

# MERGERS

## Workshop on Competition Law and Policy Bridgetown, Barbados March 13, 2019

Dan Zach  
Deputy Assistant Director  
Bureau of Competition  
United States Federal Trade Commission  
[dzach@ftc.gov](mailto:dzach@ftc.gov)



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# Reasons for Merger Review

- Some mergers result in market power, the ability to restrict output, reduce quality, or raise prices above competitive levels for a significant period of time
- Differs from dominance enforcement in that you are trying to prevent deals “likely” to harm competition because they can create market power (incipiency standard)
- Focuses on stopping mergers before they are consummated because they are difficult to unwind (hard to “unscramble the eggs”)



# How Should Merger Law Be Structured?

- Allows agency to take effective action
- Looks at substance over form—law should take into account different types of transactions
  - Full mergers
  - Joint ventures
  - Asset acquisitions
- Grounded in industrial organization economics
- Uses a transparent analysis

# Overarching Considerations

- Don't use merger law to pursue non-competition goals
- Agencies should engage in timely review so that mergers that lead to efficiencies or other benefits are not hindered
- Most mergers do not harm competition
- Don't block mergers in order to try to *improve* the competitive landscape

# Barbados Merger Law

- Section 20 prohibits mergers that control a market share of 40% unless otherwise permitted by the FTC
  - Notice to the FTC required if such a merger requested
  - Three-month review period, or as soon as practicable thereafter
- Consider market structure, degree of control exercised by the parties, alternatives, impact on consumers; competitive impact

# Permitted Mergers; Other Provisions

- Section 21 allows mergers if:
  - Real gains that offset harms to competition, or
  - Failing company and there is no better alternative
- Section 22 gives the FTC ability to initiate review of mergers where parties haven't sought permission
- Section 23 prohibits interlocking directors of significant competitors that might reduce competition

# United States Merger Law

- Clayton Act
  - Obtain preliminary relief
  - Prevent harm to competition: may be substantially to lessen competition or tend to create a monopoly
- FTC Act; Sherman Act – merger agreement
- Hart-Scott-Rodino (HSR) Act
  - Premerger notification for transactions of a certain size or involving parties of a certain size
  - Waiting period (usually 30 days); full phase and Second Requests if warranted

# Basic Analytical Framework

- DOJ/FTC issued revised and updated Merger Guidelines in 2010
  - Fact-specific approach
  - Talk to customers, competitors, potential entrants
  - Analyze ordinary course documents
  - Market shares are just one factor to consider; use available economic data and tools
  - Presumption of market power for mergers that increase concentration above certain levels; defendants may rebut

# Assessing Mergers

- A few are likely harmful to competition
  - Can give the merged firm market power unless it is disciplined by entry or repositioning
  - If entry or repositioning is difficult or unlikely, the merged firm can raise prices, reduce quality or output, inhibit innovation, and reduce efficiency
- Sometimes informed customers are not concerned anyway

