The Antitrust Bulletin

The Journal of American and Foreign Antitrust and Trade Regulation

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Reprinted from

VOL. XXXVIII, NUMBER 3—FALL 1993

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When viewed from the antitrust perspective, some mergers are considered "bad," while other mergers are considered "good," or at least "not bad." What is it that separates the bad mergers from the rest? What is it that we fear will happen if the bad mergers are not blocked? More formally, what are the potential adverse competitive effects of concern that define the objectives of antitrust merger enforcement?

Perhaps the most significant contribution of the new Horizontal Merger Guidelines, issued jointly by the Department of Justice

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AUTHOR'S NOTE: *Revised and extended from remarks made at the Western Economics Association 67th Annual International Conference Contemporary Policy Issues Session: The 1992 Merger Guidelines: View from the Inside, San Francisco, California, July 11, 1992. This article benefited greatly from discussions with the other panelists as well as comments from Tom Baker and Robert Willig. None of the above bear responsibility for what remains.*

(DOJ) and the Federal Trade Commission (FTC), is to clarify the answer to these questions and to present a framework for distinguishing the bad from the rest.[1] In doing so, the 1992 Guidelines continue the efforts of the 1982 and 1984 versions of the DOJ Guidelines and the 1982 FTC Statement on Horizontal Mergers to move away from "merger analysis by the numbers" and toward a more complete analysis considering not only market concentration but also other market factors relevant to the likely effect of a merger.

This article reviews the prior treatment of competitive effects and the relationship between market concentration and competitive effects in the Supreme Court decisions and enforcement agency guidelines before outlining the analytical framework articulated by the 1992 Guidelines.

I. Early Supreme Court precedent

The antitrust treatment of mergers is governed by section 7 of the Clayton Act, which was amended in 1950 to prohibit stock and asset acquisitions where "the effect of such acquisition may be substantially to lessen competition, or tend to create a monopoly."[2] Left to the courts were the tasks of identifying the adverse competitive effects of concern (the ways in which a merger might substantially lessen competition) and determining

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[1] Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines (April 2, 1992), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,104 [hereinafter 1992 Guidelines]. The analysis of the 1992 Guidelines builds on the framework of the 1982 Guidelines and their 1984 revisions. *See* Department of Justice, Merger Guidelines (June 14, 1984), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,103 [hereinafter 1984 Guidelines] and Department of Justice, Merger Guidelines (June 14, 1982), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,102 [hereinafter 1982 Guidelines].

[2] 15 U.S.C. § 18. Mergers may also be evaluated under section 1 of the Sherman Act, 15 U.S.C. § 1, or section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45, but the standards under those statutes have converged to the section 7 standard. *See* United States v. Rockford Memorial Corp., 898 F.2d 1278 (7th Cir. 1990).

how to distinguish mergers in which those effects were likely from mergers in which those effects were not likely. The tasks were enormous and seemingly unbounded. But after the wide-ranging congressional debate, the statutory language offered the courts at least two points of guidance: (1) Congress chose to prohibit only those mergers with adverse competitive effects, as distinguished from mergers with adverse sociopolitical effects and (2) Congress did not choose to ban all mergers in concentrated markets or all mergers significantly increasing concentration; Congress prohibited only those likely to lessen competition.

The Supreme Court was slow to respond to the tasks left to it by the amended law. Only twice in nine opinions did the Court articulate a view of the competitive effects of concern. The competitive effects focus of antitrust merger analysis has evolved over the last 30 years from a fear of concentration in and of itself to a fear of specific postmerger conduct. But whatever the competitive effect of concern was, analysis of market concentration data was somehow central to distinguishing mergers likely to have adverse effects from those unlikely to have such effects.

In *Brown Shoe*, the Supreme Court's first horizontal merger decision after the adoption of the revised Clayton Act in 1950, the Court never articulated what might happen as a result of a merger that might lead to a lessening of competition. The closest the Court came to articulating the competitive effects of concern was paraphrasing the statute, referring to section 7 as a "tool for preventing all mergers having a demonstrable anticompetitive effect."[3] By contrast, the Court noted, the legislative history was clear that section 7 was not intended to impede

> for example, a merger between two small companies to enable the combination to compete more effectively with larger corporations dominating the relevant market, nor a merger between a corporation which is financially healthy and a failing one which no longer can be a vital competitive factor in the market.[4]

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[3] *Brown Shoe*, 370 U.S. 294, 319 (1962).

