trend toward economic concentration" in the words of the Court.[8]

Notably, although the *Philadelphia National Bank* presumption was expressly based on the theory that, at least beyond some threshold, increases in market concentration resulted in less efficiently performing markets and higher prices, the Court in *Von's Grocery* and *Pabst* did not cite any economic reasons to believe that the combinations in those cases changed the market structure in ways that would impair economic efficiency and result in higher prices. Rather, the Court appeared to condemn the mergers simply because they each involved successful firms in markets exhibiting a trend toward consolidation, even though the market shares of the merging parties and the level of market concentration were remarkably low.

Moreover, although *Philadelphia National Bank* itself regarded the presumption as rebuttable in principle, in application the presumption quickly became conclusive. The lower courts' practical treatment of the presumption as conclusive, coupled with the Court's findings in *Von's Grocery* and *Pabst* that the shares in those cases were sufficient to predicate the presumption, led to widely view that horizontal acquisitions were effectively per se illegal.

Although *Philadelphia National Bank* is one of the most important precedents in antitrust law, the opinion is long, the facts are dated, and the overall method of analysis (apart from the *PNB* presumption) no longer reflects the modern approach. The class notes and the reading materials should give you all the background you need on the case, both for this course and in practice.

1968 DOJ Merger Guidelines (slides 20-27).[9] In 1968, two years after *Von's Grocery* and *Pabst* were decided, the Antitrust Division, headed at the time by Donald Turner, released its first set of merger guidelines. These guidelines, which do not have the force of law, were purportedly a statement of how the Division would exercise its prosecutorial discretion in bringing merger antitrust cases.[10] Turner, a Harvard Law professor specializing in antitrust law with a Ph.D in economics from Harvard and a law degree from Yale, believed that the Supreme Court's merger decisions were too restrictive and used the guidelines in an effort to move merger antitrust law in a more economically oriented direction. In particular, Turner sought to ground the *PNB* thresholds on the "structure-conduct-performance" economic paradigm as the *PNB* majority opinion had originally done but which the Court had abandoned in *Von's Grocery* and *Pabst*. To this end, Turner raised the thresholds that the Division would use to predicate the *PNB*

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these areas, but as the Court found that the merger presented a Section 7 violation in each geographic area, the national market with the lowest shares and market concentration is the most significant precedentially.

8. *Id*. at 550.

9. I have collected all of the versions of the merger guidelines on the Merger Antitrust Law (2018) web page if you want to see the actual documents.

10. I say "purportedly" because while it was unlikely that the Division would bring cases that did not violate the guidelines, it often exercised its prosecutorial discretion informally to allow mergers that did violate the guidelines to proceed without challenge. In this sense, the 1968 Guidelines—as have subsequent iterations—provide more of a "safe harbor" than a strict threshold for deals that require prosecution.

presumption to levels notably higher than the lowest levels the Supreme Court had found sufficient in *Von's Grocery* and *Pabst/Blatz*.[11]

General Dynamics (slides 17-19). With its 1974 decision in *United States v. General Dynamics Corp.*,[12] the Supreme Court returned to the admonition in *Brown Shoe* to look beyond market concentration statistics and reaffirmed the rebuttable nature of the *Philadelphia National Bank* presumption.[13] The Court observed that while such statistics were "of great significance," they "were not conclusive indicators of anticompetitive effects."[14] In *General Dynamics*, the Court analyzed a merger between General Dynamics and United Electric Coal Companies, two leading coal producers, which resulted in a firm with approximately 23% of sales in the relevant market. The DOJ argued that this combined market share easily surpassed those found to be unlawful in *Von's* and *Pabst* and that the merger should be found to violate Section 7. The Supreme Court disagreed. Although the combined market share did surpass those found lawful in prior cases, the Court found that the a market share based on sales was not probative of the merger's likely future effect on competition because substantially all the reserves of the acquired company had been committed to long-term supply contracts and its future ability to compete and affect market prices was negligible. Accordingly, its removal from the market as an independent company could not adversely affect competition.

General Dynamics is one of the most important opinions in antitrust law. Together with *Continental T.V., Inc. v. GTE Sylvania*[15] in 1977, *General Dynamics* paved the way for the modern approach to antitrust law involving more sophisticated economic analysis of effects of challenged conduct on market efficiency and consumer welfare.

Interestingly, the Antitrust Division vigorously prosecuted General Dynamics' acquisition of United Electric. More generally, the Antitrust Division pursued an aggressively interventionist antitrust enforcement policy through the end of the Carter administration in 1980. Indeed, Sandy Litvack, a Georgetown Law School grad and nationally known antitrust litigator who was the Assistant Attorney General in charge of the Antitrust Division in the last two years of the Carter administration, held the view that his job was to prosecute conduct that violated the antitrust laws and if he thought he could convince a court that a defendant had violated the antitrust laws—whether under existing interpretations of the law or under an interpretation he could convince the court to accept—he was morally obligated to bring the action. Litvack was a legend within the

11. Shortly after the release of the 1982 DOJ Merger Guidelines, Bill Baxter, who was then the Assistant Attorney General in charge of the Antitrust Division, told me—I was Baxter's special assistant at the time—that Turner had told him that Turner would have liked to have raised the thresholds in the 1968 Merger Guidelines even higher to be more consistent with the empirical findings by industrial organization economists testing the "structure-conduct-performance" paradigm, but that Turner concluded that the thresholds in the 1968 guidelines were the highest he could go without risking a backlash from the Supreme Court.