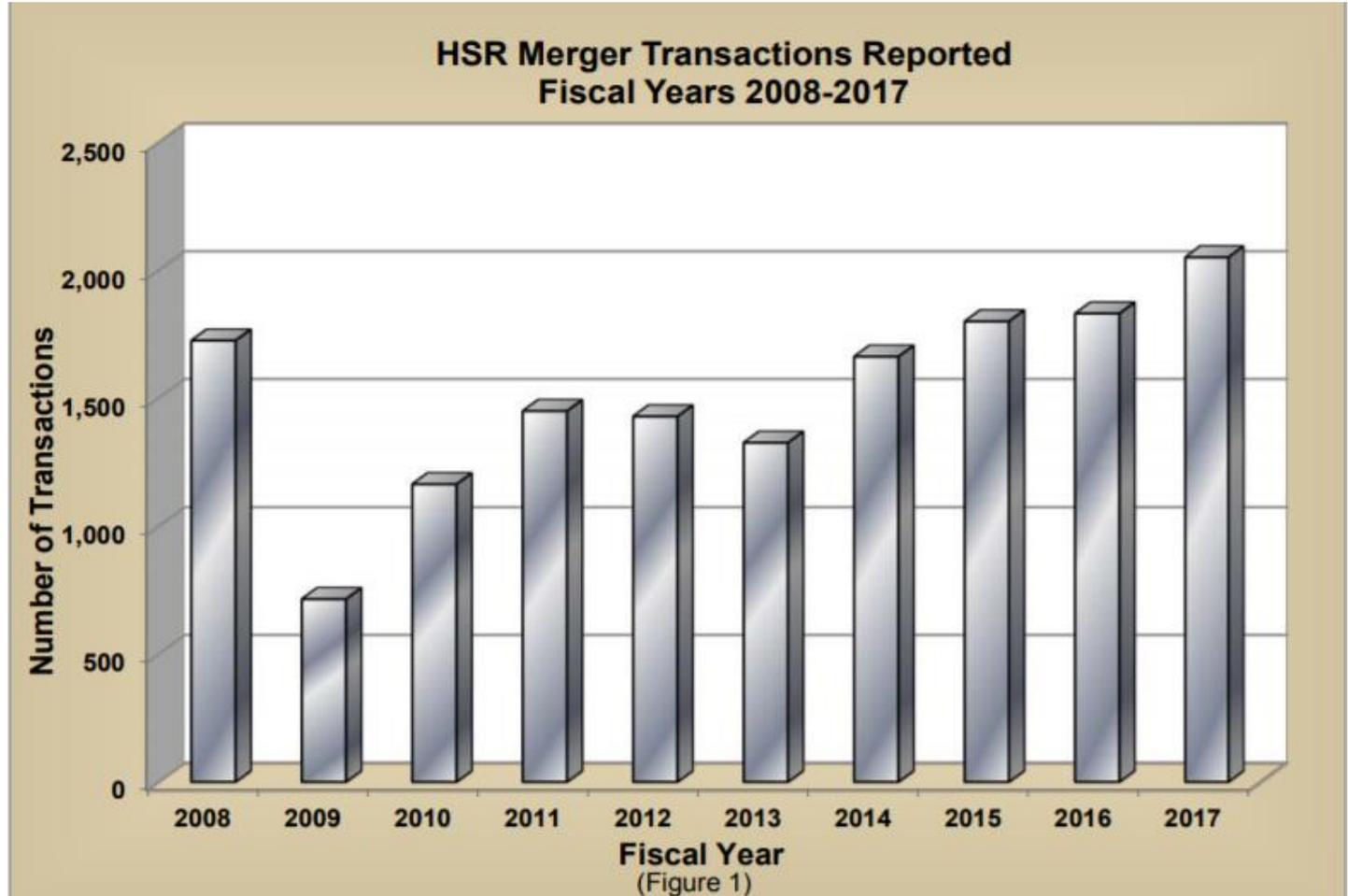
# Assessing Mergers

- Some are competitively beneficial
  - Create efficiency
  - Encourage investment
  - Allow for introduction of new products
  - But these rarely get press
- Most are competitively neutral
- Goal is international consistency in merger analysis:
  - <http://www.internationalcompetitionnetwork.org/uploads/library/doc316.pdf>

