



WHAT YOU NEED TO KNOW ABOUT THE REVISIONS TO THE MERGER GUIDELINES

Last week, the United States federal antitrust agencies—the Department of Justice Antitrust Division and the Federal Trade Commission—released proposed revisions to the Horizontal Merger Guidelines. The Guidelines, which have been revised several times over the past 40 years, delineate how the antitrust agencies review horizontal mergers and also provide the agencies' view as to how courts should evaluate these deals.

As we explained in our initial Alert (*available at www.jonesday.com/us_antitrust_enforcers_release/*), the proposed revisions significantly change the structure of the Guidelines and generally reflect a more aggressive approach to merger analysis than the previous Guidelines. However, despite some anxiety over what the new administration might do to dramatically raise the bar for mergers, the revisions predominantly reflect mainstream antitrust principles and, importantly, more accurately describe the current state of merger review at the agencies.

Rather than providing a summary of the changes or engaging in academic debates, we thought it would be more useful to simply answer the most frequent questions clients have asked since the proposed Guidelines were announced.

WHY DID THE AGENCIES DECIDE TO REVISE THE GUIDELINES?

According to the heads of the DOJ and FTC, they revised the Guidelines to more accurately reflect how the agencies currently review mergers and to make the process more transparent for businesses and their counsel. Few would argue that the Guidelines, which the agencies have not significantly revised since 1992, were not in need of refreshing. Not surprisingly, in the past two decades, there have been substantial changes in the legal and economic analysis of mergers. As a result, anyone who recently has defended a merger before the agencies knows that the agencies

take a different approach than that reflected in the current Guidelines. Some of this has been reflected in speeches and reports like the 2006 Merger Commentary, but it was clear that the Guidelines needed to be revised. The proposed revisions do an admirable job of updating the Guidelines to capture the current approach.

The agencies had another important goal in revising the Guidelines: influencing the courts. Over the past two decades, most judges have embraced the Guidelines as the proper analytical framework for evaluating mergers that the agencies challenge in court. The problem for the agencies was that, as merger analysis evolved at the agencies, the Guidelines analysis applied by courts remained largely static, and courts were often skeptical of some of the new tools and evidence presented by the agencies. As a result, the DOJ and FTC often had difficulty—especially in mergers with less well-defined product markets—in persuading courts to apply a more flexible analysis and rely on the agencies’ evidence to conclude that a deal was unlawful. In fact, in some cases the merging parties successfully criticized the agencies when they departed from the rigid Guidelines analysis. Assuming courts will eventually embrace the revised Guidelines (see discussion below), the revisions are intended to close the gap between how the agencies and courts analyze mergers and remove some of the impediments the agencies have faced in successfully blocking deals.

While the agencies were updating the Guidelines, they also took advantage of the fact that the Obama administration had the pen, not its predecessor, and inserted language in several places that reflects the more pro-enforcement mindset of the current administration. For example, in discussing the tools the agencies may use to analyze deals, the revisions tend to focus more on how these tools can show mergers are harmful than on how they may show the absence of anticompetitive effects. In addition, the language used in describing potential defenses (such as entry and efficiencies) expresses more skepticism and may raise the bar for merging parties. With that said, these changes on the surface reflect incremental change and not a fundamental analytical shift.

WHAT ARE THE THREE MOST IMPORTANT REVISIONS?

First, the revisions completely retool the analytical steps for evaluating whether mergers harm consumers. The current Guidelines take a mechanical approach and very linear path through the analysis by first defining the relevant market and then assessing market concentration, potential competitive effects, possible entry, efficiencies, and, if relevant, the failing firm defense. While the revised Guidelines reference each of these elements, they articulate a much more flexible approach by simply describing each of the elements that may be used to determine a merger’s effect rather than outlining a step-by-step process. The result is a more subjective and holistic analysis that, while appropriately recognizing the very fact-specific nature of current merger analysis, likely reduces some of the predictability that the previous Guidelines offered—although because the agencies had long since stopped following the path laid out in the previous Guidelines, this is more apparent than real.

