

Editor's Note:

Symposium on the 2010 Horizontal Merger Guidelines

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This issue of the *Antitrust Source* features a series of articles by distinguished antitrust practitioners on the new horizontal merger guidelines.¹ While the *Source* has published numerous articles on the proposed merger guidelines revisions,² this symposium provides the first collection of essays on the 2010 Guidelines. The essays are not intended to be a comprehensive discourse but are purposely limited to one or two key points on which each author wanted to focus.

There has been a general awareness in the antitrust community that an update to the seventeen-year-old Horizontal Merger Guidelines³ was appropriate, but it is likely that the close working relationship and similarity of views between the current chief economists at the Federal Trade Commission and the Department of Justice acted as the tipping point that led to the release of revised guidelines this year.

The First Merger Guidelines

Before the 1990s, the longest economic expansion by the American economy began in March 1961. The bulls charged throughout the Kennedy-Johnson years and into the first ten months of the Nixon administration.⁴ In the midst of that expansion and associated merger wave, Donald F. Turner, in his first speech as the Antitrust Division's Assistant Attorney General, spoke of the need for a set of rules to assist the Division and private bar in merger analysis.⁵ This eventually led to the first set of merger guidelines being promulgated on May 30, 1968.⁶

¹ U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines (2010) [hereinafter 2010 Guidelines], available at <http://www.ftc.gov/os/2010/08/100819hmg.pdf>.

² David Scheffman & Joseph Simons, *Unilateral Effects with Differentiated Consumer Products: A Response to Werden*, ANTITRUST SOURCE, Aug. 2010, <http://www.abanet.org/antitrust/at-source/10/08/Aug10-Scheffman8-2f.pdf>; Gregory J. Werden, *Unilateral Effects with Differentiated Consumer Products: A Response to Scheffman and Simons*, ANTITRUST SOURCE, June 2010, <http://www.abanet.org/antitrust/at-source/10/06/Jun10-Werden6-24f.pdf>; David Scheffman & Joseph Simons, *Unilateral Effects for Differentiated Products: Theory, Assumptions, and Research*, ANTITRUST SOURCE, Apr. 2010, <http://www.abanet.org/antitrust/at-source/10/04/Apr10-Scheffman4-14f.pdf>; Timothy J. Muris & Bilal Sayyed, *Three Key Principles for Revising the Horizontal Merger Guidelines*, ANTITRUST SOURCE, <http://www.abanet.org/antitrust/at-source/10/04/Apr10-Muris4-14f.pdf>; Serge Moresi, *The Use of Upward Price Pressure Indices in Merger Analysis*, ANTITRUST SOURCE, Feb. 2010, <http://www.abanet.org/antitrust/at-source/10/02/Feb10-Moresi2-25f.pdf>; Elizabeth M. Bailey et al., *Merger Screens: Market Share-Based Approaches Versus "Upward Pricing Pressure,"* ANTITRUST SOURCE, Feb. 2010, <http://www.abanet.org/antitrust/at-source/10/02/Feb10-Leonard2-25f.pdf>; Peter Boberg & John Woodbury, *Repositioning and the Revision of the Horizontal Merger Guidelines*, ANTITRUST SOURCE, Dec. 2009, <http://www.abanet.org/antitrust/at-source/09/12/Dec09-Boberg12-17f.pdf>; Darren S. Tucker, *Seventeen Years Later: Thoughts on Revising the Horizontal Merger Guidelines*, ANTITRUST SOURCE, Oct. 2009, <http://www.abanet.org/antitrust/at-source/09/10/Oct09-Tucker10-23f.pdf>; Ilene Knable Gotts & Étienne Renaudeau, *Through the Looking Glass: Ruminations on Improving the Current U.S. Merger Enforcement Guidelines*, ANTITRUST SOURCE, Apr. 2009, <http://www.abanet.org/antitrust/at-source/09/04/Apr09-Gotts4-28f.pdf>.

³ U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines (1992, rev. 1997), available at <http://www.justice.gov/atr/public/guidelines/hmg.pdf>.