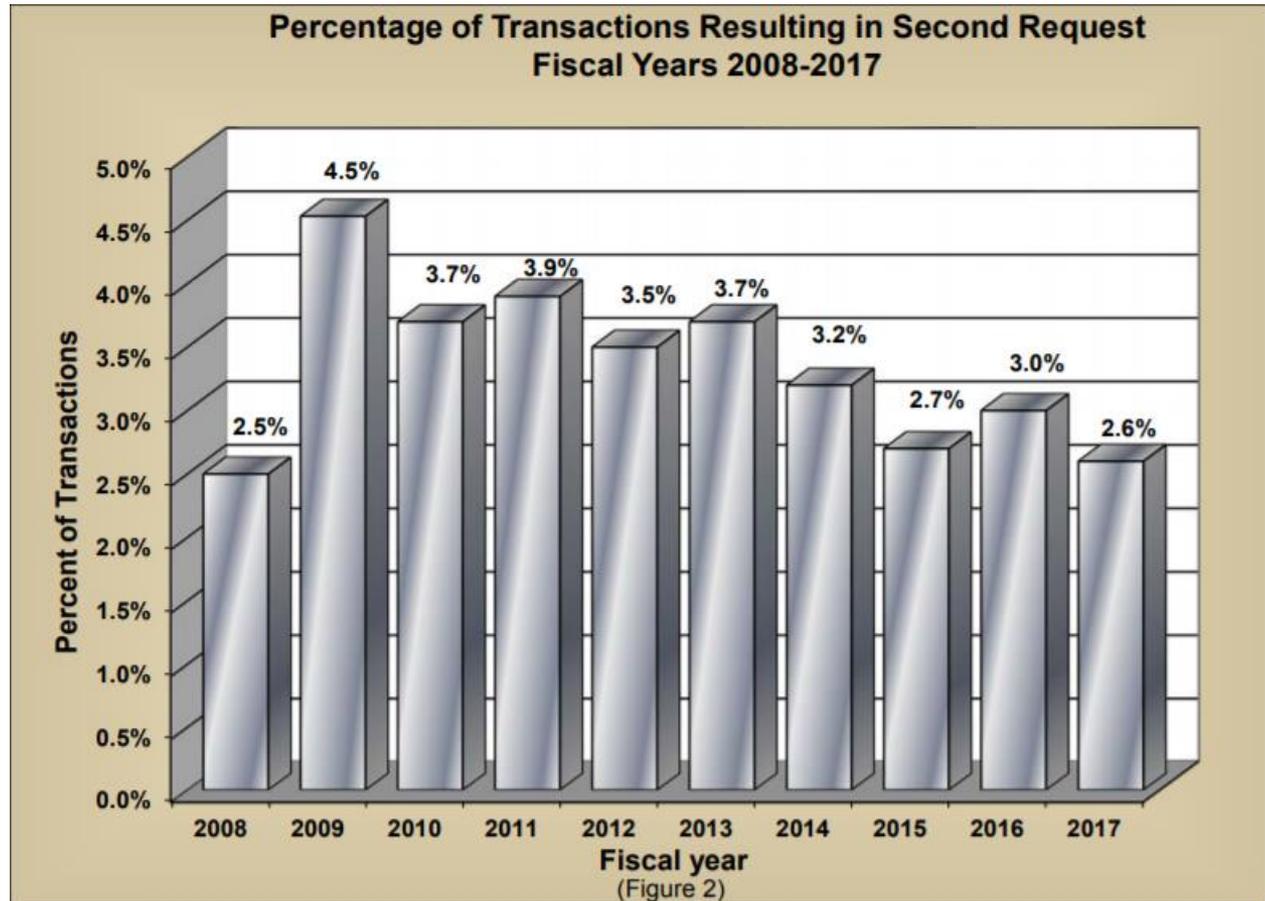
# Vast Majority of Mergers Are Legal

- FTC/DOJ's FY2017 HSR Merger report
  - 2,052 transactions were reported
  - A 12% increase from 2016
  - 78.6% of transaction request early termination had ET granted
- FTC brought 21 merger cases in FY2017
  - 14 consent orders
  - 6 transactions abandoned or restructured
  - 1 involved federal or administrative litigation
- Heavier litigation docket in 2018