Second, the revisions deemphasize the importance of defining markets and using market shares and, instead, focus on other analytical tools, including direct evidence of competitive effects, that can be used by the agencies to assess whether a merger is harmful. Indeed, market definition is no longer the centerpiece of the Guidelines, and the agencies stress the point that market definition is an imperfect process and often does not clearly predict a single market definition. The agencies also have inserted an entirely new section, “Evidence of Adverse Competitive Effects,” that explains the additional tools, including evidence of a price increase or other competitive effects following a merger, the impact of other market events (like entry or exit) that may help evaluate a merger’s effects, evidence of head-to-head competition between the merging parties, and whether the acquisition will remove from the market a uniquely disruptive competitor. The agencies have relied on this evidence in the past, but the revisions make it explicit. The revisions also identify the different types and sources of evidence on which the agencies typically will rely, including the merging parties’ documents, testimony, or data, and the views of customers, competitors, and other industry participants.

Identifying this evidence increases the transparency of the process for businesses, but could also help the agencies persuade historically skeptical courts to rely on these types of evidence. For example, the court in the DOJ's challenge of Oracle/PeopleSoft rejected as purely speculative the views of customers on what they might do in response to the merger. The revisions assert that customer views can be "highly relevant" to the merger analysis. Over time, if history is any guide, these Guidelines will, the agencies hope, influence courts to follow their teaching on issues such as this.

Finally, the revised Guidelines significantly expand the discussion of how to identify harmful mergers involving differentiated products. The revisions describe a broad range of economic tools. These tools rely more on margins and customer switching patterns, instead of the combined market share of the merging firms, to determine whether the merging products are such uniquely close competitors that post-merger prices will be higher. Importantly, these tools may indicate that a merger is harmful even when a traditional market analysis based on high market shares would suggest otherwise (and possibly vice versa). Again, this revision does reflect how the agencies currently review mergers involving differentiated products, but it is clearly also intended to help the agencies influence judges who have rejected cases relying on tools like this in the past.

WILL THE REVISIONS MAKE IT HARDER TO GET DEALS THROUGH THE AGENCIES?

Because the revised Guidelines more accurately reflect how the agencies actually review mergers today, the revisions themselves should not make it harder to get your deal approved by the agencies. To be sure, the revisions are a significant change from the previous Guidelines, but primarily this just demonstrates how out of date those Guidelines were. Some commentators have (mistakenly, we believe) seen the revised Guidelines as evidence of some tectonic shift toward more aggressive merger enforcement. They do contain some provisions that are more pro-enforcement, and merger enforcement may become more aggressive, but with only a few exceptions the Guidelines revisions stay within the

antitrust mainstream. Still, elections matter, and as one would expect, the revisions reflect the more aggressive end of the mainstream spectrum. Deals may be harder to get past the Obama administration antitrust agencies, but it will not be because of the Guidelines revisions.

HOW WILL THE REVISIONS AFFECT DEALS CHALLENGED IN COURT?

This is the important question. The agencies should describe in the Merger Guidelines how they analyze mergers. Whether one agrees with the approach or not, it is desirable to understand it. But the U.S. agencies, unlike their counterparts almost everywhere else in the world, must go to court to actually block a merger. And history shows that courts are a tough audience for complicated economic theory; they prefer "harder" facts, like documents and, yes, market share (although we all know that documents are frequently misleading or just plain wrong, and market share calculation is hardly a science). So one clear goal of these Guidelines revisions is to try to move the courts to be more accepting of what the agencies think of as more sophisticated analytical approaches. There is a bit of a gulf between the hard-core economic analysis crowd and those who prefer, and find more probative, traditional evidence (the "tell me an anticompetitive story" crowd). Because few judges were economists in their prior life, and many were practicing lawyers, they tend to naturally favor the traditional approach. As a result, the agencies have had great difficulty in recent years prevailing without strong traditional evidence.

