DEPARTMENT OF JUSTICE

An Update on the Review of the Horizontal Merger Guidelines

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Remarks as Prepared for the
Horizontal Merger Guidelines Review Project's
Final Workshop

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Today, the Department of Justice and the Federal Trade Commission are holding our final workshop examining the Horizontal Merger Guidelines. We began this project because, with the exception of the section dealing with efficiencies, the current iteration of the Guidelines has been in place since 1992. Much has changed in the way the Agencies evaluate mergers in the past eighteen years.

The Guidelines are designed to be "revised from time to time as necessary."[1] Periodic revisions are necessary to fulfill what recent Nobel laureate and, I am proud to say, Antitrust Division alumnus Oliver Williamson has identified as an original objective of the Merger Guidelines: "putting antitrust enforcement on sounder economic foundations."[2] The evolution of antitrust law needs to keep pace with the advancement of economic thinking. Judge Posner convincingly made this case for reassessing economic beliefs in his recent, thought-provoking piece entitled "How I Became a Keynesian: Second Thoughts in a Recession," wherein he questioned some of the theoretical assumptions that had previously guided his work.[3] In an even more recent interview, he is

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1 U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES § 0 n.4, *available at* http://www.justice.gov/atr/public/guidelines/hmg.pdf [hereinafter HORIZONTAL MERGER GUIDELINES].

2 Oliver E. Williamson, The Merger Guidelines of the U.S. Department of Justice: In Perspective, Remarks at the 20th Anniversary of the 1982 Merger Guidelines 5 (June 10, 2002), *available at* http://www.justice.gov/atr/hmerger/11257.pdf.

3 Richard A. Posner, *How I Became a Keynesian: Second Thoughts in a Recession*, NEW REPUBLIC, Sept. 23, 2009, at 34, 35.

quoted to say that "'the term "Chicago School" should be retired.'"[4] Theoretical assumptions that market forces naturally and inevitably correct for market failures clearly need to be reconsidered. In the context of the Horizontal Merger Guidelines, the most relevant aspect of this reassessment involves explicit or implicit assumptions that entry will erode market power otherwise enhanced by a merger.

In the past, considering whether the Guidelines should be revised was something that was conducted internally within the Agencies. In addition to these public workshops, those internal deliberations are occurring again. Within the Department, we are meeting with the civil litigating sections and our economists to discuss their views on the Guidelines and their experiences over the last eighteen years. Those discussions have involved what has worked well, what has not worked well, and a survey of current practices.

Through these workshops, we have opened the process and sought expert views on the Guidelines. We began by soliciting comments about the Guidelines and received forty-four submissions from concerned individuals and organizations expressing a variety of concerns and suggestions. Those comments reflected a considerable amount of work and effort, and the Agencies are grateful to all those who took the time to share their expertise with us. Indeed, we remain interested in receiving comments throughout the process.

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4 John Cassidy, *Letter from Chicago: After the Blowup*, NEW YORKER, Jan. 11, 2010, at 28, 33.

In addition to inviting comments, these workshops have been held over the past two months in Washington, D.C., New York, Chicago, California, and now back here again in Washington. Our nearly100 panelists have included leading practitioners, economists, consumer advocates, industry executives, and academics. We have been fortunate to have both former and current government enforcers from the United States and around the world share their perspectives with us. Again, we are grateful to those who shared their time and expertise with us.

We've learned a lot from the workshops and the comments received so far, and this morning I would like to offer some views about what we've heard during this process and where I believe areas of consensus are emerging. As we complete the five workshops, we welcome additional comments addressing the discussions that have taken place at the workshops. We especially welcome comments on the topics outlined in these remarks.

A consistent theme running through the panels is that there are indeed gaps between the Guidelines and actual agency practice—gaps in the sense of both omissions of important factors that help predict the competitive effects of mergers and statements that are either misleading or inaccurate. Those gaps are something that we are aware of within the Division, and they have been reflected in several documents issued by the Agencies over the years, including for instance the 2006 Commentary on the Horizontal Merger

Guidelines[5] and the 2003 Merger Challenges Data.[6] Our panelists and commentators have affirmed that many outside the Agencies recognize and appreciate these gaps as well.

Gaps between what the Agencies say we do and what we actually do are unfortunate for a number of reasons. Our Guidelines are meant to inform practitioners and the business community of the Agencies' standards for evaluating mergers. Gaps run counter to our goal of being transparent. That transparency helps businesses make accurate predictions about our likely enforcement intentions and adjust their behavior accordingly. Gaps increase uncertainty and thus can lead to unnecessary surprises. We want to avoid that.

Similarly, the Agencies rely heavily on the Horizontal Merger Guidelines in our competition policy efforts, both here in the United States and abroad. To be as effective and persuasive as possible, the Guidelines should reflect our best thinking about the competitive effects of mergers and appropriate merger enforcement policy. That will best promote our efforts to advocate for sound competition principles that benefit consumers.

