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Federal Agencies Propose Updated Merger Guidelines Formalizing Heightened Antitrust Scrutiny

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July 24, 2023 - On Wednesday, July 19, 2023, the Federal Trade Commission and the U.S. Department of Justice Antitrust Division published a much-anticipated draft update to their Merger Guidelines. In an accompanying joint press release, the agencies asserted that the draft Guidelines would "better reflect how the agencies determine a merger's effect on competition in the modern economy and evaluate draft mergers under the law." The draft Guidelines reflect the heightened antitrust scrutiny that the Biden administration contends is necessary to combat increasing consolidation that has reduced competition in the U.S. economy over the past several decades. Commenting on the draft Guidelines, Attorney General Merrick B. Garland noted that "[u]nchecked consolidation threatens the free and fair markets upon which our economy is based" and that the draft Guidelines will enable the agencies to "transparently and effectively protect the American people from the damage that anticompetitive mergers cause." A 60-day public comment period ends September 19, 2023. The agencies may publish finalized guidelines by the end of the year.

In addition to increasing the transparency of antitrust enforcement policy, the draft Guidelines seek to persuade the federal courts to support a more aggressive antitrust enforcement agenda. In a published statement accompanying the release of the draft Guidelines, FTC Chair Lina Kahn wrote that one of the goals is to "provide a clear and administrable framework that courts . . . can apply." To that end, the agencies assert in a "Fact Sheet" that the draft Guidelines "are built around statutory text and relevant case precedent. Notably, these are the first merger guidelines to cite case precedents." DOJ Assistant Attorney General for Antitrust Jonathan Kanter and FTC Chair Lina Kahn emphasized this point in appearances on CNBC. This full court press signals that the agencies are doubling down and expanding upon their aggressive enforcement strategy despite a string of losses in their recent challenges to various high-profile transactions, including Microsoft's acquisition of video game publisher Activision Blizzard and Meta's acquisition of virtual-reality startup Within Unlimited.

The draft Guidelines are organized around 13 principles articulating how the agencies evaluate whether a merger or acquisition, whether horizontal, vertical, or otherwise, violates the federal antitrust laws. They are:

1. Mergers should not significantly increase concentration in highly concentrated markets.
2. Mergers should not eliminate substantial competition between firms.

3. Mergers should not increase the risk of coordination.
4. Mergers should not eliminate a potential entrant in a concentrated market.
5. Mergers should not substantially lessen competition by creating a firm that controls products or services that its rivals may use to compete.
6. Vertical mergers should not create market structures that foreclose competition.
7. Mergers should not entrench or extend a dominant position.
8. Mergers should not further a trend toward concentration.
9. When a merger is part of a series of multiple acquisitions, the agencies may examine the whole series.
10. When a merger involves a multi-sided platform, the agencies examine competition between platforms, on a platform, or to displace a platform.
11. When a merger involves competing buyers, the agencies examine whether it may substantially lessen competition for workers or other sellers.
12. When an acquisition involves partial ownership or minority interests, the agencies examine its impact on competition.
13. Mergers should not otherwise substantially lessen competition or tend to create a monopoly.

While a detailed analysis of each of these principles is beyond the scope of this Client Alert, there are three key takeaways that are particularly important.

Expect opposition to smaller transactions in less concentrated markets

Under the first principle articulated by the draft Guidelines, the agencies presume a transaction is anticompetitive if it results in an increase in market concentration, as measured by the Herfindahl-Hirschman Index (HHI), over 1,800 and an increase in the index of 100 or more. This represents a significantly lower threshold than under the current merger guidelines. The current merger guidelines invoke the presumption only if a transaction increases the HHI by at least 200 and results in a market concentration over 2,500. The Herfindahl-Hirschman Index is calculated as the sum of the squares of the percentage market shares of all market participants. It is lower when there are many firms in a market, each with a small market share, and rises when a transaction reduces the number of firms.[1] A market comprised of six firms with equal shares has an HHI of 1,667; a merger of any two yields an HHI of 2,222. Such a 6-to-5 merger is not presumptively anticompetitive under the current merger guidelines but it is under the proposed draft Guidelines.

The draft Guidelines also assert that a transaction "presents an impermissible threat of undue concentration" if it creates a firm with a share over 30% and increases the HHI by more than 100, even if the resulting HHI is less than 1,800. An incremental increase in concentration of as little as 2%, from 29% to 31%, is presumptively unlawful under this test, no matter how many other firms are in the market. Both presumptions confirm that the agencies intend to seek to block much smaller transactions in less concentrated markets than prior administrations.

