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DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE

Working Party No. 3 on Co-operation and Enforcement

ROUNDTABLE ON THE STANDARD FOR MERGER REVIEW, WITH A PARTICULAR EMPHASIS ON COUNTRY EXPERIENCE WITH THE CHANGE OF MERGER REVIEW STANDARD FROM THE DOMINANCE TEST TO THE SLC/SIEC TEST

-- United States --

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The attached document is submitted to Working Party No. 3 of the Competition Committee FOR DISCUSSION under item III of the agenda at its forthcoming meeting on 9 June 2009.

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1. In the United States, mergers have been challenged under two laws. Section 7 of the Clayton Act of 1914, described in detail below, specifically addresses anticompetitive acquisitions and has long been the primary basis for merger challenges. Section 1 of the Sherman Act of 1890 prohibits certain agreements and also can be used to challenge mergers. We address Section 1 as part of a discussion of changes to the U.S. substantive merger standard over time, later in this submission.

1. The substantive merger standard in the United States

2. Section 7 of the Clayton Act currently provides that:

> *No person engaged in commerce or in any activity affecting commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no person subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another person engaged also in commerce or in any activity affecting commerce, where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.*[1]

3. Section 7 was intended to serve as "an effective tool for preventing" anticompetitive mergers.[2] The federal agencies that share merger enforcement responsibilities—the U.S. Department of Justice (DOJ) and the Federal Trade Commission (FTC) (collectively referred to as the Agencies)—believe that Section 7 can and does serve as intended. Section 7 covers "the entire range of corporate amalgamations"[3] as well as all anticompetitive effects flowing from them.

4. The substantial lessening of competition (SLC) standard in Section 7 prohibits mergers and acquisition reasonably likely to produce significant anticompetitive effects.[4] All mergers and acquisitions are "tested by the same standard, whether they are classified as horizontal, vertical, conglomerate or other."[5] "Merger enforcement, like other areas of antitrust, is directed at market power."[6] "The lawfulness of an acquisition turns on the purchaser's potential for creating, enhancing, or facilitating the exercise of market power . . . ."[7]

5. "Section 7 itself creates a relatively expansive definition of antitrust liability: To show that a merger is unlawful, a plaintiff need prove only that its effect '*may be* substantially to lessen competition.'"[8] "Section 7 does not require proof that a merger or other acquisition has caused higher prices in the affected

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1 15 U.S.C. § 18 (emphasis added).

2 *Brown Shoe Co. v. United States*, 370 U.S. 294, 319 (1962).

3 *United States v. Philadelphia National Bank*, 374 U.S. 321, 342 (1963). Since 1980, Section 7 also covers non-corporate amalgamations. *See infra* note 29.

4 The Supreme Court has never held that any particular form of anticompetitive effect, or any particular form of acquisition causing such effect, falls outside the scope of the current version of Section 7. The Court held that it reaches mergers that eliminate only potential competition. *See United States v. Falstaff Brewing Corp.*, 410 U.S. 526 (1973). The Court also indicated that a merger could violate Section 7 by leading to unlawful exclusionary conduct. *See Cargill, Inc. v. Monfort of Colorado, Inc.*, 479 U.S. 104 (1986).

5 *Federal Trade Commission v. Procter & Gamble Co.*, 386 U.S. 568, 577 (1967).

6 *Federal Trade Commission v. H.J. Heinz Co.*, 246 F.3d 708, 713 (D.C. Cir. 2001) (quoting Lawrence A. Sullivan & Warren S. Grimes, *The Law of Antitrust* 511 (2000)).

7 *United States v. Archer-Daniels-Midland Co.*, 866 F.2d 242, 246 (8th Cir. 1988).