12. United States v. General Dynamics Corp., 415 U.S. 486 (1974). For a more detailed summary of the case than the slides provide, see Seminal Cases of the 1960s, at 44.

13. *See* Hospital Corp. of Am. v. FTC, 807 F.2d 1381 (7th Cir. 1986) (noting that *General Dynamics* "casts doubt on the continued vitality of such cases as *Brown Shoe* and *Von's*" when read to hold that any nontrivial acquisition of a competitor violates Section 7).

14. United States v. General Dynamics Corp., 415 U.S. 486, 498 (1974).

15. 433 U.S. 36 (1977) (removing nonprice vertical restraints from per se treatment and returning them to rule of reason scrutiny).

Division as an aggressive antitrust enforcer. He and other AAGs in the 1970s were quite comfortable with the low market share and concentration thresholds of *Von's*, *Pabst*, and the 1968 DOJ Merger Guidelines in applying the *PNB* presumption notwithstanding the Court's movement in *General Dynamics* to a more economic and less market share (structural) approach.

1982 DOJ Merger Guidelines (slides 28-36). With the inauguration of Ronald Reagan as president in 1981, antitrust enforcement changed dramatically. Reagan appointed William F. Baxter, a Stanford antitrust law professor for 35 years and a well-known critic of many of the more interventionist antitrust rules the courts had created in the 1960s and early 1970s, to head the Antitrust Division. Merger antitrust policy was one of the areas of antitrust law Baxter wanted to change.[16] To Baxter, an adherent of the Chicago School approach to antitrust policy, the *Brown Shoe* goals of preventing industrial concentration, preserving local control of business, and protecting small businesses that had animated antitrust law were completely wrong-headed, and the only proper goal of antitrust law in general and merger antitrust law in particular was to prevent the creation of market power, or the facilitation of its exercise, by firms. A good working definition of market power is the power of a single firm acting unilaterally, or a group of firms acting in a coordinated fashion, to impair the efficient operation of the market, typically by increasing prices to customers.

With this new goal in mind, in April 1982 Baxter released a completely new set of merger guidelines to replace the 1968 DOJ Merger Guidelines. The 1982 DOJ Merger Guidelines:

1. identified the sole goal of merger antitrust enforcement to be the prevention of mergers that created or facilitated the exercise of market power;
2. introduced a new, economically rigorous "hypothetical monopolist" paradigm to define relevant product and geographic markets in a way that satisfied a necessary (although not sufficient) condition for a merger to create or facilitate the exercise of market power;
3. significantly increased market share thresholds for the *PNB* presumption;
4. recognized ease of entry as a market power-constraining force; and
5. recognized the efficiency-enhancing aspect of many mergers.

Most observers regard the 1982 DOJ Merger Guidelines as a turning point in antitrust enforcement policy. For the last 36 years, antitrust enforcement policy has followed and refined the "market power" approach of the 1982 Guidelines. The 1982 Guidelines were not immediately accepted. There was significant resistance within the Antitrust Division career staff, the Federal Trade Commission refused to join the guidelines, and the courts approached the departures from past precedent with significant hesitation.[17] By the early 1990s, however, the 1982 Guidelines approach had largely been adopted by the courts, the enforcement agencies, and the antitrust bar.

1992 DOJ/FTC Horizontal Merger Guidelines (slides 37-53). The next revision of the guidelines occurred in 1992 near the end of the George H.W. Bush administration when James Rill, a

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16. Baxter's other major focus was the judicial rules regarding vertical distribution restraints. In other areas, especially horizontal price fixing, Baxter was as aggressive an antitrust enforcer as Litvack.

17. It is useful to keep in mind that the Supreme Court decisions in *Brown Shoe*, *Philadelphia National Bank*, *Von's*, *Pabst*, and other merger antitrust cases in the 1960s and early 1970s had not been overruled—and indeed have not been overruled explicitly by the Court to this day.

prominent member of the antitrust bar and a noted contributor to antitrust policy debates, was the Assistant Attorney General. Rill had recruited Robert D. (Bobby) Willig, a Princeton economics professor and one of the best known industrial organization economists in the profession, to serve as his economics deputy and the 1992 Guidelines were largely crafted by Willig. As you would expect given Willig's involvement, the 1992 Guidelines refined the market power approach of the 1982 Guidelines by introducing a number of new economic requirements and tools. Most importantly, the 1992 Guidelines required not only that the market share/concentration thresholds be satisfied but also that the staff develop an economic theory, supported by evidence, as to why the merger in its particular circumstances would be anticompetitive. In effect, the 1992 Guidelines rejected the price-concentration hypothesis as a sufficient basis to challenge a merger. This new requirement effectively changed the *PNB* thresholds in the merger guidelines from being a "trigger" to an enforcement action if they were satisfied to being a safe harbor from enforcement actions if they were not satisfied.