Courts also rely on the Guidelines, in the words of the Fifth Circuit Court of Appeals, as providing "persuasive authority when deciding if a particular acquisition

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5 U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, COMMENTARY ON THE HORIZONTAL MERGER GUIDELINES (2006), *available at* http://www.usdoj.gov/atr/public/guidelines/215247.pdf [hereinafter COMMENTARY].

6 FED. TRADE COMM'N & U.S. DEP'T OF JUSTICE, MERGER CHALLENGES DATA: FISCAL YEARS 1999-2003 (2003), *available at* http://www.justice.gov/atr/public/201898.pdf [hereinafter MERGER CHALLENGES DATA].

violates anti-trust laws."[7] When the Guidelines either inaccurately reflect enforcement or omit crucial considerations, we do a disservice to business and law.

At the same time, I do not want to overstate the magnitude of these gaps. The focus in the Guidelines on whether a merger is likely to create or enhance market power, resulting in anticompetitive effects, remains the heart of merger analysis. The focus in the Guidelines on possible unilateral and coordinated effects, entry, and efficiencies accurately reflects the key concerns driving merger enforcement policy. I said at the outset of this project that I did not envision radical revision of the Guidelines. Nothing so far in the comments or the workshops has changed my assessment. Updating the Guidelines, however, does appear worthwhile in a number of areas.

Turning now to some specifics, I'll note a few areas where gaps between agency practice and the Guidelines seem most pronounced and where consensus about the existence of those gaps has emerged. These are issues about which I expressly encourage additional comments as our review process continues.

To begin, many of our panelists have noted that the Agencies do not mechanically apply the five-step analytical process set forth in the Guidelines, whereby markets and market shares are first assessed, followed by a sequential consideration of potentially adverse competitive effects, entry, efficiencies, and then failing-firm considerations. None of our panelists advocated following that sequence as the best and most efficient way either to assess every merger's likely competitive effects or to reach an enforcement decision.

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7 Chi. Bridge & Iron Co. v. FTC, 534 F.3d 410, 431 n.11 (5th Cir. 2008).

To be sure, the Guidelines themselves offer a note of caution regarding the potentially misleading results that can follow from "mechanical application" of the Guidelines.[8] Panelists have noted, however, that far more flexibility than is indicated in the Guidelines is both the norm of actual Agency practice and, moreover, appropriate given the diversity of considerations that are presented in the range of transactions confronted by the Agencies. Thus, as a matter of both actual practice and sound theory, some adjustment of the description of the analytical process used by the Agencies seems appropriate.

Implicit in deemphasizing the sequential nature of the Guidelines inquiry is a recognition that defining markets and measuring market shares may not always be the most effective starting point for many types of merger reviews. Remember, the purpose of defining a market and assessing shares is to assess potential harm. When it is clear, for instance, that either certain vulnerable customers are likely to be harmed by a merger, or that certain customers have in fact been harmed by a consummated merger, the need to define a market to assess likely competitive effects is diminished. For instance, the consumer harm that followed from the consummated Evanston hospital transaction lessened the importance of the Commission's market definition and market share analyses in that matter.[9] Our panelists have largely confirmed the view that market definition

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8 HORIZONTAL MERGER GUIDELINES, *supra* note 1, § 0.

9 Opinion of the Commission, *In re* Evanston Nw. Healthcare Corp., FTC No. 9315, *available at* http://www.ftc.gov/os/adjpro/d9315/070806opinion.pdf.

should not be an end-all exercise. Rather, it is something to be incorporated in a more integrated, fact-driven analysis directed at competitive effects.

Of course, this is not news. The Commentary on the Horizontal Merger Guidelines explained that the Agencies apply the Guidelines framework flexibly,[10] and those practicing before the Agencies have been aware for some time that market concentration is more important in some cases than others. For instance, a merger involving a new, disruptive entrant may well impact competition far more than market shares might suggest. Similarly, the Division's Merger Review Process Initiative has recognized the appropriateness of tailored second request schedules designed to enable the Division to take a "quick look" at "potentially dispositive issues" such as "failing firm" and "entry" at the outset of an investigation, thus precluding the need for the full, sequential review outlined in the Guidelines.[11] Expressly acknowledging this flexibility in the Guidelines themselves seems like a useful increase in transparency.

The next area I would like to discuss is one where the Guidelines appear to inaccurately describe the Agencies' enforcement policy. As the Merger Challenges Data that I referred to earlier in this talk indicate, it is relatively rare for the Agencies to challenge mergers that will lead to HHI concentration levels below 1,800.[12] Yet the Guidelines indicate that such mergers "potentially raise significant competitive

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10 COMMENTARY, *supra* note 5, at 1.

11 U.S. Dep't of Justice, Merger Review Process Initiative (rev. ed. 2006), *available at* http://www.justice.gov/atr/public/220237.pdf.