One of the clear goals of these revised Guidelines is to explain, as clearly as possible, why sometimes quite complex economic analyses should be considered persuasive evidence—and indeed, why these analyses are just as persuasive as traditional evidence. The revised Guidelines accomplish the first step in this process: They are very clearly written and do as good a job as likely possible to explain why particular economic analyses are used and should be credited by courts. But the second step—getting courts to accept this in the face of arguments by the merging parties that the traditional evidence does not

support the economic conclusions—will be much harder. Courts respect precedent, and while merger case law is relatively limited, courts in several circuits (such as the D.C. Circuit) have developed merger review standards that focus on market definition and apply the step-by-step approach in the 1992 Guidelines. It will not be easy to break courts of this habit. If we were placing bets, however, we would expect a gradual shift toward the approaches in the revised Guidelines. What will be interesting is what happens during the transition. We suspect there will be a greater tendency to litigate by merging parties and that the agencies may lose a few cases in the process.

Assuming courts do eventually adopt the revised Guidelines, the revisions could also have a significant impact on how merger challenges are tried by opening up new “fronts” in the court battle. Under the previous Guidelines, the battle was largely fought on a single front—what is the proper market definition? In virtually all cases, the agencies won when the court defined the market narrowly and lost when the court adopted a broader definition. This was the case because the previous Guidelines emphasized market definition and applied a presumption of harmful effects where markets were concentrated (the usual result of defining a narrow market).

Two recent FTC merger court cases highlight this phenomenon. In 2007, the FTC failed in the district court to block Whole Foods’ acquisition of Wild Oats, when the court rejected a narrow market consisting of premium natural and organic supermarkets. The court relied in large part on evidence of competition from outside of the FTC’s alleged market to define a broader market including traditional supermarkets. In the other case, last year the FTC won its challenge to the CCC/Mitchell merger because the court adopted its more narrow market definition, including certain types of software used by auto repair shops. The court presumed harmful effects because in those markets the merger would have left only two competitors.

Because the revised Guidelines deemphasize the importance of market definition and provide the agencies with more tools and flexibility in challenging mergers in court (more battlefronts), the revisions (if accepted by the courts) may make it easier for the DOJ and FTC to block mergers

involving differentiated products, where precise market definition can be difficult. While the agencies have been using these economic tools (such as critical loss and merger simulation) in court for many years, most courts have been reluctant to rely on them when there are doubts as to the precise boundary of the relevant market. The revised Guidelines address this problem head-on, by explaining that these economic tools can be useful and “need not rely on market definition.”

Increasing the number of fronts in a court battle may, however, very well also benefit the merging parties, especially where traditional market analysis yields high concentration levels (even under the revised Guidelines’ higher HHI thresholds). Because the revised Guidelines deemphasize the role of market definition and market shares, this should significantly weaken the presumption a court would traditionally apply that such concentration leads to harmful effects. Moreover, the revised Guidelines endorse additional tools that the merging parties may use (depending on the evidence) to overcome high concentration and demonstrate that the merger will not have harmful effects. Thus, losing the market definition battle may well no longer end the war.

WILL THE REVISED GUIDELINES INCREASE THE COSTS AND DELAYS ASSOCIATED WITH MERGER REVIEW?

The revised Guidelines do identify additional tools and evidence for evaluating mergers that rely on large amounts of data and materials that must be obtained from the merging parties and other industry participants. Evaluating this information with more of these tools can take a significant amount of time and money, potentially delaying a deal and incurring significant legal and economic consulting fees. As discussed above, however, these tools were already in use before the revised Guidelines came out, and thus the revisions themselves should not change the likely costs and delays associated with merger review. If over time the Obama administration significantly ramps up merger enforcement, it will be the result of challenging more cases on the margin and not because the proposed Guidelines preordain enhanced prosecution.

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