ALERT MEMORANDUM

FTC & DOJ Propose Radical Changes to Merger Guidelines

The new draft guidelines depart from decades of practice by introducing novel presumptions that could make it harder for mergers to obtain regulatory clearance from the agencies.

July 21, 2023

On July 19, 2023, the FTC and DOJ published draft merger guidelines.[1] Historically, the purpose of these guidelines has been to provide the public, including companies whose transactions are potentially subject to agency review, with information about how the agencies analyze mergers to identify potential competitive harm. The guidelines have no force of law and are not binding on the courts, though courts have relied on them as persuasive authority to varying degrees. Past iterations of the guidelines have therefore provided a neutral explanation of the agencies' approach, including descriptions of the economic tools that they and the courts can use to assess a merger's likely competitive effects.

In contrast to prior versions, the proposed draft guidelines offer a one-sided view of mergers' likely competitive effects, and cite extensively but selectively to antitrust precedent in an effort to support that view. Over half of the cases that the draft guidelines cite are from the 1970s or earlier, and those cases are cited four times more often than cases from this century. The proposal does not cite any of the recent agency losses. In this respect, much of the document is more like a legal brief. The courts may give these guidelines little or no weight as they do not defer to the agencies' interpretation of law, and the proposal ignores current cases and analytic tools to instead focus on precedent that is widely considered outdated.

The proposal also departs substantially from the substantive approaches to merger analysis reflected in prior guidelines. Broadly, the draft guidelines reflect the current agency leadership's avowed hostility toward mergers, and an effort to correct for what they seem to view as overly-permissive precedent. Below, we summarize the key differences between prior guidelines and the draft proposal.

[1] The FTC and DOJ initially announced their intention to update the guidelines on January 18, 2022. For background on that announcement, please see our alert.

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Renewed Emphasis on Structural Presumptions

The draft guidelines slash the thresholds for horizontal concentration as measured by the Herfindahl-Hirschman Index (“HHI”) at which the agencies view markets as “moderately concentrated” or “highly” concentrated, returning the cutoffs to the values used in the 1982 Merger Guidelines.[2]

Concentration	2023 Proposal	2010 HMG
Moderate	1,000-1,800	1,500-2,500
High	>1,800	>2,500

Simultaneously, the draft guidelines halve the change in HHI required for a presumption of anticompetitive impact to attach to a transaction that results in a highly concentrated market, from 200 to 100.[3] The practical implication would be to treat many transactions that are routinely cleared today as presumptively unlawful. For example, consider an industry with four firms that each have a 20% share, and then two smaller competitors, one of which has a 15% share and the other of which has a 5% share. The proposed Guidelines would treat a merger between the two smallest firms as presumptively anticompetitive.[4]

The proposal also introduces a new basis for a structural presumption. Mergers resulting in firms with combined shares of over 30% are presumed to substantially lessen competition provided that the change in HHI is at least 100.[5] Thus, for instance, a merger of two firms, one with a 28% share and the other with a 3% share, would be presumptively anticompetitive.[6] In support of this 30% threshold, the draft guidelines cite dicta from the 1963 Supreme Court ruling in *United States v. Philadelphia National Bank* stating that a 30% share may present an undue threat of concentration. But only a decade after that case, the Supreme Court rejected the idea that substantial lessening of competition is shown simply

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[2] Draft Guidelines at 6.

[3] *Id.* at 6-7.

[4] This transaction would have a post-merger HHI of 2000 and a change in HHI of 150.

[5] Draft Guidelines at 7.

[6] This transaction would create a company with a post-merger market share of 31% and a change in HHI of 168.

by comparing companies' combined market share to market shares found anticompetitive in the past.[7]

The draft guidelines are silent as to how strong the presumption is, though acknowledge that the agencies may examine "other pertinent factors" in assessing the probable competitive effects of a merger.[8] However, under the burden-shifting framework of *United States v. Baker Hughes*—which the draft guidelines do not acknowledge even though no circuit has declined to adopt that framework—merging parties may rebut a structural presumption of competitive harm by producing evidence about a multiplicity of factors, such as entry, efficiencies, or the financial condition of the merging parties.[9] The burden of producing additional evidence to prove anticompetitive effects then shifts back to the government, which carries the burden of persuasion at all times.[10]

Reluctance to Credit Arguments that Would Rebut the Structural Presumption

The draft guidelines are generally skeptical of arguments that other market factors could rebut the structural presumptions used by the guidelines. And even the limited arguments that the draft guidelines entertain are circumscribed to specific scenarios. But the notion that merging parties can use only certain discrete "defenses" to rebut a structural presumption disregards precedent. In *Brown Shoe Co. v. United States*, the Supreme Court explained that although market share statistics "are, of course, the primary index of market power [] only a further examination of the particular market—its structure, history and probable future—can provide the appropriate setting for judging the probable anticompetitive effects of a merger."[11] Applying this guidance, *Baker Hughes* rejected the notion that merging parties are limited to specific defenses, explaining that such an approach "would improperly narrow the Section 7 inquiry, channeling what should be an overall analysis of competitiveness into a determination of whether a defendant has shown particular facts."[12]