[4] *Id.*

Although there is reference in *Brown Shoe* to "the desirability of retaining 'local control' over industry and the protection of small business,"[5] the Court noted that "the dominant theme pervading congressional consideration of the 1950 amendments [to § 7] was a fear of what was considered a rising tide of economic concentration in the American economy."[6] The Court gave little indication of the basis for this fear of concentration other than to note, without reference to supporting authority, that "[t]hroughout the recorded discussion may be found examples of Congress' fear not only of accelerated concentration of economic power on economic grounds, but also of the threat to other values a trend toward concentration was thought to pose."[7] These fears, the Court noted, were bolstered by the release of the Federal Trade Commission's 1948 study of corporate mergers and other then-current studies.[8] But the only statistic cited was that the assets of firms acquired between 1940 and 1947 represented 5.5% of total U.S. manufacturing assets.[9]

The *Brown Shoe* Court regarded market concentration as an important, but not dispositive indicator, of the likely competitive effect of a merger. Instead, the Court wrote,

> [w]hile providing no definite quantitative tests by which enforcement agencies could gauge the effects of a given merger to determine whether it may "substantially" lessen competition or tend toward monopoly, Congress indicated plainly that a merger had to be functionally viewed, in the context of its particular industry.[10]

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[5] *Id.* at 316.

[6] *Id.* at 315.

[7] *Id.* at 316.

[8] *See id.* at 315 n.27 citing FTC, The Present Trend of Corporate Mergers and Acquisitions, *reprinted in* Hearings on H.R. 515 at 300–317; FTC, The Merger Movement: A Summary Report, *passim*; 95 CONG. REC. 11500–11507; 96 CONG. REC. 16,433, 16,444, 16,457; S. REP. No. 1775, 81st Cong., 2d Sess. 3.

[9] *See Brown Shoe*, 370 U.S. at 315 n.27.

[10] *Id.* at 321–22.

This context could be quite broad.

> [W]hether the consolidation was to take place in an industry that was fragmented rather than concentrated, that had seen a recent trend toward domination by a few leaders or had remained fairly consistent in its distribution of market shares among the participating companies, that had experienced easy access to markets by suppliers and easy access to suppliers by buyers or had witnessed foreclosure of business, that had witnessed the ready entry of new competition or the erection of barriers to prospective entrants, all were aspects, varying in importance with the merger under consideration, which would properly be taken into account.[11]

In a footnote, the Court added that

> [s]tatistics reflecting the shares of the market controlled by the industry leaders and the parties to the merger are, of course, the primary index of market power; but only a further examination of the particular market—its structure, history and probable future—can provide the appropriate setting for judging the probable anticompetitive effect of a merger.[12]

Later the Court referred to market share data as "one of the most important factors to be considered when determining the probable effects of the combination on effective competition in the relevant market."[13]

Not surprisingly, analysis of market share data played a large part in the Court's decision to affirm the lower court injunction against the merger. Noting that in 118 separate relevant geographic markets the combined shares of the merging firms exceeded five percent in one of the relevant product markets, the Court stated that "[i]f a merger achieving five percent control were now approved, we might be required to approve future merger efforts by Brown's competitors seeking similar market shares."[14] The Court went on to note that "in this fragmented industry, even if the combination controls but a small share of a

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[11] *Id.* 370 U.S. at 322.

[12] *Id.* at 322 n.38.

[13] *Id.* at 343.

[14] *Id.* at 343–44. The Court also noted that in 32 cities the combined share of the merging firms in women's shoes exceeded 20% and in 31

particular market, the fact that this share is held by a large national chain can adversely affect competition."[15]

The Court's second horizontal merger decision, *Philadelphia National Bank* (*PNB*) merely repeated the *Brown Shoe* dicta regarding the fear of rising concentration without any indication as to what might happen as concentration increased.[16] But the Court took a slightly different approach to the role of concentration, apparently motivated by three concerns: (1) the congressional mandate "to arrest anticompetitive tendencies in their 'incipiency' "; (2) the complexity and elusiveness of economic data upon which a firm understanding of the market could be based; and (3) the need for business to be able to assess the legal consequences of a merger with some confidence.[17] In light of these concerns, it was the Court's view that "intense congressional concern with the trend toward concentration warrants dispensing, in certain cases with elaborate proof of market structure, market behavior, or probable anticompetitive effects."[18] As an alternative, the Court held that

> a merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in concentration of firms in that market is so inherently likely to lessen competition that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects.[19]

Although declining to specify "the smallest [combined] market share which would still be considered to threaten undue concentration," the Court was "clear the 30% presents that threat" and

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cities the combined share of the merging firms in children's shoes exceeded 20%. In six cities the combined share of the merging firms in children's shoes exceeded 40%.