8 *California v. American Stores Co.*, 495 U.S. 271, 284 (1990).

market. All that is necessary is that the merger create an appreciable danger of such consequence in the future. A predictive judgment, necessarily probabilistic and judgmental rather than demonstrable, is called for."[9] The words "may be" indicate that Section 7 is concerned with "probabilities," not with "certainties" nor with mere "ephemeral possibilities."[10]

6. In challenging an acquisition, the Agencies (or other plaintiff) must identify "some mechanism by which the challenged acquisition causes anticompetitive effects."[11] The linchpin of that mechanism normally is the change in control over the operation of the acquired assets or company, but Section 7 also reaches anticompetitive effects that do not result from a change in control.[12] Such an effect can arise if one competitor acquires stock in another, causing the first competitor to share in the profits of the second.

2. Overview of merger assessment in the United States

7. The Agencies' general approach to assessing horizontal mergers—those that eliminate direct competition between the merging firms—is set out in the *Horizontal Merger Guidelines* (Guidelines)[13] and the *Commentary on the Horizontal Merger Guidelines* (Commentary) issued in 2006.[14] The Commentary explains that: "The core concern of the antitrust laws, including as they pertain to mergers between rivals, is the creation or enhancement of market power."[15] Consequently, "the Agencies focus their horizontal merger analysis on whether the transactions under review are likely to create or enhance market power."[16] "The unifying theme of the Guidelines is that mergers should not be permitted to create or enhance market power or to facilitate its exercise."[17]

8. The Commentary observes that the "Guidelines' five-part organizational structure has become deeply embedded in mainstream merger analysis. These parts are: (1) market definition and concentration; (2) potential adverse competitive effects; (3) entry analysis; (4) efficiencies; and (5) failing and exiting assets."[18] The Commentary also explains that the Agencies "do not apply the Guidelines as a linear, step-by-step progression that invariably starts with market definition and ends with efficiencies or failing assets."[19] Rather, they take "an integrated approach to merger review" that may not follow the "ordering of these elements in the Guidelines."[20]

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9 *Hospital Corp. of America v. Federal Trade Commission*, 807 F.2d 1381, 1389 (7th Cir. 1986) (citing *United States v. Philadelphia National Bank*, 374 U.S. 321, 362 (1963) (holding that Section 7 calls for "a prediction of [a merger's] impact upon competitive conditions in the future")).

10 *Brown Shoe Co. v. United States*, 370 U.S. 294, 323 (1962).

11 *United States v. Dairy Farmers of America, Inc.*, 426 F.3d 850, 858 (6th Cir. 2005).

12 *See Denver & Rio Grande Western Railroad Co. v. United States*, 387 U.S. 485, 501 (1967) ("A company need not acquire control of another company in order to violate the Clayton Act.").

13 The Guidelines are available on the Agencies' websites at http://www.usdoj.gov/atr/guidelines/hmg.pdf and http://www ftc.gov/bc/docs/hmg080617.pdf.

14 The Commentary is available on the Agencies' websites at http://www.usdoj.gov/atr/guidelines/215247.pdf and http://www ftc.gov/os/2006/03/CommentaryontheHorizontalMergerGuidelinesMarch2006.pdf.

15 *Commentary on the Horizontal Merger Guidelines* at 1.

16 *Id.*

17 Horizontal Merger Guidelines § 0.1.

18 *Commentary on the Horizontal Merger Guidelines* at 2.

19 *Id.*

20 *Id.*

> *Using numerous illustrations from actual investigations, the Commentary illustrates how the Guidelines' integrated process is "a tool that allows the Agency to answer the ultimate inquiry in merger analysis: whether the merger is likely to create or enhance market power or facilitate its exercise." At the center of the Agencies' application of the Guidelines, therefore, is competitive effects analysis. That inquiry directly addresses the key question that the Agencies must answer: Is the merger under review likely substantially to lessen competition? To this end, the Agencies examine whether the merger of two particular rivals matters, that is, whether the merger is likely to affect adversely the competitive process, resulting in higher prices, lower quality, or reduced innovation.*
>
> *The Guidelines identify two broad analytical frameworks for assessing whether a merger between competing firms may substantially lessen competition. These frameworks require that the Agencies ask whether the merger may increase market power by facilitating coordinated interaction among rival firms and whether the merger may enable the merged firm unilaterally to raise price or otherwise exercise market power. Together, these two frameworks are intended to embrace every competitive effect of any form of horizontal merger.*[21]

