DOJ and FTC Issue Proposed New Horizontal Merger Guidelines

The Proposed Guidelines Seek To Promote Transparency by More Clearly Identifying and Explaining the Current Flexible Analytic Approach Used by the Agencies When Analyzing Mergers

SUMMARY

The DOJ and FTC have issued revised Horizontal Merger Guidelines for public comment. The new guidelines more accurately reflect how the Agencies review mergers in practice than do the current guidelines, which were issued in 1992, and which experienced counsel have long known did not represent current Agency practice. Although there are some new clarifications, by and large the proposed guidelines reflect the way in which the Agencies have been reviewing mergers for many years.

The new guidelines do stress, however, the well-recognized point that merger review is a fact-based process that relies on analytical tools that may vary depending upon the particular characteristics of the industry, the products and the marketplace. This approach provides the Agencies with maximum flexibility in deciding what methodologies to use in analyzing the competitive effects of mergers, but naturally creates a great deal of uncertainty to the parties to any given merger. The Agencies' flexible analytical approach will place a premium on counsel for the merging parties having conducted a thorough analysis in advance of the Agencies' review.

DESCRIPTION OF THE REVISED GUIDELINES

The Proposed Guidelines are said to provide greater transparency and “more accurately reflect the way the FTC and DOJ currently conduct merger reviews.” To the extent they achieve that stated goal, the Proposed Guidelines are beneficial to antitrust practitioners. Experienced antitrust counsel have long recognized that the 1992 Guidelines, with their heavy emphasis on market definition, market shares, and the Herfindahl-Hirschman Index (“HHI”) of market concentration, do not accurately reflect how the Agencies have been reviewing mergers in recent years.

The Proposed Guidelines make clear that, in practice, the Agencies use a highly flexible approach and a “variety of tools” in analyzing whether a merger will substantially lessen competition. The guidelines state, for example, that market definition “is not an end itself or a necessary starting point,” but is just one “tool” that is used, among many, in merger analysis. The 1992 guidelines, in contrast, stated that market definition was the starting point, albeit not the determinative point, of the analysis. To emphasize the difference between the 1992 Guidelines’ fairly mechanistic approach to merger analysis that began with market definition and concentration analysis, the Proposed Guidelines instead begin with a description of several types of direct evidence the Agencies often look to when analyzing competitive effects. Just two of the listed types of evidence are market shares and concentration.

The Proposed Guidelines’ initial sections also provide a practical description of the most common sources of evidence, including documents, data and testimony provided by the merging parties, and information and views provided by customers and other industry participants. Again, experienced counsel know that contemporaneous documents obtained from the files of the merging parties, together with the views of customers, are extremely important to the Agencies’ ultimate conclusions about the competitive effects of a proposed merger. The Proposed Guidelines make this explicit, along with the Agencies’ well-known skepticism of competitors’ views about a proposed merger.

Although the Proposed Guidelines do a good job of reflecting the actual practices of the Agencies, they also make clear that the Agencies will exercise flexibility in deciding which tools in the “tool box” to use in analyzing any given merger. It will be important for antitrust counsel to be prepared to persuade the agencies as to the appropriateness of using various tools in a particular merger review and to know in advance how the use of all those tools could impact the analysis. This approach provides somewhat less predictability than did the 1992 Guidelines. The Proposed Guidelines leave open the possibility that in challenging a merger, the Agencies can choose whichever method of analysis is most likely to support their case. Indeed, the Proposed Guidelines seem to have been written with one eye towards leaving the Agencies with maximum flexibility should they need to go to court to block a merger. It will be incumbent upon the merging parties to show that another tool is more meaningful.