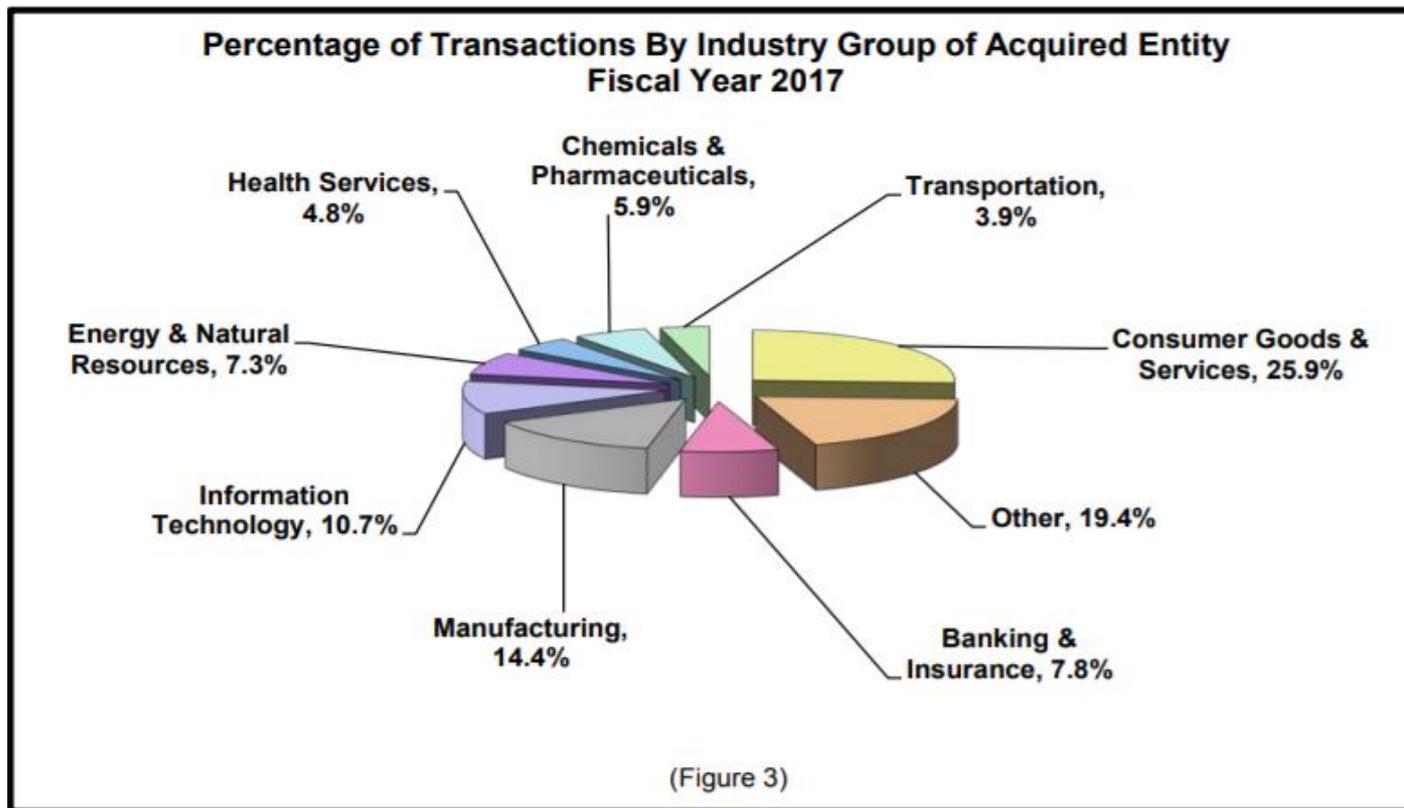
# Reported Transactions Under HSR



# Transactions Receiving Second Requests

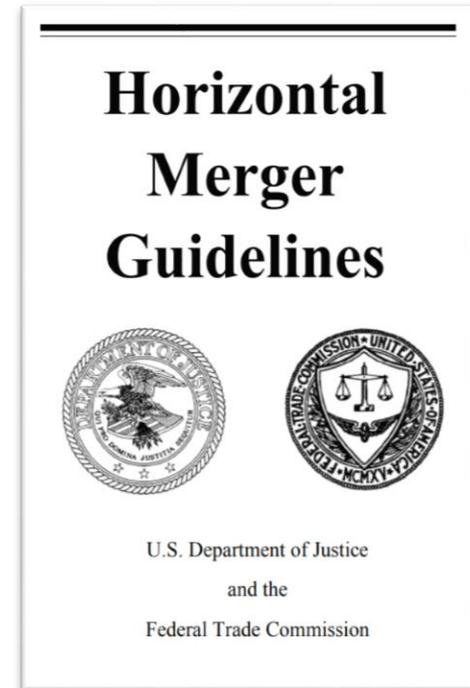


# Reported Transactions in FY2016 By Industry Group



# Analyzing Mergers

- Relevant Market
  - Product Market
  - Geographic Market
- Market Concentration
- Competitive Effects
- Entry Conditions
- Efficiencies
- Failing Firm



# Relevant Market Definition

## Key tool: Hypothetical Monopolist Test

- “Identif[ies] a set of products that are reasonably interchangeable with a product sold by one of the merging firms”
- Determines the geographic area in which competition affected by the merger occurs

# Identify the Product Market

- Fundamental question: what products are reasonable substitutes for each other and constraint each other's prices?
- Same concept as in dominance cases
- A relevant product market is the product or group of products for which a hypothetical monopolist could profitably reduce output and/or increase price by a small but significant amount (typically 5%-10%)
- What to look for:
  - Can customers easily find adequate substitutes if prices go up (price, use, quality the same) and defeat a SSNIP?
  - Can competitors easily enter so as to take away sales by offering a lower price, making a price increase strategy unprofitable?

# Evidence Supporting Market Definition

- Ordinary course party and competitor documents
  - How do the parties and other market participants view the market? (review market studies, strategic plans)
  - What do documents show happening when prices change or during bidding processes? (review sales personnel files)
  - But be aware that use of term “market” in business documents might be different than the antitrust market
- Customer testimony and documents
- Economic models
  - Must have access to relevant data available
  - Must pick an appropriate model and test its robustness
  - Models may lead to wrong conclusions if assumptions are incorrect or data has problems

# Defining the Product Market: *FTC v. Staples*

- What is the product?
