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Agencies Release Merger Guidelines Revisions for Comment; "Flexibility" Increases but Predictability May Suffer

The DOJ and FTC have released for public comment a proposed revision of their 1992 Horizontal Merger Guidelines, which for almost two decades have been used by both agencies to evaluate mergers subject to federal review under Section 7 of the Clayton Act. The 1992 Guidelines have been subject to occasional and modest revisions and updates since their issuance, most recently in 1997, but the new Guidelines are a "top to bottom" rewrite of the 1992 Guidelines.

The proposed Guidelines revision incorporates new methods of economic analysis that have evolved or emerged since 1992, and uses new tools not envisioned in the 1992 Guidelines. However, the analytical tools described in the new Guidelines are evolutionary not revolutionary; they will be familiar to members of the merger review bar because they capture methods of analysis that have already been adopted in practice by the agencies.

The High Points

The most significant proposed changes in the new Guidelines are the following:

• **Market definition** continues to play a role in the analysis of competitive effects, but a much diminished role. It is no longer a required part of the analysis but rather plays a subordinate role to a variety of more direct approaches to measuring welfare changes. The hypothetical monopolist test continues to be applied in defining markets, and critical loss analysis is adopted as the tool for undertaking the hypothetical monopolist test. While these are significant changes from the 1992 Guidelines, they do not reflect changes in current practice at the agencies.

• **HHI tests** continue to play a role, with a slight change. The HHI thresholds in a highly concentrated market have been adjusted upward: in the new Guidelines, a merger will be presumed to enhance market power where there is a post-merger HHI of 2500 with a delta of 200 (as opposed to a post-merger HHI of 1800 with a delta of 100 in the current version of the Guidelines).

• **Entry** continues to play an important role, and the "timely, likely, and sufficient" requirements continue substantially as before. However, the new Guidelines are skeptical of entry where there is no demonstrated history of entry sufficient to constrain post-merger price increases; the two-year window for entry has been dropped (the new Guidelines do not define a timeliness window); and sufficiency is equated with the market presence of one of the merging firms.

• **Innovation** plays a greater role in the new Guidelines, reflecting the increased importance of innovation in the economy as a whole, as well as the lessons learned by the agencies from their review of mergers in innovation-intensive industries.

• Through the 1980s, the agencies focused principally on **"coordinated effects"** — the increased competitive risks flowing from explicit or implicit cooperation among the reduced number of rivals in a post-consummation world. **"Unilateral effects"** — meaning the reduction in competiveness

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resulting from the unilateral action of the merged firm post consummation — was introduced in the 1992 Guidelines and plays a much larger role in the new Guidelines.

Accuracy, Flexibility, Transparency May Improve; Will Predictability Decrease?

The agencies have presented the new draft Guidelines as a substantial improvement over the 1992 Guidelines, and their metrics for improvement are accuracy, flexibility, transparency, and predictability. Initial reactions from commentators and from the antitrust bar have been mixed but largely enthusiastic, and it will be interesting to see what the comment period produces. Because the agencies sought and received substantial public input into the preparation of the draft Guidelines, it is unlikely that any substantially new issues will be raised during the comment period and incorporated into the final version, but some minor changes may be made. The public comment period closes May 20.

Each of the values the agencies seek to advance in the Guidelines are time-honored enforcement goals, but there are some inherent tensions among them. For example, both flexibility and predictability are critical in an enforcement regime, but the most flexible approach often offers the least predictable outcomes, and vice versa. The art of developing Guidelines involves skillful compromises in order to achieve the greatest net benefit.

Not surprisingly, the highest enforcement values reflected in the Guidelines appear to be accuracy of outcome, flexibility in approaches, and procedural transparency. The wide range of new ("new" meaning as compared to the 1992 Guidelines) analytical tools contained in the Guidelines have been pressure-tested through practical application by the agencies in conducting merger reviews over recent years, and for the most part the academic community, enforcement agencies, and the private bar have found these tools to be useful and accurate. Thus, the draft Guidelines generally restate current enforcement approaches, with a shift in emphasis away from market definition and toward measuring welfare changes.

Agency watchers have seen this shift take place in recent years both through hands-on merger review at the agencies and through following the academic dialogues in which the agencies participate. For example, the interesting and revealing April 2007 Discussion Paper from the DOJ's Economic Analysis Group entitled "Market Definition: Use and Abuse" anticipated much of the thinking reflected in the new draft Guidelines, particularly the shift away from market definition and toward directly measuring changes in welfare.

While the shift away from market definition reflects recent academic thinking, it also moves away from a core issue that the agencies have had difficulty mastering in court. Market definition analysis was the central issue in a number of high profile merger challenges in which the government fared badly, including Arch Coal/Triton, Oracle/PeopleSoft, and Whole Foods/Wild Oats. Perhaps not coincidently, the new Guidelines repeatedly downplay market definition, stating: "the agencies' analysis need not start with market definition"; "market definition is not an end in itself: it is one of the tools that the agencies use..."; "diagnosing unilateral effects need not rely on market definition or the calculation of market shares or concentration"; and "[the agencies will] implement these principles of market definition flexibly[.]"

While it is understandable that for strategic reasons the agencies may wish to move away from a test that has proved to be a litigation obstacle, it is not clear that the courts will follow. The centrality of market definition to litigated merger challenges is deeply ingrained in the lower courts, which have found market definition to be an accessible approach for generalist judges, and endorsed by the Supreme Court, which has required market definition in Section 7 challenges. Notably the

Guidelines state that they are "not intended to describe how the Agencies will conduct the litigation of the cases they decide to bring." The likelihood is that in future challenges the government will try to convince the courts to uphold a challenge by using the more flexible and advantageous (to the government) tools described in the Guidelines, but they also will present a parallel traditional market definition and concentration analysis in support of their arguments.

Some Drawbacks

Of course, the new provisions in the draft Guidelines will not satisfy every constituency. While the draft Guidelines substantially improve parties' ability to predict intermediate steps in investigations — such as the full range of tools that the agencies may use to examine deals — they preserve agency flexibility to such a degree that they may jeopardize the predictability of the outcome. There are few hard standards or thresholds embraced in the new Guidelines, leaving the agencies free to apply differing standards over time, among industries, or between enforcers or administrations.

Additionally, some of the analytical tools proposed in the new Guidelines are particularly data-hungry, and much of the data they require may not be readily accessible to some businesses or their lawyers. This may make merger review more costly and prolonged as the parties develop and submit the materials required for analysis. For relatively small transactions, this may be a more noticeable burden, although it will be a smaller consideration for executives involved in substantial transactions. For members of the private bar, in all but the clearest cases it will be more difficult to reach even preliminary and tentative conclusions about the likely enforcement perspective on a potential transaction because the analytical shift is away from market power, which is more easily "guess-timated," and toward changes in welfare, for which intuition may not be accurate and client perspectives may be uninformed.

Conclusion

The release of the new Guidelines is a major development in the important area of merger review. The 1992 Horizontal Merger Guidelines were among the most cited documents in modern antitrust practice, and they standardized merger review, making it more sophisticated and more transparent. The new draft Guidelines do likewise but the great flexibility in approach retained by the enforcers comes at some cost to predictability. The most significant conceptual change in direction is the continued shift away from market definition, which has been a troublesome exercise in the courts for both the DOJ and FTC, and toward direct measurement of merger-related welfare changes.

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