[15] *Id.* at 344.

[16] United States v. Philadelphia National Bank, 374 U.S. 321, 363 (1963).

[17] *Id.* at 362.

[18] *Id.* at 363.

[19] *Id.*

that an increase in the CR2 from 44% to 59% (more than a third) "plainly . . . must be regarded as significant."[20]

The Court gave no indication as to the basis for its view that concentration and competitive effects were so closely linked. Instead, the Court merely noted that its approach was "fully consistent with economic theory," citing the work of Kaysen and Turner, Stigler, and Bok.[21]

In the *Lexington Bank* case decided the year after *PNB*, the Court saw no need to even address the issue of the competitive effect of concern.[22] However, the Court appeared once again to change course in its treatment of market concentration. Rather than follow either the *PNB* or the *Brown Shoe* approach to the link between concentration and competitive effects, the Court followed *Columbia Steel*, a pre-1950 decision which held

> In determining what constitutes unreasonable restraint, we do no think the dollar volume is in itself of compelling significance; we look rather to the percentage of business controlled, the strength of the remaining competition, whether the action springs from business requirements or purpose to monopolize, the probable development of the industry, consumer demands, and other characteristics of the market. We do not undertake to prescribe any set of percentage figures by which to measure the reasonableness of a corporation's enlargement of its activities by the purchase of assets of a competitor. The relative effect of percentage command of a market varies with the setting in which that factor is placed.[23]

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[20] *Id.* at 364–65.

[21] *Id.* at 945 citing KAYSEN & TURNER, ANTITRUST POLICY 133 (1959); Stigler, *Mergers and Preventative Antitrust Policy*, 104 U. PA. L. REV. 176, 182 (1955); Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 HARV. L. REV. 226, 308–16, 328 (1960).

[22] *See* United States v. First Nat'l Bank & Trust Co., 376 U.S. 665 (1964) [hereinafter *Lexington Bank*].

[23] United States v. First Nat'l Bank & Trust Co., 376 U.S. 665, 672 (1964), *quoting* United States v. Columbia Steel Co., 334 U.S. 495, 527–28 (1948).

The Court, without any discussion in its opinion, found all of these circumstances supported finding a violation in this case. The Court's holding was succinct: "where as here the merging companies are major competitive factors in a relevant market, the elimination of significant competition between them constitutes a violation of Section one of the Sherman Act."[24]

The Court was not explicit about the basis for its conclusion that the merging firms were major competitors, perhaps finding the issue too obvious to merit mention. The relevant market was defined as commercial banking in Fayette County, Kentucky. Although no market shares were presented for this market, share data were provided separately for assets, deposits, loans, trust assets, trust department earnings, and number of trust accounts. Taking the deposit data, the data most favorable to the defendants, the combined share of the merging firms exceeded 51%, the CR4 exceeded 81%, and the postmerger Herfindahl-Hirschman index (HHI) exceeded 3330 with a change of over 940.

Later in the same term, in *Alcoa* (Rome Cable), the Court, for the first time, articulated what conduct it feared might result from a merger that would lessen competition, indicating that the concern was that "parallel policies of mutual advantage, not competition, will emerge."[25] This focus on the prospect for postmerger coordinated interaction would become the dominant theme of federal enforcement in the 1980s.[26] The Court also drew a more explicit linkage between concentration and competitive effects:

> It would seem that the situation in the aluminum industry may be oligopolistic. As that condition develops, the greater is the likelihood that parallel policies of mutual advantage, not competition, will emerge.[27]

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[24] *Lexington Bank*, 376 U.S. at 672–73.

[25] United States v. Aluminum Co. of America, 377 U.S. 271, 280 (1964).

[26] *See generally* Denis, *Antitrust Merger Analysis: Refining the Collusion Hypothesis*, 60 ANTITRUST L.J. 829 (1992).

[27] *Alcoa*, 377 U.S. at 280.

Earlier in the opinion the Court quoted *PNB* for the proposition that "if concentration is already great, the importance of preventing even slight increases in concentration and so preserving the possibility of eventual deconcentration is correspondingly great."[28] In this case Alcoa had 27.8% of the aluminum conductor market and Rome Cable had 1.3%.