- “Consumable office supplies” as a “cluster market”
  - Pens, file folders, Post-It notes, binder clips, copier paper
  - Not a real product market because pens, of course, don’t compete with clips
  - But we can group them together for analytical convenience because they are all marketed and sold under similar competitive conditions
  - Excluded, however, are ink and toner cartridges

# Defining the Product Market

- Who is the customer?
- Large, business-to-business customers constitute a targeted price discrimination market
  - Multi-year contracts with volume discounts
  - Sophisticated IT platforms for ordering, invoicing, and tracking utilization
  - Personalized, high-quality service from account manager
  - Next-day desktop delivery to all of their offices around the country

# Hypothetical Monopolist Test

- FTC's economic expert employed the hypothetical monopolist test to confirm that large B-to-B customer market is appropriate
  - He defined a hypothetical monopolist as controlling all the ways that a large B-to-B customer could order office supplies
  - Such a monopolist could charge prices much higher than what Staples and Office Depot have been charging because the parties face head-to-head price competition from each other, which would disappear with the merger

# The Product Market Battle

- FTC: Product market is the cluster of consumable office supplies sold to large B-to-B customers (\$500K and up)
- Staples and Office Depot: Product market is gerrymandered and artificially narrow
  - Ink and toner cartridges should be included
  - Marketplace does not recognize large B-to-B customers as a distinct segment

# Product Market Opinion

- Defendants' argument that ink and toner cartridges, as well as "beyond office supplies" items, should be part of the product market fails because these products are not sold under the same competitive conditions as office supplies
  - Commercial realities demonstrate that ink and toner are being sold by printer/copier manufacturers as part of a "managed print services" bundle
  - Same facts were taken into account in *Office Depot/OfficeMax*