Significantly, unlike the 1982 Guidelines, the 1992 Guidelines were joined by the FTC. As the title indicates, the 1992 Guidelines are also limited in application to only horizontal mergers. As a practical matter, there are no guidelines for vertical or potential competition mergers.

The 1997 efficiency revisions (slides 54-57). In 1997, Robert Pitofsky, a former Georgetown antitrust professor and dean who at the time was chairman of the Federal Trade Commission, led a revision to the efficiency section of the 1992 Guidelines. Pitofsky agreed that mergers could create efficiencies that can have offsetting procompetitive effects and result in lower prices, improved quality, enhanced service, and new products, but he wanted to limit the recognition of efficiencies in merger antitrust analysis to those that could have these effects. Although this forthright recognition of efficiencies was promoted as a major benefit for merging parties in their antitrust defense, in fact the Pitofsky revisions significantly narrowed the scope of cognizable efficiencies to those that created marginal cost reductions that were passed on to customers. For reasons explained in the slides, this eliminated fixed cost reductions—which are a main benefit to the merging parties in most transactions—as a factor in the merger antitrust defense, since fixed cost efficiencies (at least in theory) do not affect prices and hence are not passed on to the benefit of customers.

The 1997 efficiency revisions also imposed demanding proof requirements for efficiencies that can be taken into account in a merger antitrust analysis ("cognizable efficiencies"). In particular, the efficiencies must be:

1. *Merger specific*, so that they cannot be achievable without the merger.
2. *Verifiable* as to likelihood and magnitude.
3. *Sufficient* to negate the otherwise anticompetitive effect of the merger and eliminate any harm to customers (typically in the form of higher prices) that would otherwise result from the merger.
4. *Not anticompetitive*, that is, they cannot arise from an anticompetitive reduction in output or service.

As a result of these requirements on cognizable efficiencies, efficiency defenses were rarely successful in convincing the antitrust enforcement agencies or the courts to allow an otherwise anticompetitive merger. Indeed, by the middle of the Obama administration, the efficiency defense was essentially defunct as a formal defense.[18] Efficiencies are nonetheless important as part of a merger antitrust defense, since they provide an explanation for how the merging parties will make money from the transaction that does not depend on raising prices or otherwise harming customers.

The 2010 DOJ/FTC Horizontal Merger Guidelines (slides 60-78 and reading materials pp. 10-23). The most recent revision of the Merger Guidelines was in 2010 in the Obama administration. The explanation given by the DOJ and FTC for the revision was that the 1992 Merger Guidelines no longer reflected how the agencies analyzed mergers (true) and were too rigid and missed too many anticompetitive transactions (not very true). Personally, as I explained in a note to clients that you read in Unit 2, I think that the real reason for the revisions was that the techniques and tools of the 1992 Merger Guidelines were being used too effectively against agencies in court.[19] The DOJ/FTC response was to preserve the "market power" approach started in the 1982 Guidelines but completely rewrite the guidelines to:

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 further on entry and repositioning defenses; and
7. maintain the high bar on efficiency defenses.

The key feature of the 1992 Guidelines is that they are no longer predictive as to merger enforcement outcomes: they tell you the factors that the agencies will consider in the analysis of mergers but they do not give the details of how these factors will be incorporated into the analysis to permit the parties to argue that a proper application of the Guidelines shows that the merger does not violate the antitrust laws and should not be challenged by the agencies or condemned by the courts.

Optional case study (pp. 26-48). If you still have some energy left, take a look at the complaint in the FTC's challenge to the Albertsons/Safeway merger (pp. 34-44). It provides a good example of how the FTC applied both the number of competitors test that we developed in our predictive model (this is admittedly unusual in a DOJ or FTC complaint) as well as the HHI analysis (which is very common). There other materials in the case study give you some helpful context for the deal, but can ignore them if you like.

If you have any questions or comments, send me an e-mail.

Dale

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18. Technically, efficiency defenses are *negative defenses*, that is, they negate an essential element of a violation. In merger antitrust cases, an efficiency defense would negate the anticompetitive effects element of a Section 7 violation. Much of the confusion in the case law over efficiency defenses stems from a view of efficiency defenses as affirmative defenses, that is, defenses that do not negate an element of the violation but nonetheless excuse the violation. As a matter of practice if not of theory, there are no affirmative defenses in antitrust law.

19. Shearman & Sterling LLP, The 2010 DOJ and FTC Horizontal Merger Guidelines: Increasing Realism While Reducing Predictability (August 2010), Unit 2 reading materials 49.