In *Continental Can*, the Court framed the issue as "whether the merger . . . will have probable anticompetitive effect within the line of commerce."[29] The Court did not clearly indicate what postmerger behavior would lead to such effects but perhaps for the first time suggested that unilateral as well as coordinated effects were a matter of concern. At one point the Court seemed to suggest that both enhancing a firm's market power and improving the "vigor and effectiveness of its competitive efforts" might be competitive effects of concern.[30]

The strong linkage between concentration and competitive effects articulated in *Alcoa* appeared to be weakened somewhat by the Court's opinion in *Continental Can*. In addition, the Court, for the first time, supplied some meaning to *PNB* referring to its approach as "presumptive."[31] But *Continental Can* appeared not to follow either of these decisions and, instead used language reminiscent of *Brown Shoe*:

> Market shares are the primary indicia of market power but a judgment under § 7 is not to be made by a single qualitative or quantitative test. The merger must be viewed functionally in the context of the particular market involved, its structure, history and probable future.[32]

The Court also seemed to go beyond *Brown Shoe* and suggest that aggregate size rather than market concentration was what mattered.

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[28] *Id.* at 279 *quoting* United States v. Philadelphia National Bank, 374 U.S. 321, 365 n.42 (1964).

[29] United States v. Continental Can Co., 378 U.S. 441, 458 (1964).

[30] *Id.* at 464.

[31] *Id.* at 458.

[32] *Id.*

> Where a merger is of such size as to be inherently suspect, elaborate proof of market structure, market behavior, and probable anticompetitive effect may be dispensed with in view of § 7's design to prevent undue concentration.[33]

Nevertheless, the Court indicated that competitive concerns arose "when a dominant firm in a line of commerce in which market power already is concentrated among a few firms makes an acquisition which enhances its market power and the vigor and effectiveness of its own competitive efforts."[34] To the majority, such concerns were presented where Continental Can, the second largest firm in the glass and metal container market with 21.9% acquired Hazel Atlas Glass, the sixth largest firm with 3.1%.[35] The combined share, the Court noted, "approaches that held presumptively bad" in *PNB* and nearly matched those in *Alcoa* (Rome Cable).[36]

But for the first time, one Justice strongly attacked the notion that any inference about competitive effects could be drawn from market share data, at least in multiproduct markets. Blasting the majority's "spurious market-share analysis," Justice Harlan characterized the decision as a " '*per se*' rule that mergers between two large companies in related industries are presumptively unlawful under § 7" and criticized the majority for failing to demonstrate that such mergers are inherently likely to lessen competition.[37] As an alternative, he argued that

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[33] *Id.*

[34] *Id.* at 464.

[35] The largest firm in the market, American Can, had 26.8%. Owens Illinois Glass, Anchor Hocking Glass and National Can were the third, fourth, and fifth largest firms in the market with 11.2%, 3.8% and 3.3% respectively. The merger would raise the CR2 from 48.7% to 51.8% and would raise the CR4 from 63.7% to 66.8%. *See Continental Can*, 378 U.S. at 461 n.11. Assuming that the remainder of the market was split among 10 firms each with 3%, these shares imply a postmerger HHI of 1584 with a change of 136.

[36] *Continental Can*, 378 U.S. at 461.

[37] *Id.* at 476.

> When a merger is attacked on the ground that competition *between* two distinct industries or lines of commerce, will be affected, the shortcut "market share" approach developed in the *Philadelphia Bank* case has no place. In such a case, the legality of the merger must surely depend, as it did below, on an inquiry into competitive effects in the actual lines of commerce involved.[38]

Later Supreme Court decisions either confused or managed to avoid the question of the competitive effect of concern. Perhaps the low point came with the infamous *Vons Grocery* and *Pabst* decisions.[39] In *Vons Grocery*, the majority opinion was virtually devoid of discussion of competition. Only after a lengthy discussion of trends to concentration and the shrinking numbers of independent stores did the Court bother to even mention the effect of the merger on competition. Justice Stewart's dissenting opinion took the majority to task for failing to focus on competition:

> The Court makes no effort to appraise the competitive effects of this acquisition in terms of the contemporary [conditions] of the retail food industry in the Los Angeles area. Instead, through a simple exercise in sums, it finds that the number of individual competitors in the market has decreased over the years, and, apparently on the theory that the degree of competition is invariably proportional to the number of competitors, it holds that this historic reduction in the number of competing units is enough under § 7 to invalidate a merger. . . . This startling *per se* rule is contrary not only to our previous decisions but contrary to the language of § 7, contrary to the legislative history of the 1950 amendment, and contrary to economic reality.[40]

Vons Grocery had no discussion of the linkage between concentration and competitive effects but this is not surprising since the majority opinion showed so little consideration of competitive effects at all.[41] When faced with the argument that the market was

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[38] *Id.* at 441 (Harlan, J., dissenting) (emphasis in original).

