Comments of Joseph Farrell on the Draft Merger Guidelines (dMGs)

September 18, 2023

I comment here on some aspects of a limited set of topics: the dMGs' usage of the phrase "lessen competition," the role of concentration in horizontal merger analysis, and market definition in the dMGs.

"Lessening competition"

As others have pointed out, the 2010 Horizontal Merger Guidelines (HMGs) stated a "unifying theme" of protecting against the enhancement (etc.) of "market power." This echoed the 1992 HMGs. That language has retreated in the dMGs. Is that a mere return to the statutory language of "lessening competition," with little or no change in meaning, or is it a substantive change of focus away from a focus on effects and toward a focus on something else?

Sometimes we know "lessening of competition" when we see it. But there are problematic cases where our confidence either wavers or runs into equal and opposite confidence from others. For example, consider a horizontal merger between two relatively small rivals that not only reduces the total number of rivals but also thereby creates an additional "significant" rival.[1] Does this merger lessen competition, or strengthen it? The consensus way in principle to address that question—to make it a scientific question rather than a matter of opinion or assertion—is to ask: what is the net effect on customers or trading partners? Some commenters have expressed real concern that the dMGs are not entirely clear on whether they adopt or reject that consensus approach, nor on how they replace it if the latter.

Recommendation on role of effects: I join those who ask the Agencies to clarify that they adopt the in-principle-effects-based approach.[2]

The role of concentration

For horizontal mergers, Section II.1 of the dMGs returns to a strong concentration-based presumption. I agree that concentration (including the change in concentration) is a convenient and useful measure at least for initial screening of horizontal mergers. The change in concentration is aligned with diversion

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[1] The possibility that it is a subset of rivals, the "significant" ones, that primarily counts is reflected in the widespread shorthand practice of summarizing a horizontal merger as, for example, "a 4-to-3."

[2] See for instance *Comments of Economists and Lawyers on the Draft Merger Guidelines*, September 15, 2023 [Jonathan Baker et al.] To me, this is not to say that the Agencies ought necessarily to take on a burden of identifying and proving a specific harm. When there is a clearly identifiable lessening of competition, a presumption that it will cause harm seems to me a sensible expression of the motivating idea of antitrust and competition policy. However, asking at least whether it is reasonable to *expect or to fear that there will be harm to trading partners* seems a helpful way—and a much-needed way—to disambiguate whether, for instance, a proposed merger does "lessen competition." Some might express this as "having a theory of harm," which perhaps need not be proven harm.

ratios, which are key indicators for unilateral effects (although the alignment does depend on the various products in the market being fairly symmetrically differentiated). Concentration may also be linked to margins, another key factor in unilateral effects, although it depends whether concentration reflects a few firms' success in vigorous competition, or whether the market is concentrated for reasons other than efficiency, giving each of the few incumbents an exogenously privileged position from which they can command a high share even while failing to serve customers well. Concentration also facilitates coordinated oligopoly conduct, such that high levels and increases in concentration substantially raise the risk of conscious and purposive coordination, while some of my work with Professor Baker suggests preliminarily that the strength of non-purposive coordination may be linked to diversion ratios and that horizontal mergers are thus apt to worsen its consequences.[3] Finally, it is at least sensible to fear that high market shares exacerbate the risk of anticompetitive exclusionary conduct, as can arise for instance through exclusive dealing or market-share rebates.[4] For these reasons I agree that concentration measures (including "change in concentration") are a useful and informative tool in horizontal merger analysis.

However, consistent with the discussion of the phrase "lessening competition" above, I would urge the Agencies to preserve the principle that this useful and informative tool is one pointer—albeit sometimes a good pointer—toward the ultimate focus, which is the realistic risk that a reduction in rivalry will cause harm to trading partners. In some—by no means all—places, some expert commenters fear that the dMGs might be read to suggest that high concentration is *definitionally* the outcome that the law prohibits.[5] [6]

As some of my comments above reflect, there are gaps in the linkage between concentration (including change in concentration) and harm. But perhaps the biggest asterisk on making concentration key to competitive analysis of mergers is market definition.

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[3] See "*Comments of Professors Jonathan B. Baker and Joseph Farrell on the treatment of non-purposive coordination in the draft Merger Guidelines,*" September 16, 2023, and references therein.

[4] The 2010 HMGs mentioned (in Section 1) the risk that a merger might "make it more likely that the merged entity can profitably and effectively engage in exclusionary conduct."

[5] See *Comments of Economists and Lawyers on the Draft Merger Guidelines*, September 15, 2023 [Jonathan Baker et al.] An intermediate possibility might be that concentration is not *definitionally* the violation but that it is such a reliable indicator as to make that distinction seem meaningless. Consistent with the 2010 HMGs' statement (section 10) that "[e]fficiencies almost never justify a merger to monopoly or near-monopoly," a very strong presumption might be based on extreme levels of post-merger concentration in a well-defined market, consistent with sliding-scale logic. Even then, I would urge preserving the distinction between a very strong substantive inference of likely harm to trading partners versus a definitional condemnation. For one thing, the former is more hospitable to the development of learning over time.