3. Changes in the substantive merger standard over time

9. The United States adopted the SLC standard for mergers in 1914. Prior to that time, mergers were subject to challenge under Section 2 of the Sherman Act, which prohibits monopolization,[22] and especially under Section 1 of the Act, which prohibits unreasonable restraints of trade.[23] Before 1914, the Supreme Court declared that several railroad mergers violated Section 1.[24] From 1914 until 1980, some merger challenges continued to be based on Section 1 as a result of jurisdictional limitations within Section 7 that eventually were eliminated.

10. The most important of these limitations was called the "asset loophole." As originally enacted, Section 7 did not contain the clause now in the law referring to acquisitions of assets.[25] Consequently, the Supreme Court held that Section 7 gave the FTC no power to order relief following an asset acquisition,[26] and mergers effectuated through the acquisition of assets therefore were challenged under the Sherman Act. The original Section 7 also contained a clause referring to the elimination of competition between the parties to the transaction, which generally was understood to preclude a Section 7 challenge to a non-horizontal merger.[27] Both limitations were eliminated in 1950,[28] and others were eliminated in 1980.[29]

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21 *Id.* at 2–3 (quoting Horizontal Merger Guidelines § 0.2) (citation omitted).

22 The monopolization offense has two elements: "the possession of monopoly power in the relevant market" and "the acquisition or maintenance of that power" through anticompetitive conduct. *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 407 (2004).

23 *See State Oil Co. v. Khan*, 522 U.S. 3, 10 (1997).

24 *See United States v. Union Pacific Railroad Co.*, 226 U.S. 61 (1912); *Northern Securities Co. v. United States*, 193 U.S. 197 (1903).

25 *See* ch. 323, 38 Stat. 730, 731–32 (1914).

26 *See Arrow-Hart & Hegeman Electric Co. v. Federal Trade Commission*, 291 U.S. 587 (1934); *Federal Trade Commission v. Western Meat Co.*, 272 U.S. 554 (1926).

27 *See Brown Shoe Co. v. United States*, 370 U.S. 294, 313 & n.21 (1962). After Section 7 was amended to correct this apparent defect, the Supreme Court construed the original language so as not to preclude challenges to non-horizontal mergers. *See United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 586, 590–92 (1957).

11. For quite some time, it was understood that the substantive standards for mergers were materially different under Section 1 of the Sherman Act and Section 7 of the Clayton Act. Section 7 was originally enacted because Congress concluded that the Sherman Act was inadequate to prevent various anticompetitive practices, including acquisitions.[30] In amending Section 7 in 1950, Congress indicated that the amended Section 7 would prohibit mergers not prohibited by the Sherman Act,[31] and a major impetus for the legislation was a recent Supreme Court decision rejecting a merger challenge under Section 1.[32]

12. Nevertheless, the Supreme Court decisions applying Section 1 to mergers after World War II did not evidence a discernable difference in standards. Modern competitive effects analysis began to emerge in a 1948 decision rendered under Section 1, which was the first antitrust decision to use the term "relevant market" and to focus on market shares as an indicator of competitive significance.[33] A 1964 bank merger decision under Section 1 analyzed the transaction just as contemporaneous bank decisions decided under Section 7.[34]

13. In 1980, Professors Areeda and Turner argued that "no difference in result is mandated by the § 1 concept of unreasonable restraint as compared with § 7's concept of a probable substantial lessening of competition."[35] In 1982, the DOJ took the position that the substantive standards under Section 1 and Section 7 were identical.[36] A few years later, an important court of appeals decision adopted this view, explaining how the law under both Section 1 and Section 7 had evolved over time.[37] It is now widely agreed that a showing of likely anticompetitive effects suffices to establish a violation of Section 1, just as it does under the SLC standard.