Expect opposition to mergers of employers that increase concentration in labor markets

The eleventh principle articulated by the draft Guidelines states specifically that the agencies will examine whether a transaction would substantially lessen competition for workers among employers. As FTC Commissioner Alvaro Bedoya explained in a statement accompanying the publication of the draft Guidelines that was devoted entirely to the issue, "We have antitrust law[s] because Congress was worried about how corporate power would hurt small businesses, consumers, and – yes – workers" and condemning the fact that in over 100 years of federal antitrust law enforcement, "only one merger has been stopped because of how it would affect competition for labor."

This emphasis on labor markets is all the more noteworthy because the draft Guidelines caution that "the level of concentration at which competition concerns arise may be lower" in labor markets than in consumer markets because of labor markets' "unique features." These include the potentially high costs of finding and landing a new job, the burden that relocating for work can involve, and the fact that matching an employee to an employer is typically more complex than simply picking a product. The draft Guidelines observe that these labor market characteristics can exacerbate the anticompetitive effects of a merger between employers that compete for the same workers.

The agencies are expected to move aggressively to establish precedents for blocking transactions that may have anticompetitive effects in labor markets. In October 2022, the DOJ succeeded in blocking Penguin Random House's proposed $2.2 billion acquisition of Simon & Schuster on the grounds that it may substantially lessen competition between book publishers for authors of best-selling books. The agencies' determination to bring such cases is all the more remarkable in light of a string of defeats the DOJ suffered recently in criminal cases alleging unlawful wage fixing and "no poach" agreements among competing employers. Most prominently, in April a judge in the District of Connecticut acquitted six executives of such conduct (one of whom Hughes Hubbard & Reed represented) at the end of the government's case, finding that the DOJ's case was so weak that no reasonable juror could have found the defendants guilty.

Expect greater scrutiny of acquisitions by private equity firms and other investors

Two of the principles articulated by the draft Guidelines have significant ramifications for acquisitions by private equity funds in particular. One of the principles targets industry roll-ups that may substantially lessen competition in violation of Section 7 of the Clayton Act. The other addresses acquisitions of minority interests that may substantially lessen competition.

The ninth principle states that "When a merger is part of a series of multiple acquisitions, the agencies may examine the whole series." The draft Guidelines explain that under this principle, a "pattern or strategy of multiple small acquisitions in the same or related business lines may violate Section 7, even if no single acquisition on its own would risk substantially lessening competition[.]" The agencies, therefore, may review not just the most recent transaction in an industry roll-up, but may consider the cumulative effect on competition of the consolidation in its entirety. The draft Guidelines warn that in conducting their review, the agencies may consider not just transactions actually completed, but also unconsummated transactions, the acquirer's history, its strategic incentives and overall plans, and "its position in the industry more broadly."

The twelfth principle states, "When an acquisition involves partial ownership or minority interests, the agencies examine its impact on competition." The concern arises not just when the investor itself competes with the target, but also in the context of common ownership, that is, when an investor holds "non-controlling interests in firms that have a competitive relationship that could be affected by those joint holdings". The draft Guidelines explain that the acquisition of less than full control of a firm may substantially lessen competition by giving the investor rights to appoint board members, observe board meetings, select managers, influence capital budgets, impact operational decisions, access competitively sensitive information, or otherwise affect the target's competitive decision-making. Even further, the agencies assert that even if the investor does not obtain such rights, a minority interest may be inherently anticompetitive if it "blunt[s] the incentive of the partial owner to compete aggressively because it may profit through dividend or other revenue share even when it loses business to the rival."

The draft Guidelines, and ultimately the Guidelines in their final form, are an important avenue for the DOJ and FTC to influence merger policy in the years ahead. The message is clear: expect increased antitrust scrutiny of mergers and acquisitions involving competitors or potential competitors. Caution and careful planning are warranted.

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1 For example, in a market with 10 firms, each with an equal 10% share, the HII would be 1,000 ($10 \times 10^2 = 1,000$). The maximum HHI is 10,000, where a market has only one firm with 100% of the market share ($100^2 = 10,000$)

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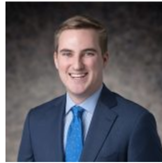

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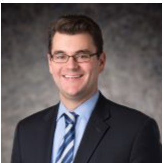

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