Declines in the future competitiveness of one of the firms. The draft guidelines acknowledge only the "failing firm" defense as a means of rebutting the structural presumption on the grounds of the merging parties' economic viability.[13] They explicitly reject the so-called "flailing-firm" defense, which refers to instances where a merging party may not exit the market entirely, but its future ability to compete will nonetheless decline such that present market shares do not accurately reflect is competitive significance.[14]

Entry. The draft guidelines recognize entry as a rebuttal argument only if entry is timely, durable, likely, and will "at least replicate the scale, strength, and durability of one of the merging parties."[15] But this approach is at odds with precedent explaining that actual entry is not required to preserve competition.[16]

Efficiencies. Under the draft guidelines, the agencies would not credit efficiencies outside the relevant market.[17] This is a reversal from the agencies' prior willingness to do so, particularly where the net result of the a merger "is likely to benefit customers overall."[18] In other words, the agencies may be

[7] *See United States v. General Dynamics Corp.*, 415 U.S. 486, 497-98 (1974).

[8] Draft Guidelines at 31.

[9] 908 F.2d 981, 985-86 (D.C. Cir. 1990). The panel in *Baker Hughes* included both future Justices Ginsburg and Thomas.

[10] *Id.* at 983.

[11] 370 U.S. 294, 322 n. 38 (1962).

[12] *Baker Hughes*, 908 F.2d at 988.

[13] Draft Guidelines at 31.

[14] *Id.* at 32.

[15] *Id.* at 32-33.

[16] *See, e.g.*, *United States v. Syufy Enters.*, 903 F.2d 659, 668 (9th Cir. 1990) (where the competitive strength of the merged firm deters entry, "the goals of competition are served, even if no actual competitors see fit to enter the market"); *Baker Hughes*, 908 F.2d at 988 ("[T]he *threat* of entry can stimulate competition in a concentrated market, regardless of whether entry ever occurs.").

[17] Draft Guidelines at 33.

[18] 2010 Horizontal Merger Guidelines at 30 n. 14.

willing to challenge mergers that trivially lessen competition in narrowly-defined relevant markets, even if they agree that the overall effect of those mergers would be procompetitive.

Introduction of "Dominant Firms"

The draft guidelines introduce the notion of a "dominant firm," defined as a firm that has at least 30% market share, or, circularly, that "has the power to raise price, reduce quality, or otherwise impose or obtain terms that [it] could not obtain but-for that dominance."[19] Transactions involving dominant firms could receive additional scrutiny to assess whether they would entrench those firms' existing dominance in a market, or enable them to expand their dominance into another market.

While not found in US law or precedent, the notion of a dominant firm resembles the concept of a "dominant position" used by the European Commission. However, the threshold for dominance applied by the EC is higher—at 40%—than the proposed threshold in the draft guidelines; and the EC considers whether other factors, such as the strength of rival firms, rebuts the share-based presumption.

Aggressive Enforcement Against Vertical Mergers

The draft guidelines propose a number of new analyses that could make it harder to receive clearance for vertical mergers in which one merging party is a current or potential supplier or customer of the other party's rivals. The draft guidelines take the position that the FTC asserted in *Microsoft/Activision*—and which the court rejected—that the agencies may prove a vertical case either by showing (1) the merged firm's ability and incentive to foreclose rivals' access to supplies or customers; or (2) a structural case and plus factors.[20]

As to the first approach, the draft guidelines would look only to the new firm's ability and incentive to foreclose rivals, without evaluating whether such foreclosure would actually harm competition. The courts have rejected this position, requiring an evaluation of not only the merged firm's ability and incentive to foreclose competitors, but also whether the ultimate result of that foreclosure "may be to substantially lessen competition."[21]

As to the second approach, where a merging firm has a share above 50% in a given market, the proposed guidelines state that fact alone is sufficient to conclude that the merger may substantially lessen competition.[22]

For firms with 50% or less of the market, the draft guidelines propose "plus factors" to determine whether the merger may substantially lessen competition.[23] The partial list provided in the draft includes trends toward vertical integration, the purpose of the merger, the existing level of concentration in the relevant market, and how the merger could increase barriers to entry. While the last three factors have roots in earlier guidance, it is not apparent that a trend toward vertical integration is inherently problematic. Indeed, such a trend could indicate that vertical integration is efficient for market participants.[24]

[19] Draft Guidelines at 19.