⁴ JAMES R. WILLIAMSON, FEDERAL ANTITRUST POLICY DURING THE KENNEDY-JOHNSON YEARS 56 (1995).

⁵ Donald F. Turner, *Antitrust Enforcement Policy*, 29 A.B.A. ANTITRUST SECTION 187 (1965).

⁶ U.S. Dep't of Justice, Merger Guidelines (1968), available at <http://www.justice.gov/atr/hmerger/11247.pdf>.

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While the concept of merger guidelines was novel in the 1960s, the consensus was that the 1968 Guidelines contained nothing new and thus were of little use.⁷ The market share thresholds had already been approximated by the private bar, and the rules were all to be found in recent Supreme Court decisions.⁸ As a result, Turner's guidelines were all but forgotten less than a decade after their release.⁹ This similarity to commentary on the 2010 Guidelines—that they contain nothing new—could be concerning.¹⁰ The 2010 Guidelines will likely prove more memorable than the 1968 Guidelines, however, not necessarily because they contain concepts hitherto unknown to antitrust practitioners, but because they accurately reflect current agency practice¹¹ that has evolved since the last major revision to the horizontal merger guidelines in 1992.¹² They also provide strong signals to what the agencies consider best practices.

Calls to Redraft the 1992 Guidelines and Challenges to Overcome

The calls to update the horizontal merger guidelines have gradually increased in frequency over the last couple of years. Both before and after FTC Chairman Jon Leibowitz and DOJ AAG Christine Varney announced plans to hold workshops to consider updating the 1992 Guidelines on September 22, 2009,¹³ many antitrust practitioners had published articles identifying the need for a revised set of horizontal merger guidelines.¹⁴ The growing consensus was that despite the agencies' efforts to keep the public informed of their "evolving interpretation of the Guidelines" through closing statements, speeches, workshops, merger enforcement dates, and most notably the 2006 Merger Guidelines Commentary, the "growing patchwork of glosses on the Guidelines ha[d] become unwieldy for all but the most seasoned veterans of the antitrust agencies."¹⁵

One of the main challenges that seemed to face the agencies was whether they would agree with each other on revisions. The agencies have diverged over some fundamental aspects of policy in recent years. The most striking example of differences between the agencies was when

⁷ Gregory J. Werden, *Should the Agencies Issue New Merger Guidelines?: Learning From Experience*, 16 GEO. MASON L. REV. 839, 841 (2009).

⁸ See WILLIAMSON, *supra* note 4, at 67.

⁹ See Werden, *supra* note 7, at 841.

¹⁰ Statement of Chairman Leibowitz on the Release of the 2010 Horizontal Merger Guidelines (Aug. 19, 2010), available at <http://www.ftc.gov/os/2010/08/100819hmgleibowitz.pdf> ("the new Guidelines provide a clearer and more accurate explanation to merging parties, courts, and antitrust practitioners of how the agencies review transactions."); David P. Wales & Craig A. Waldman, What You Need to Know About the Revisions to the Merger Guidelines, JONES DAY COMMENTARY (Apr. 2010), available at http://www.jonesday.com/what_you_need_to_know/ ("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.").

¹¹ Although some may disagree. See Statement of Commissioner J. Thomas Rosch on the Release of the 2010 Horizontal Merger Guidelines (Aug. 19, 2010), available at <http://www.ftc.gov/os/2010/08/100819hmgrosch.pdf> ("These Guidelines do not describe the way that the Bureau of Competition and enforcement staff at the Commission proceed today.").

¹² U.S. Dep't of Justice & Fed. Trade Comm'n Statement Accompanying Release of Revised Merger Guidelines, 4 Trade Reg. Rep. (CCH) ¶ 13,104 (Apr. 2, 1992).

