

FTC and DOJ Release Final Revised Horizontal Merger Guidelines

On August 19, 2010, the two federal antitrust agencies, the U.S. Federal Trade Commission (“FTC”) and the Antitrust Division of the U.S. Department of Justice (“DOJ”), jointly released the revised Horizontal Merger Guidelines. Not surprisingly, the final version contained no material departures from the draft that was released in April 2010, although the document reflects some shifts in tone. The revised Guidelines reflect a significant change in U.S. merger control policy. They are nothing short of a shot across the bow of the defense bar and the strongest signal yet that the Agencies under the Obama Administration intend to pursue a more activist agenda than their predecessors.

The role that the Guidelines have played in developing U.S. (and, indeed, global) merger control policy cannot be overstated. Although they lack the force of law, the Guidelines have shaped the practice of the antitrust agencies from Washington to Australia, and all points in between. As FTC Chairman Jon Leibowitz has noted, the Guidelines are “one of the most cited documents in modern antitrust.” The 2010 Guidelines promise to shape the future of international merger control policy.

Significant Revisions

The 2010 Guidelines recognize that merger analysis is a fact-intensive exercise that demands a more flexible approach than was originally set forth in the 1992 Guidelines and appear to offer the Agencies a wide array of analytical methodologies to employ in any given investigation. Although the 2010 Guidelines reflect that a more flexible approach to merger control has prevailed at the Agencies for some time now, the Guidelines are not a complete and accurate description of the Agencies’ present approach to merger investigations. Much in these Guidelines is aspirational, reflecting the Agencies’ intent to fundamentally reshape U.S. (and perhaps global) merger policy for years to come. What follows is a brief overview of some of the key elements of the 2010 Guidelines.

- Although the final version tones down some of the rhetoric of the initial draft, the revised Guidelines still make clear an intention to diminish the primacy of market definition in analyzing horizontal mergers. The Agencies’ desire to sidestep the gatekeeper role that market definition has historically played in merger analysis is not surprising given the Agencies’ setbacks in recent merger cases—*Whole Foods/Wild Oats*, *Oracle/People Soft*, and *Arch Coal/Triton* all turned on market definition issues. By comparison with the 1992 Guidelines, market definition under the 2010 Guidelines is employed merely to help “specify the line of commerce and the section of the country in which the competitive concern arises.” (Guidelines at § 4) Indeed, while the Agencies note that they “will normally identify one or more relevant markets,” the Guidelines also expressly state that market definition “is not an end in itself.” (*Id.*) The Guidelines now suggest that market definition is but one of several “tools” the Agencies can choose from in analyzing competitive effects.
- By deemphasizing the role of market definition, the revised Guidelines refocus horizontal merger analysis squarely on competitive effects. The Guidelines identify several analytical tools for measuring the competitive effects of a transaction, including merger simulation models and critical loss analysis. Also among these tools is the “Upward Pricing Pressure” test that was developed by the two lead economists for the Agencies, Joseph Farrell and Carl Shapiro, as an alternative to market definition analysis. Indeed, the Guidelines reflect their authors’ theories, noting that “[d]iagnosing unilateral price effects based on the value of diverted sales

need not rely on market definition . . .” (Guidelines at § 6.1, emphasis added) It is not without reason that, in his separate statement, FTC Commissioner J. Thomas Rosch faulted the Guidelines’ “overemphasis on economic formulae and models based on price theory.” (Statement of Commissioner J. Thomas Rosch on the Release of the 2010 Horizontal Merger Guidelines, at 2)

- The Guidelines also reflect the primacy of unilateral effects analysis in merger investigations by including enhanced discussions on topics such as price discrimination, pricing of differentiated products, markets where buyers and sellers participate in auctions or otherwise negotiate price and the other terms of trade, the incentives for output suppression in markets for homogeneous products, the curtailment of innovation, and the reduction of consumer choice. The Guidelines further include expanded sections on entry, power buyers, and efficiencies.
- The Guidelines present unique challenges for companies in industries characterized by high fixed costs and low variable costs. As Commissioner Rosch notes in his Statement, many of the economic theories used to evaluate unilateral effects in the Guidelines rely on the presumption that high margins are the result of market distortion or some form of collusive conduct. (Statement at 2) The Guidelines provide that “[u]nless the firms are engaged in coordinated interaction . . ., high pre-merger margins normally indicate that each firm’s product individually faces demand that is not highly sensitive to price.” (Guidelines, at § 4.1.3) A footnote qualifying this statement (“high margins are not in themselves of antitrust concern”) does little to offset the negative presumption that high margin industries may face in future investigations.
- The Guidelines reflect a wide range of sources the Agencies may collect and rely on during their investigation. In keeping with Agency practice, the Guidelines identify company documents, company data, company business decisions, customer opinions on available substitutes and competitive effects, and competitors’ assessment of the market as particularly important sources of evidence.
- As expected, the 2010 Guidelines significantly redefine the Herfindahl-Hirschman Index (“HHI”) thresholds contained in the 1992 Guidelines, while also eliminating the 35% safe harbor. It is worth noting that the revised thresholds set forth below do not reflect the Agencies’ practice, as reported in the Agencies’ 1999-2003 Merger Challenges Data study. That study reported that the Agencies rarely challenge mergers with HHIs less than 2000 points or pre/post merger changes in HHI (the “ Δ ”) of less than 300 points. Indeed, the study concluded that more than 75% of all merger challenges reflected HHIs in excess of 2,400 points with simultaneous changes in HHI in excess of 500 points. The following revisions to the HHI thresholds fall well-short of that mark.

