CLASS 3 SLIDES

Unit 2: Predicting Merger Antitrust Law Challenges

Dale Collins
Merger Antitrust Law
Georgetown University Law Center

August 29, 2018

Synergies

- Synergies play two roles in an antitrust merger analysis
  1. They provide an explanation why the acquiring firm is pursuing the deal (and probably paying a significant premium) that does not depend on price increases to customers or other anticompetitive effects
  2. In close cases, large synergies can tip the agencies into not challenging the deal
- Types of synergies enabled by the deal
  1. Customer value-enhancing synergies
  2. Cost-saving synergies
- Overall
  - Synergies are very helpful in fashioning a procompetitive narrative
  - But agencies are (irrationally?) skeptical/hostile to the existence of synergies
  - Synergies will almost never outweigh prima facie evidence of an anticompetitive effect

Synergies

- To be credited by Investigating agency, synergies must be:
  1. *Merger-specific*
     - That is, could not be accomplished in the absence of the merger
  2. *Verifiable* by sufficient evidence
  3. *Sufficient* to completely and immediately offset any anticompetitive tendencies of the merger
  4. *Not anticompetitive*

- Agency view
  - Efficiencies usually given very little weight in the Obama administration
  - *Query*: What will be the weight given to synergies in the Trump administration?
    - Apparent (surprising) answer: Not much

Canonical structure of a complete defense

1. The parties and the deal
2. The deal rationale
3. The market will not allow the deal to be anticompetitive

TransDigm/Takata

- Homework assignment for Class 1
  - Six questions for the company (Instructor's answer):
    1. In what product lines do TransDigm and SCHROTH compete in the United States?
    2. For each overlapping product line, will TransDigm be able to increase its profits by raising prices, reducing product or service quality, or reducing investment in innovation or product improvement following the acquisition?
    3. In each product line, are there significant other competitors to whom customers can turn to protect themselves in the event that TransDigm increases its price, reduces its product or service quality, or reduces investment in innovation or product improvement following the acquisition?
    4. Are any customers likely to complain about the transaction and, of so, what will they say?
    5. What is Transdigm's business rationale for making the acquisition (i.e., how will TransDigm make money by acquiring SCHROTH)?
    6. How, if at all, will customers benefit from the transaction?

TransDigm/Takata

- Homework assignment for Class 1
  - Questions for the company (from homework submissions):
    1. What are the relevant markets that will be affected by this acquisition?
    2. How would you define the market (products/services and geography) for your products?
    3. Will this acquisition substantially decrease competition in the relevant markets?
    4. Does TransDigm have any current or potential competitors other than SCHROTH?
    5. How big a player is TransDigm within the market?
    6. For each product TransDigm's produces, please provide the names of all competitors and their respective market shares?
    7. Will consumers be harmed by this acquisition by increase in prices?
    8. To customers "play off" TransDigm and SCHROTH against each other to get better prices?
    9. What would TransDigm's new market share in an already highly concentrated market be after the acquisition?

TransDigm/Takata

- Homework assignment for Class 1
  - Questions for the company (from homework submissions):
    10. Would the potential acquisition decrease innovation of future technologies or would TransDigm remain motivated to innovate?
    11. Will consumers benefit from or be harmed by differences in product quality after the acquisition?
    12. Has TransDigm received any customer complaints about the transaction?
    13. What documents do the merging parties have that might reveal the intent of the transaction?
    14. Does TranDigm have any documents or has it made any public statements suggesting that postmerger it will raise prices, reduce production, or decrease R&D investment?
    15. How difficult is it for a new company to begin producing/offering the products in competition with TransDigm?
    16. Will TransDigm discontinue any products after the acquisition?
    17. Has TransDigm ever been accused or found guilty of actual or attempted collusion or coordination?

CLASS SLIDES

Unit 3. Presumptions and Merger Guidelines

Merger Antitrust Law

Fall 2018 Georgetown University Law Center

Dale Collins

September 4, 2018

Courts and the *PNB* Presumption

Clayton Act § 7

- Provides the U.S. antitrust standard for mergers

> 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.

  - *Simple summary*: Prohibits—
    1. acquisitions of stock or assets that
    2. "may substantially lessen competition or tend to create a monopoly"
    3. "in any line of commerce" (product market)
    4. "in any part of the country" (geographic market)

  - This summary assumes that the jurisdictional prerequisites are satisfied.
    - Since the reach of Section 7 today is coextensive with that the Commerce Clause, the jurisdictional prerequisites are almost always satisfied

United States v. Philadelphia National Bank

- 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)

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.

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

United States v. Philadelphia National Bank

- Supreme Court: Reversed with instructions to enter an injunction
  - Majority: Brennan for a 6-member majority
    - Section 7 applies to mergers
      - Within the statutory scheme (especially after the 1950 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
    - Geographic market: Four-county Philadelphia metropolitan region

We will address the formalities of market definition later in the course. Our focus in this unit is on prima facie proof of anticompetitive effect.

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."