12 *See* MERGER CHALLENGES DATA, *supra* note 6, at 3 tbl.1.

concerns."[13] Similarly, the Guidelines suggest that a 100 point increase in an HHI concentration level raises competitive concerns.[14] In actual practice, however, the Agencies have only infrequently challenged mergers unless they increase concentration several times that much.[15]

More broadly, our panelists have generally confirmed that the Guidelines overstate the importance of HHIs in merger analysis. It will not surprise you that HHIs have been the focus of neither a party presentation nor a staff recommendation since I've been the Assistant Attorney General. That reality reflects the current state of economic thinking, where HHI levels are given a far less prominent place as a predictive tool for assessing competitive effects than the one suggested by the current Guidelines. In that vein, I note that, while many panelists have noted their usefulness as a tool for assessing likely competitive effects, none has maintained that HHIs should be the key driver of enforcement decisions.

It is thus relatively clear that the HHI thresholds set forth in the Guidelines no longer capture agency practice or economic learning about the kinds of mergers that are most likely to lead to consumer harm. Revising the HHI thresholds to express accurately how the Agencies use HHIs seems not just appropriate but also necessary to correct what has become an affirmative misstatement at this point.

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13 HORIZONTAL MERGER GUIDELINES, *supra* note 1, § 1.5.

14 *Id.*

15 *See* MERGER CHALLENGES DATA, *supra* note 6, at 3 tbl.1.

A third area I would like to discuss concerns unilateral effects. This is an area where economic thinking and Agency practice have progressed significantly since 1992, when the concept of adverse unilateral effects was first explicitly introduced in the Guidelines. That introduction was a major step forward, but the treatment of unilateral effects was sparse, and several of our panelists and commentators have noted that significant advances in thinking have taken place since 1992.

Unlike the HHI thresholds I just discussed, where the gaps are more in the nature of misstatements, in the area of unilateral effects the gaps are more in the nature of omissions. There are important considerations that the Agencies routinely employ when assessing unilateral effects but are not mentioned or even alluded to in the Guidelines, and our panelists have likewise identified a number of considerations that are used in their practices and academic work to assess unilateral effects but are not discussed in the Guidelines. Diversion ratios, price-cost margins, win-loss reports, customer switching patterns, and the views of competitors, customers, and industry observers, for instance, are all tools used to analyze mergers of firms selling differentiated products. Yet the Guidelines say rather little about how the Agencies use these types of evidence to assess unilateral effects.

In fact, when assessing pricing effects in markets with differentiated products, both Agencies employ a variety of techniques to evaluate whether the merger is likely to lead to higher prices. There is a growing body of evidence that measures of upward pricing pressure, which focus on diversion ratios, and price-cost margins, can be highly informative in assessing the likelihood of unilateral pricing effects.

Unilateral effects can arise along many dimensions of competition, including pricing of differentiated products, negotiations between buyers and sellers, output and capacity for more homogeneous products, product variety, and innovation. The Agencies have accumulated a great deal of experience analyzing such effects that is not reflected in the Guidelines. Updated Guidelines can enhance transparency by explaining how the Agencies evaluate unilateral effects along these dimensions.

I'll briefly mention five other areas where clarification of the Guidelines appears to be worthwhile. First, the discussion in the Guidelines of targeted customers and price discrimination could usefully be clarified. Many of our cases involve price discrimination,[16] yet the Guidelines treatment of price discrimination is quite abbreviated. Second, the Guidelines could more accurately convey actual Agency practice by indicating that market shares are normally assessed using recent or projected sales in the relevant market, while explaining the conditions under which other measures such as capacity may be used. Third, different parts of the Guidelines employ closely related concepts of supply-side responses by non-merging firms: expansion by firms already selling in the relevant market, uncommitted entry, repositioning, and committed entry. A number of panelists suggested a more unified approach to the concepts of expansion, entry, and repositioning. Fourth, the Guidelines could clarify that coordinated effects can arise through accommodating behavior among a small number of rivals without the necessity of

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16 *See, e.g.*, Complaint, United States v. Dean Foods Co., No. 10-C-0059, ¶ 46 (E.D. Wis. filed Jan. 22, 2010) (alleging price discrimination market).

reaching terms of coordination. Lastly, several panelists have pointed out that the Guidelines are virtually silent regarding innovation, despite widespread recognition that innovation generates enormous value for consumers over the long run. A revision could move the Guidelines into the 21st century by explaining how the Agencies account for market dynamics, the procompetitive role of disruptive entrants, and a merger's effect on innovation.

It is now time to turn to our expert panelists, but I would first like to reiterate several notes of thanks. To all our panelists and those who either have submitted or will submit comments, thank you for volunteering your time and expertise. You are all rendering an important public service. I would also like to offer my warm thanks to the Federal Trade Commission and Antitrust Division staffs who have worked very hard to organize these workshops. I'm particularly appreciative of the cooperative relations we have had with the Federal Trade Commission and would like to thank them for their hospitality today.