July 2023

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New Draft Antitrust Merger Guidelines Seek to Turn Screws on Merging Parties

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The Department of Justice Antitrust Division and Federal Trade Commission issued new draft Merger Guidelines on July 19 that aim to significantly increase scrutiny of merger activity. The new Merger Guidelines would replace prior pronouncements of antitrust policy from the FTC and DOJ, including the 2010 Horizontal Merger Guidelines and the 2020 Vertical Merger Guidelines. The proposed changes are largely consistent with the commentary over the last two years from Biden administration appointees about a perceived lack of antitrust enforcement. Stated in the form of 13 individual guidelines for assessing M&A activity, the draft document reads like an outline of every way the FTC and DOJ might challenge a deal as meeting the Clayton Act's prohibition: a transaction where the effect "may be substantially to lessen competition, or to tend to create a monopoly."[1]

Whether courts will look to the updated Merger Guidelines for persuasive authority in litigated merger challenges, as they have with past iterations, remains to be seen. However, more important for many deals is the increasingly broad lens through which the DOJ and FTC intend to consider potential anticompetitive effects. Even deals that do not find their way to the courtroom may face the increased burden of addressing the potential harms addressed in the draft Merger Guidelines, often seeking to accomplish the difficult task of proving a negative (i.e. the lack of an antitrust concern). When combined with the substantial proposed re-write of the HSR notification requirements announced last month,[2] the impact on merging parties will likely be significant additional time and expense needed to achieve antitrust approval generally and a tendency toward greater opposition to deals that have seemingly limited impact on relevant markets.

The draft Merger Guidelines will be subject to a public comment period for 60 days, ending on September 18, 2023. Following the comment period, the agencies intend to issue final Merger Guidelines later this year.

Overview of the Merger Guidelines

The Merger Guidelines purport to reflect how the DOJ and FTC investigate transactions for anticompetitive harm. They can therefore help companies anticipate concerns that the agencies may raise during the HSR review process. Moreover, while not legally binding precedent when the agencies go to court, the Merger Guidelines have historically been persuasive to judges looking to apply antitrust principles in the context of an agency's bid to enjoin a deal. Courts can decline to follow the Merger Guidelines to the extent that they do not reflect binding law, and during the Biden administration, several

courts have already been highly skeptical of some of the claims advanced by the DOJ and FTC that are now reflected in the draft Merger Guidelines.

In spite of this skepticism from courts and others, the current leadership at both the FTC and the DOJ has consistently criticized modern antitrust enforcement, arguing that it too often failed to stop increasing concentration and allowed large companies to amass market power, to the detriment of American customers and workers.

While the new Merger Guidelines will have far-reaching effects on deal-making, we have highlighted here some of the most impactful changes in thinking around antitrust reviews.

New Market Concentration Presumptions

Prior iterations of the Merger Guidelines have focused on a threshold at which a transaction is presumed likely to have anticompetitive effects. When making this assessment, the agencies look to whether a deal will result in "undue concentration" in a "highly concentrated market." If so, the deal is presumed unlawful—the so-called "structural presumption"—making it much more difficult to secure antitrust clearance. The draft Merger Guidelines significantly alter the landscape by redefining the relevant terms, causing many more deals to face a structural presumption of anticompetitive effects.

The structural presumption threshold has historically been based on the Herfindahl-Hirschman Index, a tool for measuring industry concentration and the change in concentration from the merger.[3] The draft Merger Guidelines revise the threshold for determining that a market is "highly concentrated" from 2,500 to 1,800. And they declare that a transaction resulting in a change in the HHI Index of 100 points or more is presumptively anticompetitive, whereas previously the threshold had been 200. They add the same structural presumption for transactions where the combined share exceeds 30%.

To add some context, consider the following hypothetical market:

Competitor	Market Share	HHI Calculation
Alpha	30%	900
Beta	20%	400
Gamma	20%	400
Delta	10%	100
Epsilon	10%	100
Zeta	5%	25
Eta	5%	25
TOTAL HHI VALUE		**1,950**

This hypothetical 7-competitor market would be "highly concentrated" under the new draft Merger Guidelines, since the HHI is above 1,800. Moreover, a merger between Epsilon and Zeta, which would yield a combined share of 15%, would be presumptively anticompetitive (i.e. with a change in HHI of 100), despite the combined firm being the fourth-largest competitor in the market even post-transaction. While these more aggressive positions are not without precedent,[4] they reflect a view of concentration not seen at the Agencies in a generation.

Entrenchment or Extension of Dominance

The draft Merger Guidelines resurrected a theory of anticompetitive harm largely seen in cases in the 1960s and 1970s—entrenchment or extension of a dominant position. While the European Commission has investigated and enforced on this basis, the US agencies have rarely done so in the last 40+ years.

Entrenchment or extension of dominance can arise in a number of different contexts, but the unifying theme is that for many companies, getting bigger is presumptively problematic. For example, the draft Merger Guidelines anticipate that a company can use acquisitions to strengthen its overall position across multiple products or services and thereby frustrate competition from companies who do not offer a similar array of products or services.[5] Such a theory could apply to any large company that is expanding into a new product area through acquisition.

