July 27, 2015

**FTC’s Challenge to Family Dollar/Dollar Tree Merger Suggests Potential for Significant Increase in Merger Enforcement**

The Federal Trade Commission preliminarily approved a settlement to resolve its concerns that the acquisition of Family Dollar Stores, Inc. by Dollar Tree, Inc. would substantially lessen competition. As part of its investigation of the merger, the Commission staff employed a relatively new analytic approach – the gross upward pricing pressure index, or GUPPI. This approach requires only a limited amount of information and has previously been used only as a screen for assessing whether potential mergers merit further investigation or as part of a broader analysis. The GUPPI uses only the margins of the merging parties and the percentage of sales that would be diverted from one to the other in the event of a price increase by one of them (generally known as the diversion ratio). The statements of the Commission and dissenting Commissioner Wright concerning the proposed settlement each discuss the proper use of the GUPPI analysis. They are notable because: (1) the Commission declined to establish a safe harbor for transactions with low GUPPIs, and (2) the Commission appears to have required divestitures in markets with very low GUPPIs, suggesting a significant increase in the number of markets where potential mergers may be subject to challenge.

The Commission staff identified some 330 local geographic markets in which it believed the merger would allow the combined Dollar Tree-Family Dollar to raise prices. This finding, based on the GUPPI analysis and other factors, was accepted by the majority of the Commissioners. Commissioner Wright, however, dissented in part from the Commission’s decision, citing 27 markets in which the Commission is requiring divestitures although he believed there was a sufficiently low GUPPI (below 5%) that the merger would not harm competition. Commissioner Wright urged the FTC to “adopt a safe harbor in unilateral effects

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1. See Analysis of Agreement Containing Consent Orders in Aid of Public Comment, In the Matter of Dollar Tree, Inc. and Family Dollar Stores, Inc., F.T.C. File No. 141-0207 (July 2, 2015) at 1, 3. The proposed Decision and Order requires Dollar Tree to divest 330 Family Dollar stores located in areas where Dollar Tree and Family Dollar directly compete. See id. at 4.
2. Id.
merger investigations by defining a GUPPI threshold below which it is presumed harm is unlikely.”6 The majority declined to do so even though this is the approach the Department of Justice Antitrust Division is believed to follow.7

The GUPPI attempts to measure the incentives for a merged firm to raise price unilaterally after a merger. Its premise is that if one firm raises price, it will lose some sales to other competitors and lose the associated profit margin. Absent the merger, the loss of sales to competitors stops the first firm from raising price. If the first firm merges with a competitor, however, the merged firm retains the value of sales that would have been diverted to the competitor premerger (lost sales times margin) and, thus, the merger increases incentives to raise price. Where such incentives are sufficiently strong, there is a basis for concern that prices will rise.

The $64,000 question is when incentives to raise prices are “sufficiently” strong that enforcement authorities should be concerned. Any merger between horizontal competitors produces a positive GUPPI and thus arguably every horizontal merger produces some incentive to raise price. But to assume that every horizontal merger is anticompetitive would be a virtual return to the discredited standard applied by the federal enforcement authorities during the 1960s. The FTC’s failure to adopt a low GUPPI safe harbor revives fears of 1960s style over-enforcement.

Paul, Weiss antitrust group co-chair Joseph J. Simons and FTC economist Malcolm B. Coate have urged caution in the use of the GUPPI.8 They point out that GUPPI may identify as anticompetitive “a large class of mergers generally considered innocuous or even pro-competitive.”9 Commissioner Wright, citing the work of Simons and Coate, agreed that “GUPPI-based presumption of competitive harm is inappropriate at this stage of economic learning.”10

Commissioner Wright urged that the GUPPI of less than 5 percent should be used to demarcate a “safe harbor . . . below which it is presumed competitive harm is unlikely.”11 Because the Commission declined to adopt his suggestion, antitrust practitioners, business executives and dealmakers – at least with respect

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6 Id. at 1-2.
7 Commission Statement at 2.
9 Id.
10 Wright Statement at 8 (emphasis in original).
11 Id. at 1-2.
to mergers investigated by the FTC\textsuperscript{12} – are left without a potentially valuable tool to reduce regulatory uncertainty for deals with potential unilateral effects concerns. Moreover, if the Commission believes that transactions with GUPPIs of 5 percent or lower may cause competitive harm, this could lead to dramatic increases in enforcement activity, causing Commission staff to investigate (and possibly demand remedies for) transactions which historically would not have been of concern.

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

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\textsuperscript{12} Commissioner Wright suggests that the Antitrust Division of the Department of Justice does recognize an under-five-percent safe harbor. \textit{Id. at} 4.