Why Dropping Market Power from the Merger Guidelines Matters

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The draft Merger Guidelines recently released by the Department of Justice and the Federal Trade Commission (the Agencies) seek to reinvigorate merger enforcement. As someone who has been calling for stronger enforcement of horizontal mergers for many years, who has helped draft previous guidelines to achieve that end, and who has testified on behalf of the government and a private plaintiff in a number of merger challenges over the past decade, I share that goal. However, I question whether these draft Guidelines will advance that goal rather than set it back. I suggest revisions that would make the Guidelines more effective and more durable.

The draft announces a dramatic shift in merger policy: it abandons the focus on market power that has been fundamental to all merger guidelines for several decades. As a result, the framework it offers for reviewing mergers is disconnected from the central harm that merger control seeks to prevent, namely harm to consumers caused by a lessening of competition.

The 2010 Horizontal Merger Guidelines makes this unequivocal statement:

> The unifying theme of these Guidelines is that mergers should not be permitted to create, enhance, or entrench market power or to facilitate its exercise. For simplicity of exposition, these Guidelines generally refer to all of these effects as enhancing market power. A merger enhances market power if it is likely to encourage one or more firms to raise price, reduce output, diminish innovation, or otherwise harm customers as a result of diminished competitive constraints or incentives.

The "unifying theme" of preventing mergers that harm customers due to enhanced market power has been in the merger guidelines for forty years.

The 2010 Horizontal Merger Guidelines further explains that enhanced market power exercised against buyers is treated in analogous fashion:

> Enhancement of market power by buyers, sometimes called 'monopsony power,' has adverse effects comparable to enhancement of market power by sellers. The Agencies employ an analogous framework to analyze mergers between rival purchasers that may enhance their market power as buyers.

Purely for clarity and simplicity, in this piece I discuss harm to direct customers and final consumers. Everything I write here about protecting them also applies to protecting workers and other suppliers from mergers that lead to enhanced buyer power.

The draft Guidelines abandon enhanced market power, and thus harm to customers, as its unifying theme. Moreover, none of the draft's 13 specific guidelines even refers to market power. Indeed, the draft rarely uses the term "market power" and does not define it.

Critically, the draft says nothing to indicate that the Agencies will evaluate mergers based on whether they are likely to harm customers due to enhanced market power. Unless revised, protecting consumers will no longer be the Biden Administration's stated goal of merger enforcement. That would represent a fundamental and reckless change from forty years of merger guidelines spanning many administrations. In my view, that change is neither wise nor necessitated by the Biden Administration's desire to strengthen merger enforcement.

No one should be surprised that the draft Guidelines abandon the protection of customers from harm due to enhanced market power as their unifying theme, given the prior positions taken by the Agency leaders. FTC Chair Lina Khan has written that it is an error to evaluate mergers based on their economic effects because doing so "imports into structural analysis a focus on outcomes, misreading its purpose and orientation and potentially exposing it to weaker enforcement." Favoring an approach based on preserving deconcentrated market structures, she believes that focusing on harm to consumers "has warped America's antimonopoly regime, by leading both enforcers and courts to focus mainly on promoting 'efficiency' on the theory that this will result in low prices for consumers." Assistant Attorney General Jonathan Kanter has not gone so far, but he has stated the consumer welfare standard "does not reflect the law as passed by Congress and interpreted by the courts." Despite these statements, I hold out hope that the draft Guidelines will be revised to place consumer harm front and center.

New Theme: Preserving Deconcentrated Market Structures

The draft Guidelines do not offer a single, new unifying theme. What are its major themes?

One major theme that comes across loud and clear is that a merger will be prohibited if it "may substantially lessen competition or tend to create a monopoly," as per the text from Section 7 of the Clayton Act. The phrase "lessen competition" and its cognates appear more than one hundred times in the draft Guidelines. There is, of course, nothing wrong with Guidelines referring to the statutory language they are meant to effectuate. But incessant references to the broad statutory language found in Section 7 of the Clayton Act provide no guidance to the business community or the courts. Indeed, more than fifty years of Guidelines are testament to the value of going beyond that statutory language to clarify how the Agencies will enforce Section 7 consistent with the case law that has evolved to interpret the statute.

