FTC and DOJ Proposed Horizontal Merger Guidelines

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Merger Guidelines Methodology

• The Merger Guidelines describe the principal analytical techniques and the main types of evidence on which the Agencies usually rely to predict whether a horizontal merger may substantially lessen competition.

• Merger analysis does not use a single methodology

• Merger analysis is a fact-specific process through which the Agencies, guided by their extensive experience, apply a range of analytical tools to the reasonably available and reliable evidence to evaluate competitive concerns in a limited period of time.

• The Agencies presume, absent convincing evidence to the contrary, that adverse effects on direct customers also cause adverse effects on final consumers.
Evidence of Competitive Effects

- New section
- Substantial weight given to evidence of observed post-merger price increases or other changes adverse to customers.
- Natural experiments
- Comparative price data (*FTC v. Staples*)
- Market shares and concentration
- Head-to-head competition
- Elimination of “maverick”
- Ordinary course documents
- Customer behavior, choices and views regarding effects of merger
- Price discrimination against targeted customers
Unilateral Effects

- Elimination of competition between the merging firms
- If products are differentiated, but products of the merging firms are close substitutes for one another, merger may increase profitability of a price increase for one or more products of the merged firm by allowing firm to recapture a portion of lost sales through increased sales of a competing product of the merger partner.
- Diversion ratios
  - Win/loss reports and customer surveys
- Incremental margin
- Little reliance on market shares and HHI level
- 35% combined market share presumption eliminated
Unilateral Effects

• Elimination of competition between 2 lowest bidders in bid or auction market
• Merged firm may profitably be able to restrict industry capacity and output of homogeneous product
  - If merged firm accounts for a large share of industry capacity
  - If other firms are capacity constrained
• Effect of merger on innovation competition
• Effect of merger on product variety valued by consumers
Coordinated Effects

- Explicit agreement
- Parallel accommodating conduct
- Coordinated interaction includes conduct not otherwise illegal under the antitrust laws
- Increase in market concentration may increase predictability of rivals’ responses to a price change
- Anticompetitive coordination unlikely in unconcentrated markets
Coordinated Effects

- Agencies likely to challenge a merger that significantly increases concentration if market shows signs of vulnerability to coordinated conduct and agencies have plausible theory of effect of merger
  - Previous express collusion in the market or in a market with comparable salient characteristics
  - Market transparency
  - Responses by rivals
    - Homogeneous product
    - Relatively easy switching between suppliers
    - Meeting competition clauses
  - Firms initiating price increase lose relatively few sales after rivals respond
  - Firms offering lower price retain relatively few customers after rivals respond
  - Low market elasticity of demand
Targeted Customers and Price Discrimination

• New section
• When price discrimination is reasonably likely, the Agencies may evaluate competitive effects separately by type of customer
• Conditions:
  - Differential pricing
  - Limited arbitrage
Market Definition

- Not an end in itself
- A useful tool to the extent it illuminates merger’s likely competitive effects
- Analysis need not start with, or rely on, market definition
- Multiple product markets may be identified
  - Smallest market principle weakened
- Hypothetical monopolist test preserved
- Hypothetical cartel if merging firms sell other products that affect their pricing incentives
- 10% increase in price measured as value contribution of merging firms
  - When implicit prices cannot be identified, apply 5% or smaller SSNIP (small but significant non-transitory increase in price)
Market Definition

- Agencies may consider “critical loss analysis”, including demand elasticity implication of pre-merger margins (Lerner Index)
- Geographic market may be based on
  - locations of suppliers or
  - locations of customers for products sold on delivered basis
Market Participants and Market Shares

- Market includes “rapid entrants”
- Market shares based on
  - Revenue
  - Unit sales
  - Capacity
Market Concentration - Herfindahl-Hirschman Index (HHI)

