Unit 3. Presumptions and Merger Guidelines

Merger Antitrust Law

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Setting the Stage

Setting the Stage

- The predictive model
  - The model developed in Unit 2 for predicting outcomes in DOJ and FTC horizontal merger reviews is relatively simple and depends on—
    - *Number of firms postmerger*: The number of alternative suppliers realistically available postmerger to each identifiable customer group
    - *Bad documents*. The existence, if any, of company documents or statements that say or suggest that the transaction is anticompetitive
    - *Customer complaints*. Opposition to the deal by customers
    - *Unilateral effects*. Whether the merging parties are especially close competitors and whether most other competitors are more distant
    - *Dominant firm*. Whether one of the merging firms is "dominant" in a competitive overlap
    - *Mavericks*. Whether either merging parties in especially disruptive in the relevant market
    - *History of industry coordination*. Whether one or both of the merging firms and their close competitors have succeeded or attempted to coordinate pricing, capacity, or other competitive variables, whether tacitly or through explicit collusion
  - The model does not depend on—
    - Any rigorous definition of the relevant market
      - The "line of commerce" or "section of the country" in the language of the Clayton Act
    - Any test of how much market concentration increases as a result of the transaction

Setting the Stage

- The courts
  - Not surprisingly, adopt an approach that follows the language of Section 7
    - Define the product and geographic dimensions of a the relevant market(s) implicated in the transaction
      - In the language of Section 7, the "line of commerce" and "section of the country"
    - Within each relevant market, determine whether the transaction is likely to have the requisite anticompetitive effect
      - In the language of Section 7, whether "the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly"
  - In 1963, the Supreme Court in United States v. Philadelphia National Bank[1] created a rebuttable presumption of anticompetitive effect:

    > Undue combined market + Significant increase in market concentration
    > → Section 7 anticompetitive effect

  - Note that the *PNB* presumption applies only to horizontal transactions
    - It plays no role in vertical and other nonhorizontal transactions
  - Today, the *PNB* presumption remains—in practice if not in principle—an essential part of the proof of a prima facie horizontal Section 7 case in court
    - It is one of the most important presumptions in antitrust law

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

Setting the Stage

- The DOJ and FTC
  - "Formal" agency approach is embodied in the 2010 DOJ/FTC Horizontal Merger Guidelines ("2010 HMG")
    - Revises 1992 DOJ/FTC Horizontal Merger Guidelines
    - Describes what factors the agencies consider, but is not especially predictive compared to the 1992 HMG
  - The 2010 HMG recognize two approaches to determining anticompetitive effect
    - *Direct proof*: Utilizes evidence and economic tools that are directly probative of a likely anticompetitive effect (NB: Not yet accepted as sufficient proof by the courts)
    - *Indirect proof*: Utilizes market definition and the *PNB* presumption to infer anticompetitive effects
  - The Guidelines require an "economic story" of anticompetitive effects in both approaches
    - Unilateral effects
    - Coordinated effects
    - Elimination of a maverick

    Remember, only looking at traditional horizontal mergers
  - At trial, the agencies typically seek to prove their cases using both approaches

In this set of notes, we will consider only indirect proof under the 2010 DOJ/FTC Horizontal Merger Guidelines. Later in the course we will examine the direct methods of proof.

Courts and the *PNB* Presumption

United States v. Philadelphia National Bank[1]

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

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

[1] United States v. Philadelphia National Bank, 374 U.S. 321 (1963).
[2] I have not yet been able to find the premerger number.

United States v. Philadelphia National 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 National 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 National Bank

- District court
  - E.D. Pa.: Dismissed complaint on merits
    - 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 even assuming Section 7 applied, the transaction was not likely to substantially lessen competition because PNB and Girard actively compete in commercial banking with other banks throughout the northeastern United States
  - United States appealed directly to the Supreme Court under the Expediting Act[1]

[1] The Expediting Act was discussed in the Note on the Expediting Act, Unit 1 materials 30.

United States v. Philadelphia National 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 1950 Celler-Kefauver Amendments[1]), mergers are better viewed as stock acquisitions
      - Section 7 reaches any stock acquisition by a corporation (whether or not within the jurisdiction of the FTC
    - Product market: Commercial banking
    - Geographic market: Four-county Philadelphia metropolitan region

[1] Ch. 1184, 64 Stat. 1125 (1950) (amending Section 7 of the Clayton Act). Recall that the Supreme Court in addressed the legislative goals of the Celler-Kefauver Amendments in Brown Shoe Co. v. United States, 370 U.S. 294 (1962). *See* Unit 1 reading materials 26.