# Product Market Opinion

- Defendants' argument that large, B-to-B customers don't deserve protection under the antitrust laws is contrary to the economics of price discrimination markets
  - Even targeted customers who make up a small share of the overall market are entitled to enjoy the benefits of competition
  - Parties' documents showed that they recognized their ability to target these customers for significant price increases after the merger

# Defining the Geographic Market

- Where can the producer profitably and sustainably impose a “small but significant and non-transitory increase in price” (“SSNIP”)?
- Where can consumers turn for alternative sources of supply?
- Economists look at:
  - Consumers’ historical purchase patterns
  - Company’s own business plans and selling patterns
  - Switching costs
  - Look for the “smallest market”

# Defining the Geographic Market: *FTC v. Sysco Corp.*

- FTC alleged two geographic markets for foodservice
  - National for “national broadline” because national customers need products delivered nationally
  - Local for “other broadline” based on proximity to distribution centers
- Defendants claimed “local” markets were too narrow
- Court ruled for FTC based on expert analysis

# Competitive Effects

- This is heart of merger analysis
- Two types of effects:
  - Unilateral effects: Can merged firm exercise market power on its own?
  - Coordinated interaction: Will a reduction in the number of competitors make collusion likely post-merger?
- Increase in market concentration can establish presumptions of anticompetitive effects under US merger guidelines

# Unilateral Effects

- Does the merger create or enhance the merged firm's ability to exercise market power?
- Will it be possible for the merged firm to raise prices no matter what anyone else does?
  - Will timely, likely, and sufficient entry occur?
  - Do Power Buyers exist to constrain prices?
- If firm *already* had market power in an area, the power is not due to the merger!
- Market share is just a starting point

# Unilateral Effects: Diversion

- The likelihood of anticompetitive effects increases the closer the merging parties compete with each other
  - One way to evaluate closeness of competition is to look at the percentage shares of customers that view one of the merging parties as the next best choice to the other
  - In other words, how much business would be diverted from one merging party to the other if one opens a location in the same geographic market as the other?

# Competitive Effects: Sysco

- Battle of the experts
- Court agreed FTC showed significant increase in market shares for both national and local markets
- Court looked at FTC bid study and defendants “switching” study
- Defendants viewed each other as closest competitors
- Concluded unilateral anticompetitive effects likely in national markets and local (closer call) markets

# Coordinated Interaction

- Overt collusion
- Tacit collusion
  - Allocation of territories
  - Price increases
  - Conscious parallelism
- Interdependent Behavior

# Coordinated Interaction

- Easier if:
  - Products are commoditized
  - Prices are detectable/policing
  - Demand is inelastic
- Harder if:
  - Buyer power
  - Maverick firm
  - Easy entry



# Coordinated Effects: Eliminating a Maverick

Mavericks have incentives that may make them less likely to go along with a coordinated scheme

If one of the merging parties has behaved as a maverick in the market; its elimination may make it easier for the remaining market participants to agree on prices or output

# What courts find compelling to prove coordinated effects

- Few players in the market
- Homogenous products (or little differentiations)
- Market characterized by mutually recognized independence
- Evidence of market participants accommodating each other
- Competitors have ability to monitor each others' actions
- History of private or public statements conveying information about strategies
- Evidence that market has low demand elasticity

# Entry and Expansion

- This can be a pivotal consideration in merger analysis
  - Even if a merger results in a large market share, that may not translate into market power if entry is relatively easy and inexpensive
  - It is routinely considered by staff in investigations and becomes part of the defendants' rebuttal case if litigated
- Questions of timeliness (how quickly), likelihood (are there barriers, incentives), and sufficiency (will entrant be an effective competitor)