¹³ Press Release, Fed. Trade Comm'n, Federal Trade Commission and Department of Justice to Hold Workshops Concerning Horizontal Merger Guidelines (Sept. 22, 2009), available at <http://www.ftc.gov/opa/2009/09/mgr.shtm>; Christine A. Varney, Assistant Att'y Gen., Antitrust Div., U.S. Dep't of Justice, Merger Guidelines Workshops (Sept. 22, 2009), available at <http://www.usdoj.gov/atr/public/speeches/250238.pdf>; Remarks of FTC Chairman Jon Leibowitz as Prepared for Delivery at the Third Annual Georgetown Law Global Antitrust Enforcement Symposium (Sept. 22, 2009), available at <http://www.ftc.gov/speeches/leibowitz/090922mergerguideleibowitzremarks.pdf>.

¹⁴ See, e.g., Tucker, *supra* note 2; Gotts & Renaudeau, *supra* note 2.

¹⁵ Tucker, *supra* note 2, at 3.

three of the four FTC Commissioners criticized the DOJ's 2008 Single-Firm Conduct Report. The DOJ retracted their report shortly thereafter.¹⁶

During the course of the workshops that the agencies held to discuss topics likely to be addressed in the revised guidelines, it became clear that many panelists thought that the heads of the Bureau of Economics at the FTC and the Economic Analysis Group at the DOJ would exert more than a marginal influence on the drafting of the next set of guidelines. This was hardly surprising because Joe Farrell and Carl Shapiro were on the faculty at the University of California-Berkeley together, co-authored numerous articles on merger analysis, and both served as deputy attorneys general at the DOJ. Their close working relationship and Farrell's experience at both agencies likely helped bridge any differences that might have existed between the two agencies during the drafting process.¹⁷ Their association and early work also appeared to signal what the revised merger guidelines would emphasize. These were themes that were not necessarily new, but ended up shaping how the 2010 Guidelines were presented.

The Farrell and Shapiro Dynamic

Significantly, Farrell and Shapiro had been highly critical of the linear approach to investigating mergers. In a 2008 paper, they argued that the step-by-step process in the 1992 Guidelines to assess whether a challenge to a horizontal merger was appropriate was inconsistent with modern economics and "has created a tangle of problems."¹⁸ It was of little surprise then that the 2010 Guidelines depart from this linear approach and describe a flexible analysis that explains how a number of elements could be used to investigate a merger. Since the agencies had long stopped following a linear approach in favor of a more holistic analysis, this was a welcome change to the text, but not a change in practice.

The 2010 Guidelines do, however, hint at a new "merger screen" incorporated from some of Farrell's and Shapiro's earlier work. The 2010 Guidelines discuss the use of "upward pricing pressure" to diagnose markets with differentiated products. Farrell and Shapiro developed the Upward Pricing Pressure (UPP) method in a series of articles while at Berkeley.¹⁹ UPP is based on pre-merger gross margins of the merging parties and estimates of the diversion ratios between their products. The use of pre-merger gross margins and diversion ratios has been standard agency practice over the last decade.

Before the 2010 Guidelines came out, commentators had already started to speculate about the role of UPP in the new guidelines.²⁰ Serge Moresi described the benefits of the UPP method-

¹⁶ Commissioners Harbour, Leibowitz, and Rosch described the DOJ's Section 2 Report as a "blueprint for radically weakened enforcement of Section 2 of the Sherman Act." Statement of Commissioners Harbour, Leibowitz and Rosch on the Issuance of the Section 2 Report by the Department of Justice (Sept. 8, 2008), available at <http://www.ftc.gov/os/2008/09/080908section2stmt.pdf>.