[20] *Fed. Trade Comm'n v. Microsoft Corp.*, No. 23-CV-02880-JSC, 2023 WL 4443412 at *43-44, 72-73 (N.D. Cal. July 10, 2023) (though note that the FTC attempted to argue that it could prevail by showing the merger would increase either the ability or the incentive of Microsoft to foreclose rivals).

[21] *See, e.g., id.* at *13 ("[T]he FTC must show… competition would probably be substantially lessened as a result of the withholding."); *United States v. UnitedHealth Group, Inc.*, 630 F. Supp. 3d 118, 150 (D.D.C. 2022) ("Even if the Government had established that United's post-merger incentives would drive it to 'misuse' Change's claims data, the Government also had to demonstrate a likely substantial lessening of competition.").

[22] Draft Guidelines at 17.

[23] *Id.* at 17-18.

[24] *See, e.g., Microsoft*, 2023 WL 4443412 at *21 ("To the extent the FTC relies on a 'trend toward further concentration in the industry,' it fails to explain how this trend is anticompetitive here—Microsoft's investment in game developers and publishers allows for increased innovation in content.")

Finally, the draft guidelines make no reference to elimination of double marginalization ("EDM"). EDM occurs when vertical integration allows a merged firm to reduce or eliminate the markups that were previously applied by separate entities seeking profit at different levels in the supply chain. The omission of EDM from the draft guidelines is unsurprising given the controversy around its inclusion in the 2020 Vertical Merger Guidelines. This update reflects several years of agency reluctance to credit EDM as a potential efficiency. However, the courts would remain free to consider EDM and other merger efficiencies.[25]

Competition to Displace Platforms

The draft guidelines refer not only to competition on and between platforms, but also to competition to displace platforms—including by a "non-platform service."[26] This appears to be a response to *United States v. Sabre Corp.* There, the trial court, bound by the Supreme Court's holding in *Ohio v. Amex* that "only other two-sided platforms can compete with a two-sided platform," permitted Sabre's acquisition of Farelogix despite the apparent weight of the DOJ's evidence that the two firms competed.[27]

Acknowledging competition between platform and non-platform companies could subject mergers between the two to additional scrutiny. However, crediting that competition could also reduce the market shares imputed to platform companies, potentially helping them avoid some of the structural presumptions and thresholds described above.

The draft guidelines also propose numerous special concerns that the agencies could bring to bear in evaluating transactions involving platforms. These include the possibility of creating or entrenching a dominant platform participant, cutting off rival platforms from access to participants, or the use of network effects to disadvantage nascent platforms.[28]

Focus on Labor Markets

While the agencies have always evaluated the potential for mergers to create monopsony power (reduced competition to purchase an input), including with respect to labor, the draft guidelines specifically call out concerns with labor markets for the first time.[29] They articulate particular attributes of labor markets, such as high switching costs and geographic limitations, that in the agencies' view often cause those markets to be narrow. This emphasis on labor markets is consistent with the stated priorities of agency leadership. However, this view of labor markets seems unpersuasive for perhaps all but the most niche jobs. Even if some individuals are constrained to, say, atypically narrow geographies, prospective employers would have to somehow identify those applicants to leverage their limitations when negotiating employment agreements.

One-Sided Description of Minority Acquisitions

The draft guidelines discuss the acquisition of partial ownership or minority interests at some length, identifying the possibilities that such investments may harm competition by giving an investor the ability to steer the target firm's conduct, reduce the investor's incentive to compete, or gain access to competitively sensitive information.[30] But unlike the prior guidelines, which also explained that "the Agencies consider whether a partial acquisition is likely to create cognizable efficiencies," the proposed draft makes no reference to the potential competitive benefits from such investments.[31] These can include allowing an investor to share best practices or insight about the market, or that where an investor is also a customer of the target, they are incentivized to provide capital on

[25] *See, e.g., United States v. AT&T Inc.*, 310 F. Supp. 3d 161, 197-98 (D.D.C. 2018) (crediting EDM).

[26] Draft Guidelines at 25.

[27] 452 F. Supp. 3d 97, 136-38 (D. Del. 2020), *vacated as moot,* No. 20-1767, 2020 WL 4915824 (3d Cir. July 20, 2020).

[28] Draft Guidelines at 24-25.

[29] *Id.* at 25.

[30] *Id.* at 27-28.

[31] 2010 Horizontal Merger Guidelines at 34.

more favorable terms than neutral investors because they will benefit as a consumer of the target's output in addition to as a financial backer.

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A sixty-day period for public comment will end September 18, 2023. Those interested in commenting may do so here. As the guidelines do not carry the force of law, they are not subject to the Administrative Procedures Act or court review. Ultimately, the agencies will likely promulgate merger guidelines substantially similar to the proposed draft.

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