# Entry and Expansion: Sysco

- Defendants:
  - It just takes “a guy and a truck”
  - Other distributors have grown
- FTC:
  - Broadline foodservice business is capital- and labor-intensive
  - Entry would likely take years
  - Regionals have said not likely to enter
- Court: Not timely, likely, or sufficient

# Entry and Expansion: *Staples*

- Defendants' argument: Amazon Business's entry will discipline the merged entity's exercise of market power
- FTC's response: No evidence that entry by Amazon Business or expansion by regional players will be timely and sufficient
- Court: Amazon Business may want to compete for large, B-to-B customers but it lacks demonstrated ability to do so; regional players don't have the desire or the ability

# Cognizable Efficiencies

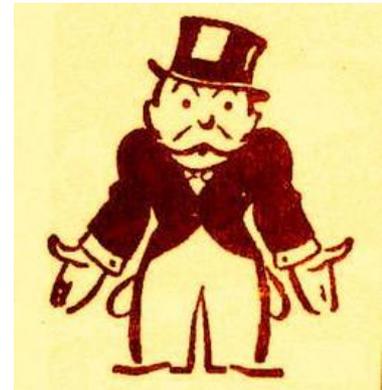
- Verifiable not speculative
- Specific to the merger
- Passed on to consumers
- More important if competitive effects are small
- Judge in *Sysco* rejected efficiencies claims as not merger-specific, not verifiable, and not beneficial to consumers

# Efficiencies: *Sysco*

- Defendants:
  - \$600M to \$1B in operational savings
  - \$490M merger-specific
- FTC:
  - 65% of efficiencies were not merger-specific
- Court reviewed expert testimony
  - No showing of what savings were due to merger—  
"product optimization," use of technology

# Failing Firm Defense

- Imminent danger of failure
  - Failing not “flailing”
  - Not able to meet its immediate, ongoing obligations
  - Not able to reorganize
  - Not just accounting losses
- No better alternative purchaser
- Firm assets would otherwise exit the market



# Failing Firm: Evidence

- Compare claims to communications with shareholder or investors
  - Often rosier picture for shareholders
- Board minutes
- Interview executives/CFOs
- History of financing alternatives
- History of shopping for other buyers

# Small Market Mergers: *St. Luke's*

- FTC and State of Idaho challenged hospital acquisition of large doctor group in Nampa, Idaho (pop. 86,000)
- Market was “adult primary care physician services” in Nampa
- Preliminary relief denied but the judge found for FTC/Idaho after trial
  - Also found harm in ancillary services
  - Required divestiture
- Circuit Court affirmed trial judge
  - Insurers needed these doctors in their networks
  - Efficiencies were achievable without merger



# Vertical Mergers: What is the competitive concern?

- Involve those in supplier-customer relationships
- Frequently present significant opportunity for efficiencies
- But could negatively impact one or more levels of production by:
  - Foreclosing competition/raising rivals' costs
  - Facilitating collusion
- Can the merged entity impede or foreclose competitive access by its rivals to suppliers and/or customers?
- Can the merged entity raise rivals' costs?



# Vertical Mergers May Need Different Remedies

- For horizontal mergers, structural remedies are preferred
- In vertical mergers, remedy must counteract ability and/or incentive to impair the competitive process, but in some situations other remedies may be possible

## Example: *General Electric/Avio*

- GE bought Avio, a company that made a critical component in a new Pratt & Whitney engine
- Concern: GE would have the ability and incentive to disrupt the design of this component in Pratt's new engine for the Airbus A320neo aircraft
  - Only other engine available for the A320neo was manufactured by CFM, a company in which GE owned a 50% interest
- FTC Remedy: Consent incorporates provisions of the original contract as well as a new commercial agreement between the parties; monitor to ensure GE's compliance; firewall governs GE's access to Pratt's proprietary information

# Summary

- Mergers present the same, market power concerns as dominance but are typically examined before they occur
- Market definitions are critical but market share is just one factor
- Look at the “real world”; talk to customers and competitors
- Look for competitive effects if evidence is available