¹⁷ See, e.g., Joseph Farrell & Carl Shapiro, *How Strong Are Weak Patents?*, 98 AM. ECON. REV. 1347 (2008); Jonathan B. Baker, Joseph Farrell & Carl Shapiro, *Merger to Monopoly to Serve a Single Buyer: Comment*, 75 ANTITRUST L.J. 637 (2008); Joseph Farrell & Carl Shapiro, *Improving Critical Loss Analysis*, ANTITRUST SOURCE, Feb. 2008, <http://www.abanet.org/antitrust/at-source/08/02/Feb08-Farrell-Shapiro.pdf>; Joseph Farrell, John Hayes, Carl Shapiro & Theresa Sullivan, *Standard Setting, Patents, and Hold-Up*, 74 ANTITRUST L.J. 603 (2007); Joseph Farrell & Carl Shapiro, *Scale Economies and Synergies in Horizontal Merger Analysis*, 68 ANTITRUST L.J. 685 (2001); Joseph Farrell & Carl Shapiro, *Antitrust Evaluation of Horizontal Mergers: An Economic Alternative to Market Definition*, 10 B.E. J. THEORETICAL ECON. (2010), <http://www.bepress.com/bejte/vol10/iss1/art9/>; Joseph Farrell & Carl Shapiro, *Recapture, Pass-Through, and Market Definition*, 76 ANTITRUST L.J. 585 (2010).

¹⁸ Farrell & Shapiro, *Antitrust Evaluation of Horizontal Mergers*, *supra* note 17, at 5.

¹⁹ See *supra* note 17.

²⁰ See, e.g., Moresi, *supra* note 2; Bailey et al., *supra* note 2.

ology as an initial merger screen for differentiated product markets.²¹ Alternatively, he outlined the role of UPP in a more complete analysis of competitive effects in conjunction with a number of other factors currently considered in merger analysis. The benefits of UPP as a merger screen were also addressed by Elizabeth Bailey, Gregory Leonard, Steven Olley, and Lawrence Wu.²² They considered UPP to be an analytical improvement over current market share screens, provided that reliable estimates of three key inputs are available: diversion ratios, gross profit margins, and efficiencies. But the likelihood that reliable data could be assembled during the initial Hart-Scott-Rodino screening period of thirty days seems unlikely. This implied that UPP seemed most appropriate as an analytical tool after parties provided more comprehensive data during the Second Request process. The agencies could, therefore, apply the UPP methodology instead of running merger simulations that require far more data and can be more time consuming.

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Considering the academic work of two of the principal drafters, the discussion of UPP in the 2010 Guidelines is probably less prominent than most commentators expected. The phrase “upward pricing pressure” is used once. In their only mention of UPP, the Agencies carefully tie the concept to diverted sales: “the Agencies assess the value of diverted sales, which can serve as an indicator of the upward pricing pressure on the first product resulting from the merger.”²³ By emphasizing that UPP rests on diversion ratios, the Agencies directly link the relatively new with more tried and trusted techniques. This blurring of the lines could counter potential criticisms that the 2010 Guidelines incorporate new methodologies and possibly reflect a bias toward Shapiro and Farrell’s previous work.

Along the same lines, the Agencies explain that they do not rely exclusively on UPP to diagnose unilateral effects. Instead, the Agencies stress that they use a “range of analytical tools”²⁴ in merger analysis of markets consisting of differentiated products. In accordance with the commentators’ warnings, the Agencies are careful to point out that merger analysis is highly fact-specific and that upward pricing pressures will only be considered when “sufficient information is available.”²⁵ To emphasize the multiplicity of methodologies available, the Agencies also briefly describe merger simulation models and discuss the more specific concepts of diversion ratios and margins, as well as some of the factual evidence considered including win/loss reports and documentary evidence.²⁶ Once again, the Agencies emphasize that they have a variety of tools in their merger toolkit allowing for flexible analyses depending on what factual information is available.

Commentary by Symposium Authors

While the 2010 Guidelines accurately reflect the more flexible analysis already employed by the Agencies, the codification of these changes has generated some criticism. John Harkrider notes that the more flexible approach makes it far less clear whether a merger will be challenged. He suggests that abandoning the linear approach could lead to the possible return of the uncertain

²¹ See Moresi, *supra* note 2.

²² See Bailey et al., *supra* note 2.

²³ See 2010 Guidelines, *supra* note 1, § 6.1.

²⁴ See *id.* § 1 (“These Guidelines should be read with the awareness that merger analysis does not consist of uniform application of a single methodology. Rather, it 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.”).