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28 Celler-Kefauver Act, ch. 1184, 64 Stat. 1125.

29 Until 1980, Section 7 applied only to acquisitions by corporations engaged in commerce. Thus, it did not apply to acquisitions by individuals, partnerships, and unincorporated associations, nor did it apply to acquisitions of firms that did not participate directly in the sale, purchase, or distribution of goods and services in interstate commerce. *United States v. American Building Maintenance Industries*, 422 U.S. 271 (1975). Both limitations were eliminated by section 6 of the Antitrust Procedural Improvements Act of 1980, 94 Stat. 1154, 1157–58.

30 *See United States v. Penn-Olin Chemical Corp.*, 378 U.S. 158, 170–71 (1964) ("The grand design of the original § 7 . . . was to arrest incipient threats to competition which the Sherman Act did not ordinarily reach."); David Dale Martin, *Mergers and the Clayton Act* 43–49 (1959); Senate Committee on the Judiciary, Senate Report No. 698, 63rd Congress, 2d session, at 1 (1914) (the purpose of the Clayton Act in general was "to prohibit and make unlawful certain trade practices which, as a rule, singly and in themselves, are not covered by the" Sherman Act).

31 *See* House Committee on the Judiciary, H.R. Report No. 1191, 81st Congress, 1st session, at 8 (1949) (the legislation prohibits mergers even if their "effect is not so far-reaching as to amount to" Sherman Act violations); Senate Committee on the Judiciary, Senate Report No. 1775, 81st Congress, 2d session, at 6 (1950) (the legislation "seeks to arrest restraints of trade in their incipiency and before they develop into full-fledged restraints violative of the Sherman Act.").

32 The case was *United States v. Columbia Steel Co.*, 334 U.S. 495 (1948). The DOJ alleged that the acquisition of a steel fabricator by the largest U.S. steel producer would eliminate competition in the sale of fabricated steel products and in supplying the acquired company.

33 *United States v. Columbia Steel Co*, 334 U.S. 495 (1948).

34 *United States v. First National Bank & Trust Co. of Lexington*, 376 U.S. 65 (1964).

35 4 Philip Areeda & Donald Turner, *Antitrust Law* ¶ 906, at 22 (1980).

36 This position was announced in the Merger Guidelines issued by the Department on June 14, 1982.

37 *United States v. Rockford Memorial Corp.*, 898 F.2d 1278, 1282 (7th Cir. 1990).

4. Alternative Standards

14. The SLC standard carries with it no special risk of overenforcement or underenforcement. The standard is flexible, leaving initially to the Agencies, and ultimately to the courts, the task of determining whether the standard is met in each particular case in the light of the available evidence. There is a general consensus today that the Agencies and courts were overly restrictive in the 1960s. The flexibility of the SLC standard, however, allowed merger policy to incorporate enforcement experience and developments in economics. The SLC standard appropriately invites a highly fact-intensive investigation in which the evidence is carefully examined through the lens of modern economics.

15. The precise wording of the SLC standard has not been important to agency or judicial decision-making. What has mattered, and continues to be critical, is Section 7's explicit focus on competition. In the first important decision following the 1950 amendments to Section 7, the Supreme Court observed that the law was designed for "the protection of *competition*, not *competitors*" and reflects "the desire to restrain mergers only to the extent that such combinations may tend to lessen competition."[38] Also critical is the insight that focusing on competition implies focusing on market power. That same focus, however, could be achieved without the precise SLC formulation.

16. The Agencies often cooperate in merger investigations with agencies in other jurisdictions, many of which employ a dominance standard. The Agencies have not encountered a case in which a difference in substantive merger standards was an impediment to successful cooperation.

38 *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962).