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U.S. Antitrust Agencies Propose Revisions to Merger Guidelines

On April 20, 2010, the Federal Trade Commission released for public comment a proposed revision of the Horizontal Merger Guidelines.¹ The Guidelines, developed jointly by the FTC and the U.S. Department of Justice Antitrust Division (and last revised in 1997), outline the policies and practices used by the enforcement agencies in evaluating mergers of actual or potential competitors under the antitrust laws.² The newly proposed revisions to the Guidelines contain several significant changes, including: updated market concentration thresholds; new discussions of the evidence that enforcement agencies consider in analyzing mergers and the economic and other types of analysis they apply; a new explanation of the role of innovation in merger enforcement, which may be of particular interest to businesses in technology-based industries; new guidance with respect to mergers of competing buyers; and a new section addressing partial acquisitions, which may impact private equity firms, among others. The period for public comments on the proposed Guidelines closes on May 20, 2010.

The current revision process began in September of last year, with the agencies' announcement that they would solicit public comments and hold a series of five joint public workshops to address the possibility of updating the Guidelines. The Agencies invited numerous lawyers, economists, academics, and others to participate in the workshops, including Joe Simons and Dan Crane from Paul, Weiss.³ In remarks presented at the final Guidelines workshop, Assistant Attorney General Christine Varney acknowledged that "there are indeed gaps between the Guidelines and actual agency practice," and outlined certain areas in which revisions would be desirable – including updating the agencies' guidance with respect to concentration levels at which a merger is likely to be challenged and including a fuller discussion of techniques the agencies may use to assess pricing effects, especially in markets consisting of differentiated products.⁴ The proposed Guidelines address these and other significant issues.

¹ Horizontal Merger Guidelines, For Public Comment: Released on April 20, 2010, available at <http://www.ftc.gov/os/2010/04/100420hmg.pdf> ("Proposed Guidelines").

² In 2006, the DOJ and FTC issued a joint Commentary on the Guidelines addressing some of the same issues as the recent revisions, but did not revise the Guidelines themselves. Fed. Trade Comm'n & U.S. Dep't of Justice, Commentary on the Horizontal Merger Guidelines (Mar. 2006), available at <http://www.justice.gov/atr/public/guidelines/215247.pdf>.

³ Joseph J. Simons & Daniel A. Crane, Comments to the Federal Trade Commission and Department of Justice Antitrust Division, *Unified Merger Analysis: Integrating Anticompetitive Effects and Efficiencies, and Emphasizing First Principles* (Nov. 2009), available at <http://www.ftc.gov/os/comments/horizontalmergerguides/545095-00007.pdf>.

⁴ Christine A. Varney, An Update on the Review of the Horizontal Merger Guidelines (Jan. 26, 2010), available at <http://www.justice.gov/atr/public/speeches/254577.pdf>.

What Has Changed

Consistent with almost every public comment submitted, the proposed Guidelines include updated market concentration thresholds. One method the agencies use to determine the likelihood that a proposed merger will raise competitive concerns is to apply the Herfindahl-Hirschman Index (“HHI”) of market concentration.⁵ Under the existing Guidelines, markets with a post-merger HHI between 1000 and 1800 are considered “moderately concentrated” and markets with a post-merger HHI above 1800 are regarded as “highly concentrated.” Yet, it is widely acknowledged that these thresholds do not accurately reflect the actual, historical practice of the DOJ and FTC with respect to merger challenges.⁶ As AAG Varney pointed out: “it is relatively rare for the Agencies to challenge mergers that will lead to HHI concentration levels below 1,800.”⁷

In the proposed Guidelines, the agencies raise the threshold for highly concentrated markets to those with HHIs above 2500 and for moderately concentrated markets to those with HHIs between 1500 and 2500. The proposed Guidelines also emphasize that the agencies will not apply the HHI thresholds mechanically to determine which mergers they will challenge and which they will not. Rather, these thresholds “provide one way to identify those mergers for which it is particularly important to examine whether other competitive factors confirm, reinforce, or would counteract the potentially harmful effects of increased concentration.”⁸