United States v. Philadelphia National Bank

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

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

    - Application in case
      - Combined firm had at least a 30% share in the relevant market: Enough for an "undue market share"
      - Share of the two largest banks in the relevant market should increase from 44% to 59%: Enough for a significant increase in market concentration
      - *PNB* presumption satisfied
      - 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, 363 (1963).

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).

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.[1]

  - 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
  - Von's Grocery/Shopping Bag Food Stores (1966)[2]
    - 4.7% (#3) + 4.2% (#6) → 8.9% (#2) in an unconcentrated market
  - Pabst Brewing/Blatz Brewing (1966)[3]
    - 3.02% (#10) + 1.47% (#18) → 4.49% (#5) 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). *See* Seminal Cases of the 1960s, at 12.
[2] United States v. Von's Grocery Co., 384 U.S. 270 (1966). *See* Seminal Cases of the 1960s, at 36.
[3] United States v. Pabst Brewing Co., 384 U.S. 546 (1966). *See* Seminal Cases of the 1960s, at 40.

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). *See* Seminal Cases of the 1960s, at 44.

Current state of the *PNB* presumption

- Two ways to think about the 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 independent of the price-concentration hypothesis
     - 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 *PNB* presumption

- 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?

Merger Guidelines

Some Background

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

Evolution of the Merger Guidelines

- 1968 DOJ Merger Guidelines
- 1982 DOJ Merger Guidelines
  - FTC refused to join
  - Insignificant revisions by the DOJ in 1984
- 1992 DOJ/FTC Horizontal Merger Guidelines
  - Limited to horizontal mergers
  - Joint product of the DOJ and FTC
  - Rewrite by the DOJ and FTC of the efficiencies section in 1997
- 2010 DOJ/FTC Horizontal Merger Guidelines

In the following slides, we will focus on how the various iterations of the Guidelines operationalized the *PNB* presumption.

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). See the Class 3 supplementary for the full text.
[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 former 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). See the Class 3 supplementary for the full text.

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 already moving in this direction beginning with its 1977 *GTE Sylvania* decision[2]

[1] 1982 DOJ Merger Guidelines § I.
[2] Continental T.V., Inc. v. GTE Sylvania, 433 U.S. 36 (1977) (removing nonprice vertical restraints from the per se illegal category and applying the rule of reason).

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. We will examine market definition and the hypothetical monopolist test in detail in Unit 9.

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:

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

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

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

The Greek capital letter sigma is just fancy mathematical notation meaning "take the sum of the variables" (in this case, the s_i^2)

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 being anticompetitive as *Brown Shoe* had indicated
    - 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

1992 DOJ/FTC Horizontal Merger Guidelines

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

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

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

[1] 1992 DOJ/FTC Merger Guidelines § 0.1. See the Class 3 supplementary for the full text.

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[1]

[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

> 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." We will examine this theory in detail later in the course.

1992 DOJ/FTC Horizontal Merger Guidelines

- Anticompetitive effect—Unilateral effects

> 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.[1]

- 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%[2]
    - Intended to make threatened anticompetitive effect "substantial"—No empirical supporting evidence
    - Largely ignored in practice

[1] 1992 Merger Guidelines § 2.2. We will examine this theory in detail later in the course.
[2] 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

- 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.

1997 Efficiency Revisions

1997 Efficiency Revisions

- Amended the efficiency section of the 1992 Merger Guidelines[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

It is worth trying to remember your high school calculus and plow through the following reasoning. If you have never taken calculus, just read the words and ignore the equations.

Reasoning. 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 π 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. *Sufficient*: Efficiencies must be sufficient to negate the otherwise anticompetitive effect of the merger
    4. *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

2010 DOJ/FTC
Horizontal Merger Guidelines

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[1]
  - Hold that there is no one right way to do merger analysis
    - Eliminate the programmatic approach of the 1882 and 1992 guidelines
      - The 1982 and 1992 guidelines were explicitly rigid in their approach and designed to provide predictable outcomes
    - Any way the agencies deem reliable can be used
      - Significantly reduces predictability
    - 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

[1] U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines (rev. Aug. 19, 2010). See the Class 3 supplementary for the full text.

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
    - The agencies have not brought a merger case for a reduction of product variety
    - For all practical purposes, this can be ignored
  - Other effects that "harm customers as a result of diminished competitive constraints or incentives"
- Observation
  - None of these potential types of anticompetitive harm are necessarily harmful
    - Since most involve reducing costs, it is possible that the net effect in the circumstances of a particular case of a reduction in product quality, service, innovation, and especially product variety could be competitively neutral or even procompetitive

Remember, a merger is—
Anticompetitive if its effect on competition harms customers
Procompetitive if its effect on competition benefits customers
Competitively neutral if its effect on competition does not affect customers

[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 eliminate "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)
  - 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

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

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

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

This ratio is also called the *Lerner index*

    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