- Requires—
  - The combined firm to pass some (undefined) threshold of market share, and
  - The increase in market concentration caused by the transaction
- Originally created as a *rebuttable presumption* of the requisite anticompetitive effect under Section 7
  - But quickly treated by lower courts as a conclusive presumption—essentially no defenses
- Supposed to reflect the latest in economic thinking in the then prevailing structure-conduct-performance paradigm

The *PNB* presumption

- Application in *Philadelphia National Bank*
  - 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)

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

1968 DOJ Merger Guidelines

1968 DOJ Merger Guidelines

- 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
- Animating concern
  - Current interpretation of Section 7 overly restrictive and preventing efficiency-enhancing mergers

1968 DOJ Merger Guidelines

- Solution: Issue prosecutorial discretion guidelines that—
  1. Reorient goal of merger antitrust law toward "market structures conducive to competition"
     - The number of substantial firms selling in the market
     - The relative sizes of their respective market shares
     - The existence and magnitude of barriers to the entry of new firms into the market
  2. Increase *PNB* thresholds above levels the Supreme Court has recognized as sufficient
  3. Give more credit to efficiencies as a defense
     - Supreme Court had suggested that efficiencies could be anticompetitive since they can undermine the ability of smaller, less efficient firms to compete

1968 DOJ Merger Guidelines

- PNB prosecutorial thresholds
  - 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"

General Dynamics

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)
  - DOJ action—Filed September 22, 1967
    - DOJ relied on *PNB* presumption
      - 1959: 15.1% (#1) + 8.1% (#5) → 23.2% (#1) (in Illinois market at the time of the acquisition)
      - 1967: 12.9% (#2) + 8.9% (#6) → 21.8% (#2) (in Illinois market at the time of the complaint)
      - Increasing concentration
  - Supreme Court—No violation
    - Agreed that DOJ's evidence triggered *PNB* presumption under *Von's* and *Pabst*
    - 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

1982 DOJ Merger Guidelines

1982 DOJ Merger Guidelines

- Origins
  - Issued by AAG William F. Baxter, a former Stanford law professor
  - FTC refused to sign—wanted more flexibility
- Animating concerns
  - Merger antitrust law still structurally oriented and very restrictive
  - 1968 Guidelines and *General Dynamics* did not move the needle much
  - DOJ and FTC had resisted a more efficiency-oriented approach and were aggressively prosecuting mergers under the *Von's* and *Pabst* standards
  - U.S. businesses needed to become more efficient to compete with non-U.S. firms at home and abroad
  - Supreme Court implicitly recognized the need for antitrust law to protect and promote economic efficiency in *GTE Sylvania*

1982 DOJ Merger Guidelines

- *Innovation 1*: New explicit focus on market power as the competitive harm

> "The unifying theme of the Guidelines is that mergers should not be permitted to create or enhance 'market power' or to facilitate its exercise."

  - Primarily through theories of oligopolistic interdependence
  - Echoes *PNB* approach → Increasing concentration implies greater likelihood of higher prices through oligopolistic interdependence

1982 DOJ Merger Guidelines

- *Innovation 2*: Introduced new "hypothetical monopolist" market definition paradigm
  - Rigorous, economics-based standard that linked the market definition test to oligopolistic interdependence
  - *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*: 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?
    - Usual SSNIP to be used is a 5% increase over prevailing market prices
  - Intended to solve the "Potter Stewart problem"

1982 DOJ Merger Guidelines

- *Innovation 3*. Increased market share thresholds for the *PNB* presumption

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"

1982 DOJ Merger Guidelines

- *Innovation 4*. Recognized ease of entry as a market power-constraining force

> "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."

  - Look at likelihood and probable magnitude of entry in response to a SSNIP (5%)
  - Entry to be assessed over a 2-year time period
- *Innovation 5*. Recognized the efficiency-enhancing aspect of many mergers
  - 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 still rejected efficiencies as a defense in most cases
- *Innovation 6*. Created an algorithmic approach to merger analysis

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]

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]

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"
    - Did not change the numbers—just the interpretation
    - No longer a predictor of prosecutorial decision-making
  - Required explicit explanation of how the merger is anticompetitive

> [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]

    - 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

1997 Efficiency Revisions

1997 Efficiency Revisions

- Amended the efficiency section of the 1992 Merger Guidelines
  - 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

1997 Efficiency Revisions

- *Innovation*: Imposed demanding proof requirements for efficiencies to be considered ("cognizable efficiencies")
  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
  4. *Not anticompetitive*, so that they cannot arise from an anticompetitive reduction in output or service
- Negative defense
- Practical consequences
  - Essentially limited cognizable efficiencies to—
    - marginal cost reductions
    - that are passed on to customers
  - Implicitly rejected fixed cost reduction as cognizable efficiencies
  - Burden of proof elements can be interpreted very differently by different administrations

2010 DOJ/FTC Horizontal Merger Guidelines

2010 DOJ/FTC Horizontal Merger Guidelines

- *Animating concerns*: DOJ/FTC 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)

2010 DOJ/FTC Horizontal Merger Guidelines

- *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 but increase *PNB* thresholds
  4. Increase emphasis on unilateral effects and on targeted customers
  5. Eliminate the unilateral effects structural requirements in the 1992 Guidelines
     - The overlapping products of the merging firms need not be each other's closest demand-side substitutes
     - Combined share need not be greater than 35% in the relevant market
  6. Increase emphasis on "direct" evidence
  7. Raise the bar on entry and repositioning defenses
     - Eliminated the two-year period for evaluating entry and repositioning
     - Now must be "rapid enough" to ensure no anticompetitive effect ever arises
  8. Maintain a high bar on efficiency defenses

2010 DOJ/FTC Horizontal Merger Guidelines

- The *PNB* presumption
  - Increase the thresholds, but use presumption as one more type of evidence that the reviewing agency will consider

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."

  - Practical consequence
    - Very little prosecutorially, since the 1992 thresholds were never close to binding
    - 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