The proposed Guidelines continue to use the hypothetical monopolist test for market definition, but they also contain significantly revised discussions of techniques the agencies employ to implement that test and to determine the likely pricing effects of a merger. One such technique is Critical Loss analysis that was developed by our partner Joe Simons in conjunction with a former chief economist at the Department of Justice Antitrust Division. Although the use of this technique was already well established at the agencies and in the courts, the draft Guidelines suggest it may be applied in a way that could result in the definition of substantially narrower markets. The proposed Guidelines also expand the discussion of unilateral effects analysis and include for the first time a reference to Upward Pricing Pressure (“UPP”), an approach developed by the chief economists of the FTC and Antitrust Division. Depending on how UPP is applied, it can predict price effects from mergers that would not have previously attracted scrutiny.

The proposed Guidelines contain several entirely new sections, as well. These include:

- a section addressing the sources and types of evidence that the agencies consider in determining whether a merger is likely to reduce competition. In addition to market shares and concentration levels, the proposed Guidelines suggest that the agencies will consider historical data from already consummated mergers in the relevant market or analogous markets, whether the merging parties have been head-to-head competitors in the past, and whether a merger would eliminate a “maverick” firm – *i.e.*, one that has played a disruptive role in the market to the benefit of consumers;
- a section addressing the impact of powerful buyers on the ability of merging parties to raise prices, and also a section on mergers of competing buyers and the possibility that such mergers will lead to increases in “monopsony” power;

⁵ HHI levels are calculated by summing the squares of the market shares of each firm in a relevant market.

⁶ See Simons & Crane, *supra* note 3.

⁷ Varney, *supra* note 4, at 7.

⁸ Proposed Guidelines at 19.

- a section addressing “partial acquisitions,” in which a firm acquires a minority stake in one or more competitors. The analysis of such acquisitions, which have not traditionally been a target of merger enforcement but which the agencies suggest may lessen competition in a variety of ways, is of particular interest to private equity investors; and
- a section addressing the potential adverse effects that a merger may have with respect to firms’ incentives and ability to innovate – an issue of significant concern for businesses in the technology and pharmaceutical industries, among others.

Open Questions

Throughout the proposed Guidelines, and in public comments about them, the agencies have stressed that “merger analysis does not consist of uniform application of a single methodology.”⁹ Rather than prescribing such a methodology for merger enforcement, the Guidelines are intended to provide the business community with a transparent description of the various tools and approaches the agencies actually use in analyzing horizontal mergers. Nevertheless, the proposed revisions raise a number of questions with respect to possible changes in agency practice going forward.

For example, while the proposed Guidelines reflect higher market concentration thresholds than the existing Guidelines, the HHI thresholds for “moderately concentrated” markets arguably still encompass a far broader range of transactions than the agencies – for at least the past two decades – have shown a willingness to challenge. The proposed Guidelines do not specify the source of the new HHI thresholds, and it is unclear whether and to what degree they are intended to signal a departure from historical practice.

Likewise, the proposed Guidelines’ expanded discussion of how the agencies may apply the hypothetical monopolist test – and the economic assumptions that appear to underlie the application of that test as well as other analytical tools, such as UPP – arguably leave open the possibility that the agencies will challenge mergers that would not have received close scrutiny in the past.¹⁰

What’s Next

The FTC will continue to accept public comments on the proposed Guidelines through May 20, 2010. Based on the comments received, and on internal discussions, the DOJ and FTC may choose to make further revisions to the Guidelines before they are accepted as final.

* * *

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Any questions concerning the issues addressed in this alert may be directed to:

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⁹ Proposed Guidelines at 1.

¹⁰ See generally Malcolm B. Coate & Joseph J. Simons, *Critical Loss v. Diversion Analysis: Another Attempt at Consensus*, Competition Policy Int’l (Apr. 2010); David Scheffman & Joseph Simons, *Unilateral Effects for Differentiated Products: Theory, Assumptions & Research*, The Antitrust Source (Apr. 2010).