Summarized below are some of the additional important differences between the current and Proposed Guidelines:

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The Proposed Guidelines expand the discussion of potential “unilateral” effects, which was introduced in the 1992 Guidelines. Unilateral effects may occur, for example, when the merging parties are able to raise prices on their own because there are only a few market participants, and the products of the merging parties are “very close substitutes” for each other. The Proposed Guidelines better reflect that many merger challenges today are based on a unilateral effects theory -- in contrast to “coordinated” effects -- and describe some of the common evidence that the Agencies rely on, such as “win/loss reports,” “customer switching patterns” and “customer surveys.” The Proposed Guidelines also describe some of the analytical tools the Agencies use to determine if unilateral effects are likely, such as measuring “diversion ratios” and preparing merger simulations, and formally introduce a new and controversial tool directed at measuring the “upward price pressure” created by a merger based on valuing sales likely diverted from one merging firm to the other when the merged firms’ products are close substitutes for one another. Few courts have relied solely on a unilateral effects theory or applied these new analytical tools in merger analysis, and it will be interesting to see how the courts treat them in the future.

The Proposed Guidelines also discuss more explicitly than before the Agencies’ view that there may be a number of properly defined relevant markets in which at least some mergers should be reviewed, and that there is not necessarily a single “correct” market. In this context, the Proposed Guidelines discuss at length the Agencies’ likely attention to analyzing whether the merging parties will be able to price discriminate against a targeted set of customers. Where this is the case, the Agencies may define a product market to include only a subset of customers, or may eschew market definition and instead simply focus on the likely competitive effects of the merger with respect to this subset of customers. This approach is consistent with recent practice of the Agencies, but it remains to be seen whether it will be accepted by the courts when merger challenges go to litigation.

The Proposed Guidelines provide a revised description of how the Agencies apply the “hypothetical monopolist test” in defining relevant antitrust markets, which better reflects how the test has been applied in practice. The Proposed Guidelines also describe some of the analytical tools the Agencies use in applying the hypothetical monopolist test, including a description of the “critical loss analysis” that may be employed by the Agencies when the necessary data is available.

As noted, the Proposed Guidelines put much less emphasis on market shares, market concentration and the HHI test of market concentration than do the 1992 Guidelines. The Proposed Guidelines also raise the HHI thresholds for “unconcentrated,” “moderately concentrated” and “highly concentrated” markets to levels that more accurately reflect agency practice. For example, the 1992 Guidelines provide that a merger producing an HHI increase of more than 100 points in a market with a post-merger HHI of more than 1800 will be “presumed” likely to create or enhance market power. The Proposed Guidelines reserve that presumption (which is rebuttable) for mergers producing an HHI increase of more than 200 points in a market with a post-merger HHI of more than 2500.

The Proposed Guidelines provide a simplified and somewhat different description of how the Agencies evaluate potential new entry into the relevant market. For example, the Proposed Guidelines replace the confusing term “uncommitted entrants” with “rapid entrants” to describe firms that could quickly and easily enter a market in response to a small but significant and non-transitory increase in price. The Proposed Guidelines make clear that such “rapid entrants” will be considered current “market participants and may be assigned market shares.” The biggest difference in the entry discussion is the elimination of the explicit two-year time period within which any projected entry must be shown likely to occur. The new guidelines simply say that entry “must be rapid enough” to defeat a post-merger price hike. Statements by Agency personnel suggest this change indicates a shortening, not a lengthening, of the period.

The Proposed Guidelines add new sections on (i) markets that have “powerful buyers,” (ii) mergers between “competing buyers” that may gain “monopsony power,” and (iii) partial acquisitions of a competitor that do not result in control but which may nonetheless lead to a substantial lessening of competition between the two firms. The last of these three new sections will be of particular interest to private equity firms that own stakes in different portfolios that compete with one another.

Finally, the Proposed Guidelines contain a section on “efficiencies” that is largely unchanged in substance from that added to the 1992 Guidelines in 1997. As before, the agencies will carefully
scrutinize claimed efficiencies resulting from a merger, and such efficiencies are unlikely to persuade the agencies to approve a merger that is perceived to have substantial anticompetitive effects.

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