Although the draft Merger Guidelines provide a litany of examples of mechanisms that might give rise to entrenchment concerns, they stop short of identifying when a deal crosses the line. Without further guidance, dealmakers can assume that any evidence of existing market power, or at least 30 percent market share, can trigger scrutiny into potential mechanisms in this theory.

Interestingly, there is not a modern economic model supporting such a theory that has been accepted by a US court. And, this change seems to be a quick reversal from just a few years ago, when DOJ panned such theories: "efficiency and aggressive competition benefit consumers, even if rivals that fail to offer an equally 'good deal' suffer loss of sales or market share."[6] The resurrection of these concerns reflects a clear shift in agency thinking toward greater hostility to strategic M&A generally.

Labor and Input Markets Will Become Prominent

While antitrust enforcement has historically focused on harm to purchasers of a merged firm's products, the draft Merger Guidelines would place equal emphasis on avoiding harm to the merged company's employees and suppliers. Among other things, the draft Merger Guidelines note that the FTC and DOJ will "examine merging firms' power to cut or freeze wages, exercise increased leverage in negotiations with workers, or generally degrade benefits and working conditions without prompting workers to quit." And, notably, the agencies emphasize that any potential concerns about labor or supplier markets must be analyzed independently of any other aspect of the deal.

The emphasis on supplier and labor markets is an important change to the analytical framework, and it also indicates significant additional complexity for merger reviews. In order to evaluate these issues, the agencies are likely to require broader access to the merging parties' documents and additional time. This is already evident in the June 27 Notice of Proposed Rulemaking regarding the HSR Act, which contemplates gathering significant additional information from all merging parties at the HSR filing stage regarding labor market issues.

Efficiencies No More

Since the 1997 Horizontal Merger Guidelines, the Agencies have embraced a recognition that efficiencies—cost savings gained from the transaction—may support allowing a transaction. The basic premise was that if a transaction could generate substantial savings, those should be balanced against potential concerns about loss of competition. The draft Merger Guidelines largely undercut parties' ability to establish an efficiencies defense at the investigation stage.

FTC Chair Lina Khan previewed this in June, stating that "The word 'efficiency' doesn't appear anywhere in the antitrust statutes."[7] Consistent with that view, the draft Merger Guidelines view efficiencies as often speculative, often not passed through to customers, and in some cases anticompetitive because they may actually make it more difficult for other parties to compete with the merged firm. Moreover, the draft Merger Guidelines explicitly reject the idea that potential synergies in one market could justify any loss of competition in a different market. So, for example, a transaction that results in a reduction

in employers for a particular field (i.e., a loss of labor market competition) could not be justified on the basis that it would substantially reduce output costs or prices.[8]

Increasing Litigiousness

The changes in the Merger Guidelines also reflect an increased interest among Agency leaders in litigating their views of antitrust law. Leaders at the FTC and DOJ have, in fairly short tenures, shown a hostility to deals. The draft Merger Guidelines continue that trend, reflecting a view that M&A activity should be viewed skeptically across the board. Inevitably, as the agencies ratchet up investigations, refuse to negotiate remedies, or will try to extract onerous concessions from merging parties, a greater number of deals will go to litigation.

Takeaways for Dealmaking

While the draft Merger Guidelines technically are not yet in place, the FTC and DOJ have been applying many of the theories found in this document in pending reviews. Thus, unlike the proposed changes to the HSR reporting rules, the principles in the draft Merger Guidelines are already impacting M&A activity. For the foreseeable future, the antitrust environment will be one of hostility from the DOJ and FTC, and that appears likely to increase toward the end of this year and into 2024. The best path forward for dealmakers is to plan for such uncertainty in deal documents, their clearance strategy, and potential litigation/settlement scenarios.

If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings Washington, D.C. lawyers:

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[1] 15 USC § 18.

[2] See our prior update here: https://www.paulhastings.com/insights/client-alerts/ftc-plans-massive-revamp-of-hsr-act-reporting-requirements.

[3] The Herfindahl-Hirschman Index is defined as the sum of the squares of the market shares of the respective competitors.

[4] In *Brown Shoe Co. v. United States*, the Supreme Court blocked a merger that would have increased the defendant's market share from a mere 5.6% to just 7.2%. 370 U.S. 294 (1962).

[5] *FTC v. Procter & Gamble*, 386 U.S. 568 (1967) (upholding challenge to "product extension merger" because it would "substantially reduce the competitive structure of the industry by raising entry barriers and by dissuading the smaller firms from aggressively competing").

[6] *See, e.g.*, https://www.paulhastings.com/insights/attorney-authored/considerations-for-private-equity-after-ftc-vet-clinic-deal.

[7] https://www.promarket.org/2022/06/03/qa-with-ftc-chair-lina-khan-the-word-efficiency-doesnt-appear-anywhere-in-the-antitrust-statutes/.

[8] The FTC and DOJ focus heavily on older Supreme Court precedent, including *FTC v. Procter & Gamble*, where the Supreme Court wrote that "[p]ossible economies cannot be used as a defense to illegality. Congress was aware that some mergers which lessen competition may also result in economies but it struck the balance in favor of protecting competition." 386 U.S. 568, 580 (1967).

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