²⁵ See *id.* § 6.1 (“In some cases, where sufficient information is available, the Agencies assess the value of diverted sales, which can serve as an indicator of the upward pricing pressure on the first product resulting from the merger.”).

²⁶ See *id.* § 6.

era of *Von's Grocery*,²⁷ when a merger that created a combined market share of under 8 percent was found unlawful. By contrast, Dennis Carlton and Mark Israel raise the concern that the identification of specific techniques could lead to what is effectively a codification of certain techniques that may fall out of favor at a later point of time. Joseph Farrell acknowledged that these types of concerns were uppermost in the minds of the Agencies as they tried to strike the right balance.²⁸ Whether they succeeded may not be known until the Agencies develop a track record of cases in which they apply the 2010 Guidelines.

To set the scene for future merger cases, Deborah Garza and Deborah Feinsein chronicle and discuss the move away from structural presumptions. They also point out possible issues surrounding alternative techniques that include UPP, which Jerry Hausman suggests improving with a “predicted price change bounds” approach. Using the same information required to calculate UPP, Hausman suggests estimating a range of potential price changes instead, which he argues are easier to interpret.

Apart from the general move to a more flexible approach, the symposium authors also focus on a number of other distinct issues. The future treatment of the 2010 Guidelines by the courts is of particular concern, especially whether courts will be prepared to forgo market definition in certain Section 7 cases. Leah Brannon and Kathleen Bradish discuss this issue in detail. Ilene Gotts, and Carlton and Israel, share the apprehension that the de-emphasis of the use of market definition may lead to some confusion and less effective antitrust policy, especially by the courts and foreign antitrust agencies. Gary Zanfagna does not agree that the market definition section de-emphasizes the necessity of market definition in merger analysis, noting that the Agencies clarified in the final version of the 2010 Guidelines that they “will normally identify one or more relevant markets in which the merger may substantially lessen competition.”²⁹ Zanfagna concludes that the Agencies would be “unwise to go to court without including market definition in their case.”

In sharp contrast to the much discussed question of market definition, an issue that has not yet received much attention from commentators is the incorporation of a hypothetical exclusionary conduct test drawing on concepts developed under Section 2 of the Sherman Act into traditional Section 7 analysis. Bruce Hoffman and Daniel Francis put the spotlight on this issue in their essay. An issue that has generally captured the attention of the antitrust bar is the treatment of dynamic competition and so-called innovation markets. Jay Ezrielev and Janusz Ordover explain that they regard the 2010 Guidelines as falling short by not better integrating dynamic competition into merger assessment. Susan Creighton extends this point by specifically referencing high-tech markets, explaining how the Guidelines reflect a “textbook picture” of a merger framework instead of a “capitalist reality” that captures dynamic innovation. As a result, Creighton concludes that a “disproportionately large percentage of high-tech mergers” fit poorly into the Agencies’ current merger framework.

Not a Destination But a Journey

As with prior iterations of the horizontal merger guidelines, discussion over best practices will con-

²⁷ *United States v. Von's Grocery Co.*, 384 U.S. 270 (1966).

²⁸ See e.g., Joseph Farrell, Remarks at Horizontal Merger Guidelines Review Project Workshop 7 (Jan. 14, 2010), available at <http://www.ftc.gov/bc/workshops/hmg/transcripts/100114transcriptstanford.pdf> (“[I]t’s kind of an open-ended inquiry that is both about economics and about process at the same time. In my way of thinking, that’s what we’re here to discuss and try to figure out, what’s the best way to summarize or to describe what is the best, and most useful, and also the most used ways of analyzing that question.”).

²⁹ See 2010 Guidelines, *supra* note 1, § 4.

tinue, econometrics will improve, and eventually it will be time to revise the horizontal merger guidelines once again. The 2010 Guidelines have already stirred up many competing viewpoints that will likely be debated for years before there is sufficient consensus upon which to base another set of guidelines. The articles in this symposium touch on many of the hot button issues. We know you will enjoy reading them and hope they will bolster your thinking about future improvements. ●