Presumption	1992 Guidelines	2010 Guidelines
<i>No anticompetitive effects presumed</i>	HHI < 1,000	HHI < 1,500 <u>or</u> Δ < 100
<i>Potential for significant anticompetitive effects</i>	1000 < HHI < 1,800 <u>and</u> Δ > 100	1,500 < HHI < 2,500 <u>and</u> Δ > 100
	<i>or</i>	<i>or</i>
	HHI > 1,800 <u>and</u> 50 < Δ < 100	HHI > 2,500 <u>and</u> 100 < Δ < 200
<i>Presumption of anticompetitive effects</i>	HHI > 1,800 <u>and</u> Δ > 100	HHI > 2,500 <u>and</u> Δ > 200

Practical Implications

More merger challenges

The Guidelines evince a clear pro-enforcement stance and will likely result in a more activist merger enforcement policy at the Agencies. The effectiveness of the Guidelines in supporting the Agencies' agenda depends, to some degree, on the willingness of the courts to sanction the 2010 Guidelines' approach to merger analysis. It is no secret that courts have frequently cited to the 1992 Guidelines in analyzing mergers, and the motivation behind the Agencies' devotion of significant resources to this project may have been an attempt to garner judicial sanction for the Agencies' reliance on econometric analysis of anticompetitive effects in cases where the empirical evidence is equivocal. That approach, as well as the subordination of market definition to competitive effects discussed above, conflicts with well-established precedent in merger cases. This suggests that adoption of the Guidelines' more flexible approach by courts may prove to be a much slower process than the courts' adoption of the original 1992 Guidelines. Nonetheless, precedent cannot be changed in a vacuum and it is reasonable to expect that merger challenges will increase over the near term.

More aggressive agency investigations

Most merger investigations, however, are resolved at the Agency level. The more immediate impact of the Guidelines may therefore prove to be more aggressive Agency case teams and increased demands for divestitures. As detailed in our August 23, 2010 memorandum on the recently proposed revisions to the Hart-Scott-Rodino Notification and Report Form, the Agencies have proposed a significant expansion of the scope of documents that transacting parties must provide to the Agencies along with the HSR Form. Through these documents, the Agencies will have access to more meaningful competitive information up-front and parties should be prepared to address both legal and economic arguments from the Agencies at a much earlier point in the investigation.

Higher costs

Even parties to transactions that do not result in a challenge or consent to divestiture are likely to be affected by what appears to be a significant shift in enforcement perspective. Parties to strategic horizontal transactions can expect both lengthier investigations and more detailed and substantive requests for the documents, data and other information needed to conduct the various analyses set forth in the Guidelines. These delays and additional burdens will mean higher up-front costs for transacting parties. Those costs could be compounded should the Agencies deploy their own econometric analyses during the first waiting period. Best practices could soon demand the routine retention of economists much earlier in the process to help rebut expected Agency economic arguments and to develop the parties' own analyses.

Market concentration analysis may no longer reliably predict agency behavior

The deletion of the 35% safe harbor and the revised role of market definition in merger analysis severely downgrades the utility of traditional concentration estimates to predict regulatory behavior. Indeed, under the Guidelines, relevant markets could prove to be extremely narrow, encompassing only those firms that divert sales from each other or only individual or small groups of "targeted" customers.

Evidence of diverted sales, win/loss data key

Transactions between competitors will face enhanced scrutiny, particularly if an examination of recent won/lost sales data reveals diverted sales between the two companies. This analysis will be especially critical in high margin industries. While diversion ratios have long been considered to be integral to merger analysis, the Guidelines imply that diverted sales between the merging parties may suggest a much narrower market definition, thereby avoiding the market definition quagmire that has stalled prior enforcement efforts.

Impact on international merger control unclear

Finally, the 1992 Guidelines inspired the development of sophisticated merger control regimes across the globe. Although merger analysis does differ from jurisdiction to jurisdiction, the core of the 1992 Guidelines approach has been replicated in law and practice in dozens of countries. The effect of the revised Guidelines on practice outside the U.S. is difficult to gauge at this early date. The U.S. Agencies are blessed with a wealth of resources, most notably a deep bench of seasoned antitrust lawyers and sophisticated economists, that few, if any, of their counterparts in other jurisdictions can match. The 2010 Guidelines represent a quantum leap in the level of sophistication brought to merger investigations in the U.S. But if the rest of the world is either unready or disinclined to follow, international divergence on merger analyses may create additional headaches for transacting parties.



The revised Guidelines are the most tangible evidence that a more activist enforcement agenda has taken root in the Agencies under the Obama Administration. If you have any questions or would like to discuss how the revised Guidelines may affect your best practices, please contact James Kobak (212-837-6757; kobak@hugheshubbard.com), Ethan Litwin (212-837-6540; litwin@hugheshubbard.com), or Michael Salzman (212-837-6833; salzman@hugheshubbard.com) of the Antitrust Practice Group.

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