The draft should be revised to explain how the Agencies operationalize the core concept of a "lessening of competition." The Guidelines do state: "Competition often involves firms trying to win business by offering lower prices, new or better products and services, more attractive features…" The draft should be revised to build on this helpful language. The Guidelines should clarify that the goal of the Agencies is to protect customers by stopping mergers that harm them through higher prices, lower quality, reduced innovation, etc. due to reduced competition. That change will make the Guidelines more effective at deterring mergers that "may substantially lessen competition," by making them more coherent and specific, by clarifying what evidence is needed to rebut the presumptions asserted in the draft, and by weakening the inevitable arguments from merging firms that the new guidelines are inconsistent with recent case law.

A second major theme found in the draft Guidelines is broad skepticism if not hostility to mergers. Such hostility is a sharp change from the 2010 Guidelines. Those Guidelines strengthened merger enforcement by making it easier for the government to define narrow markets, including markets for targeted customers, and to win based on a theory of unilateral anticompetitive effects. They achieved widespread acceptance and credibility by presenting a balanced yet pro-enforcement view and by applying widely-accepted economic principles. For example, they acknowledged that many mergers are competitively neutral or beneficial. The draft Guidelines seem instead to be an ideological or political statement, making them less persuasive in court and less durable. Taken at face value, they seem designed to enable the government to win in court without regard to whether a proposed merger is actually harmful rather than beneficial to customers. Notably, Guidelines 1-8 of the draft Guidelines assert that the government can win in court by clearing any one of eight rather low bars. That claim echoes Justice Potter Stewart's famous quip in his dissent in the *Von's Grocery* case in 1966: "The sole consistency that I can find is that in litigation under §7, the Government always wins."

The third major theme I detect in the draft Guidelines is that deconcentrated market structures should be preserved, along with the corollary that successful firms should not be allowed to grow further through acquisition. This view can be found in Chair Khan's writings: "Congress originally passed antitrust laws to safeguard against excessive concentrations of private power and to protect market structures that distributed individual opportunity and prosperity."

Many passages in the draft Guidelines fit with this theme. Perhaps most important, a "lessening of competition" seems to be equated with "greater market concentration" without reference to the benefits that competition produces for customers, such as low prices and higher quality products and services. Here are a few such passages. Guideline 1 refers to market structure without any discussion of the merger's effects on people. In Guideline 4, "market deconcentration" itself is listed as a "procompetitive effect" of new entry into a market, rather than something that *leads* to procompetitive effects. Guideline 6 asserts a structural presumption against vertical mergers without any discussion of whether the merger will benefit or harm customers. Guideline 7, which seeks to prevent a firm with at least a 30 percent share of one market from expanding into neighboring markets by acquisition, does not inquire into whether that expansion would benefit or harm customers. Guideline 8 would stop a merger that furthers a trend toward concentration, regardless of whether that trend was serving to benefit or harm customers, and regardless of whether the merger itself would benefit or harm customers.

All of these passages need to be revised to explain that the concern ultimately is about harm to customers caused by diminished competition. Done properly, such revisions would promote *stronger* merger enforcement than does the current draft by clarifying what it means to "lessen competition" while not placing an undue evidentiary burden on the government.

Implications of the Structural Approach Taken in the Draft Guidelines

What difference will it make if the Agencies put these draft Guidelines into effect?

My concerns with the draft Guidelines are greatest for mergers that are likely to benefit customers while increasing concentration in at least one market or enabling a successful firm to further grow. In other words, my concerns arise in situations where the fundamental change announced in the draft Guidelines—from stopping mergers that enhance market power to stopping mergers that increase market concentration or allow a successful firm to grow further—really matters. Which mergers are those?