- Updated thresholds
- Unconcentrated market: HHI <1500 (equivalent to 6-7 equal size firms)
- Moderately concentrated market: HHI 1500-2500
- Highly concentrated market: HHI >2500 (equivalent to 4 equal size firms)
- Mergers with $\Delta$HHI <100 points or resulting in unconcentrated market are unlikely to have adverse competitive effects and ordinarily require no further analysis
- Mergers that $\Delta$HHI >100 points resulting in moderately concentrated market, or $\Delta$HHI 100-200 points resulting in highly concentrated market potentially raise significant competitive concerns and often warrant scrutiny
- Mergers that $\Delta$HHI >200 points resulting in highly concentrated market are presumed likely to enhance market power, which may be rebutted by persuasive evidence
Market Concentration - Herfindahl-Hirschman Index (HHI)

- The higher the post-merger HHI and the increase in the HHI, the greater is the likelihood that the Agencies will request additional information to examine whether other competitive factors confirm, reinforce, or would counteract the potentially harmful effects of increased concentration.
Powerful Buyers

- New section
- May negotiate favorable terms reflecting
  - lower costs of serving buyers or
  - price discrimination
- Agencies examine choices available to powerful buyers and how choices likely would change due to the merger
- Agencies consider whether market power can be exercised against other buyers
Entry

• Deter or counteract anticompetitive effects of merger
• Timely
• Likely
• Sufficient
  - Replicate at least the scale and strength of one of the merging firms
• 2-year limit eliminated
• Agencies consider actual history of entry
• If not widely available, focus on firms with necessary assets or particularly strong incentives to enter
Efficiencies

- Merger may enhance competition by permitting two ineffective competitors to form a more effective competitor.
- Marginal cost reductions may:
  - Reduce or reverse any increases in merged firm’s incentive to elevate price.
  - May make coordination less likely or effective by enhancing incentive of maverick to lower price or by creating a new maverick.
  - Agencies credit only merger-specific efficiencies:
    - Consider only practical alternatives in business situation faced by merging firms, not merely theoretical alternatives.
Efficiencies

- Merging firms must substantiate efficiency claims so agencies can verify by reasonable means
  - The likelihood and magnitude of each asserted efficiency
  - How and when each would be achieved
  - Costs of achieving each efficiency
  - How each would enhance merged firm’s ability and incentive to compete
  - Why each would be merger-specific
- Most likely to credit efficiency claims substantiated by analogous past experience
Failure and Exiting Assets

- Recognize that failing firm is an extreme instance of the more general circumstance in which competitive significance of one of the merging firms is declining
- Requirements:
  - Failing firm must be unable to meet its financial obligations in the near future
  - Unable to reorganize successfully under Chapter 11
  - Made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and impose less severe danger to competition
Failure and Exiting Assets

- Failing division requirements:
  - Applying cost allocation rules that reflect true economic costs, the division has a persistently negative cash flow on an operating basis that is not economically justified for firm by benefits such as added sales in complementary markets or enhanced customer goodwill.
  - Made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and impose less severe danger to competition.
  - Agencies require evidence not based solely on management plans that could have been prepared to demonstrate above.
Mergers of Competing Buyers

- New section
- Guard against monopsony power
- Effects are not evaluated primarily on basis of effects in downstream markets in which the merging firms sell
Partial Acquisitions

- New section
- May give acquiring firm the ability to influence the competitive conduct of target
- May reduce incentive of acquiring firm to compete
- May give acquiring firm access to non-public, competitively sensitive information from the target firm
- Heightened risk of coordination if transaction also facilitates flow of competitively sensitive information from acquiring firm to the target
Rhett Krulla joined Proskauer in 2005 following an illustrious career at the Federal Trade Commission (FTC). His practice focuses on antitrust and consumer protection counseling, litigation and representation of clients before U.S. and international enforcement agencies and the courts. Before joining Proskauer, Rhett was a Deputy Assistant Director in the FTC’s Bureau of Competition, responsible for a group of approximately 25 lawyers that investigated and challenged mergers and alleged anticompetitive conduct in chemicals, plastics, computer hardware and software, coal, automotive, recorded music, video distribution and other industries, and he represented the FTC in numerous litigated cases. In previous FTC positions, as Senior Litigator and attorney, he investigated, litigated and negotiated consent orders involving mergers, horizontal restraints and monopolization in these industries and in the oil industry.