[6] At the risk of too close a reading, consider the last sentence in the first paragraph of section II.1 in the dMGs: "In the Agencies' experience, [a] structural presumption provides a highly administrable and useful tool for identifying mergers that may substantially lessen competition." Does this mean that a concentrating merger "may" be harmful and thus warrants further investigation by the Agency, or does it mean that the Agency immediately concludes that the merger *has already been identified as* one that "may substantially lessen competition" and thus *is* illegal?

Market Definition

The more weight is placed on concentration, the more controversy will arise regarding market definition. At the same time as perhaps becoming even more pivotal, market definition is the topic of one of the biggest substantive proposed changes in the dMGs.

Tools A and B

Tool A concludes (if there is direct evidence of substantial competition between the merging firms) that "a relevant market exists in which the merger may substantially lessen competition". This seems to construct a direct path from direct evidence of substantial competition between the parties to a conclusion of a violation, without fully (or perhaps much at all) specifying the "metes and bounds" of any market. This is substantively consistent with many economists' recommendations through the years (including my own "upward pricing pressure" work with Professor Shapiro). So at one level I think it is a significant step forward. Yet the way it's positioned, as part of market definition rather than as an alternative to market definition, seems awkward. Why not just say that economic analysis shows directly, without market definition, that trading partners are likely to be harmed by the loss of competition due to the merger?[7] I worry that the answer might be that the dMGs are retreating from a focus on harm to trading partners—see above.

I am unclear on what Tool B means. Is it proposing a single-firm market within which (as suggested by the direct evidence) monopoly or market power is already being exercised? Or is the proposed relevant market defined by the firm/product with market power plus some (perhaps small) set of alternatives including that firm's proposed merger partner? If the latter, does this amount to a rule against all horizontal acquisitions by a firm with market power? If so, how much market power?—most firms have some, at least in the technical economic sense.

The Hypothetical Monopolist Test

The 1992 HMGs, in principle, claimed that, starting with each product of the merging firms, the Agencies would follow an algorithm to determine the appropriate relevant market. While in practice things were inevitably looser (often substantially looser), in principle there was no discretion. The 2010 HMGs described a more flexible process but still one in which, if not a single right answer, there were identified ways in which a candidate market might be more or less informative (or misleading). In particular, both the 1992 and 2010 HMGs presented the hypothetical monopolist test (HMT) as a necessary (again, in principle) quality of an acceptable relevant market.

The dMGs appear to depart radically from that tradition. They present four options for how one might define a market, and suggest that there are more, not described there.[8] The fourth is the HMT. That structure plainly claims that it is acceptable to knowingly use a market that *is* "too narrow," as long as it satisfies "any one or more" of the other three-or-more options! In other words, while the HMT used to be (in principle) a *necessary* condition, so that the choice of market would be among those candidate

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[7] Another option, possibly intended by the dMGs' Tool A (but if so not well disclosed by it), is the narrow-market approach explicitly described in Nancy Rose and Carl Shapiro, *What Next for the Horizontal Merger Guidelines*, *Antitrust* 36(2), 2022, at Example 5A.

[8] I am referring to the phrases "For example,…" and "may rely on any one or more" in the sentence immediately before the list of four approaches A-D in the dMGs, section III.

markets that passed the HMT (or at least did not visibly fail it), the test now appears to be presented as a *sufficient* condition. Do the Agencies really propose to use market definitions that have been found to be "too narrow"?!

Moreover, while previous HMGs also imposed (1992), or at least urged (2010), satisfaction of some additional conditions even once the HMT is passed, the dMGs are silent once "any one or more" of the proposed sufficient conditions is satisfied.

Thus it seems that the dMGs would design-in so much flexibility that it would be very difficult for the merging parties to criticize (within the new MGs' framework) the Agencies' proposed market definition. At the same time, however, that very flexibility would make it very difficult for the Agencies to criticize (in that framework) the parties' proposed market definition. It is not clear what kind of tussle would result. Possibly the drafters are planning to argue that, yes, perhaps there is another possible market definition within which there is low concentration, but that doesn't change the fact that there is a market (our proposal) within which there is high concentration. And I can see the logic of that position: a burglar caught in the act can't defend himself by pointing to all the houses he didn't burgle that night. But it will be a very different market definition debate: It will be one where the Agencies have not committed themselves in their Guidelines to criteria that the parties' proposed market violates; and it seemingly may be one where the Agencies' own proposed market definition is "too narrow" according to a widely-accepted test.

Recommendation on market definition: I suggest that the Agencies reconsider the logical structure of the list of four "tools" in section III, re-promote the HMT to in-principle-necessary status (with a thoughtful discussion of how they view it when no precise test is available), explain what they mean by hinting that there may be more un-enumerated tools, make tools A and B more explicit, and express their views, if any, about what makes one "valid" market more reliably informative than another about a merger's impact on trading partners or on market power.

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Disclosure: During the past two years, I have not consulted on any proposed mergers, nor am I currently engaged in or specifically anticipating any such engagement. While I was serving as Director of the Bureau of Economics, I led the FTC team that, together with DOJ, drafted the 2010 Horizontal Merger Guidelines.