For many horizontal mergers, the goal of preserving a deconcentrated market structure overlaps with the goal of protecting customers from harm due to enhanced market power. After all, in the 1963 Philadelphia National Bank case, which established the structural presumption for horizontal mergers, the Supreme Court explicitly linked increased market concentration to harm. The Court stated that a reduction in "the number of banks in the locality" would likely diminish "the vigor of competition for filling the marginal small business borrower's needs," harming those borrowers due to their "concomitantly greater difficulty in obtaining credit." But even for these horizontal mergers, the draft would make merger enforcement less clear and less coherent.

Furthermore, some horizontal mergers would be treated very differently under the draft guidelines than under the 2010 Horizontal Merger Guidelines. Notably, under Guideline 8 the Agencies would block virtually any merger taking place in an industry experiencing a trend toward concentration. Guideline 8 considers only structural factors, not economic effects. The fundamental problem is that Guideline 8 does not inquire into *why* there is a trend toward concentration or whether that trend has helped or hurt customers. Consider, for example, an industry in which technological change is increasing the minimum efficient scale, which in turn is causing smaller firms to combine and exit. Under the draft guidelines, those responses would count *against* a proposed merger. The Agencies might well block a merger involving two firms, each with a market share of 10 percent, even if that merger would allow the merged entity to gain scale to compete more effectively against larger firms to the benefit of customers. Indeed, Section IV.3.D tells us that the Agencies would not credit any efficiencies for such a merger, even proven ones. It makes no economic sense to say that such a merger "lessens competition."

My concerns are greatest for non-horizontal mergers. Most worrisome, Guideline 7 states that a firm cannot use an acquisition to "extend a dominant position" into a "related market." As stated, this prohibition applies regardless of whether the acquisition is harmful or beneficial to customers. Guideline 7 would ensnare many firms, because a firm is said to have a "dominant position" if its market share is at least 30 percent. Various tactics that multi-product firms often use to compete, such as offering multi-product discounts "or otherwise linking sales of the two products" are viewed with suspicion, regardless of whether they are antitrust violations. The draft states that the Agencies "instead will assess whether such conduct, if it were to occur, may tend to extend the firm's dominant position." The draft Guidelines seem to ignore the substantial pro-competitive effects that commonly arise when successful firms expand and inject more competition into adjacent markets by acquisition. Guideline 7 can be fixed by clarifying that such extensions will only be blocked if they are likely to harm customers in that related market.

Guideline 6, which seeks to create a structural presumption against certain vertical mergers, also suffers because it is not rooted in harm to customers. The draft states: "If the foreclosure share is above 50 percent, that factor alone is a sufficient basis to conclude that the effect of the merger may be to substantially lessen competition, subject to any rebuttal evidence." This Guideline lacks a sound economic basis, either theoretically or empirically, if the goal is to protect customers from the exercise of market power. Furthermore, it is not clear what would qualify as an effective rebuttal. Suppose the merging parties show that the merger will enable it to achieve cognizable efficiencies that are large enough that customers will benefit from the merger. Will the Agencies stand down? If merger enforcement is about preventing mergers that harm customers by leading to enhanced market power, they will. Under these draft Guidelines, it would seem not. (For similar reasons, the entire draft lacks clarity about what constitutes an acceptable rebuttal.) Guideline 6 should be dropped or somehow folded into Guideline 5.

Lastly, Guideline 5, which applies to mergers involving products or services that rivals may use to compete, lacks clarity and coherence because it is untethered from customer harm. The basic ability-and-incentive framework described in Guideline 5 has good economic pedigree, but the draft does not employ that framework to determine whether customers will be harmed by the merger rather than benefit from it. Instead, the draft suggests that harm to *rivals* is enough to trigger a challenge by the Agencies. Guideline 5 can be fixed by explaining that the ultimate concern is harm to customers and by addressing how the Agencies account for the benefits as well as the harms to customers from combining complementary activities within a single firm.

In summary, concerns about mergers that "may substantially lessen competition or tend to create a monopoly" are really about the risk of losing what competition delivers to real people, such as lower prices, better products, and greater innovation. We cannot effectively and consistently police merger activity to prevent a lessening of competition unless we use tools that identify when competitive activity is or is not delivering these outcomes.

Author Disclosure: I am currently consulting for parties that have a financial interest in the Merger Guidelines. Please see my full disclosure statement [here].