[39] United States v. Vons Grocery Co., 384 U.S. 270 (1966) and United States v. Pabst Brewing Co., 384 U.S. 546 (1966).

[40] United States v. Vons Grocery Co., 384 U.S. 270, 282 (1966) (Stewart, J., dissenting).

[41] In any event, concentration figures were hardly startling. The largest firm in the market had only 8%. The merging firms, the third and sixth largest firms in the market, had a combined share of only 8.9%.

competitive before the merger, had been since the merger, and would continue to be competitive, the Court noted:

> It is enough for us that Congress feared a market marked at the same time by both a continuous decline in the number of small businesses and a large number of mergers would slowly but inevitably gravitate from a market of many small competitors to one dominated by a few giants, and competition would be destroyed.[42]

Concentration was no longer presumptive evidence of likely competitive effect. It was not even particularly relevant. Instead, trends to concentration were conclusive proof of illegality. The dissent clearly saw some link between concentration and competitive effects since it excoriated the majority for failing to consider "the economic concentration of the market, the level of competition in the market, or the potential adverse effect of the merger on that competition."[43] But the dissent also failed to provide any insight as to how competition might be reduced by a merger or how concentration was relevant to that effect.

The emphasis on trends toward concentration continued in *Pabst* where the Court held that "a trend toward concentration in an industry, whatever its cause, is a highly relevant factor in deciding how substantial the anticompetitive effect of a merger might be."[44]

With the *General Dynamics* and *Citizens & Southern* decisions the Court managed to swing the focus of merger analysis back to the likely effect of the merger on competition, or more accurately, the impact of the merger on probable future competition.[45] Like most past decisions of the Court, *General Dynamics* and *Citizens & Southern* gave no indication of the dynamic through which a merger might lessen competition. But this was an issue the Court had no cause to reach in either case.

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[42] *Vons Grocery*, 384 U.S. at 278.

[43] *Id.* at 282 (Stewart, J., dissenting).

[44] *Pabst*, 384 U.S. at 552–53.

[45] United States v. General Dynamics, 415 U.S. 486 (1974) and United States v. Citizens & Southern National Bank, 422 U.S. 86 (1975).

In *General Dynamics*, the Court affirmed the lower court's holding that the depleted reserves of the acquired company meant it had no future ability to compete. The acquisition of a company with no future ability to compete, the Court reasoned, effected no change in the nature of competition in the market and, therefore, logically could not lessen competition.

Other portions of the *General Dynamics* opinion, however, suggest that the Court had still not developed a theory of what might happen as a result of a merger that would lessen competition. In discussing the significance of market concentration data the Court appeared to suggest that the concern was that the combined firm would have a market share equal to the sum of the market shares of the merging firms.

> In most situations, of course, the unstated assumption is that a company that has maintained a certain share of a market in the recent past will be in a position to do so in the immediate future. Thus, companies that have controlled sufficiently large shares of a concentrated market are barred from merger by § 7, not because of their past acts, but because their past performances imply an ability to continue to dominate with at least equal vigor.[46]

The Court went on to clarify that under its past decisions in *Brown Shoe*, *PNB*, *Continental Can*, *Vons*, and *Pabst*, market concentration data were of evidentiary rather than substantive significance. Market concentration data merely established "prima facie violations." While the government was entitled to rest its case at this point, the Court was still to hear evidence on why, notwithstanding these statistics, the merger was unlikely to lessen competition. "Evidence of past production does not, as a matter of logic, give a proper picture of a company's future ability to compete."[47] The Court affirmed the district court holding that it "was justified in finding that other pertinent factors affecting the coal industry and the business of appellees mandated a conclusion that no substantial lessening of competition occurred or was threatened by the acquisition."[48] Historical sales data were misleading as to the

[46] *General Dynamics*, 415 U.S. at 501.

[47] *Id.*

[48] *Id.* at 498.

future competitive significance of the acquired firm because it effectively had no uncommitted reserves of coal that were needed to compete in the future.

Similarly, in *Citizens & Southern* the Court affirmed the lower court decision that found that the acquisition of banks that had been found to be de facto branches of the acquiring firm would not lessen competition for the simple reason that there was no competition to be lessened. *Citizens & Southern* reaffirmed the evidentiary role of concentration and stated squarely that proof of a highly concentrated market and an increase in concentration due to the merger was prima facie evidence of a violation of section 7.[49] It was "thus incumbent upon C&S to show that the market-share statistics gave an inaccurate account of the acquisition's probable anticompetitive effect."[50] Here the burden clearly was met since the acquired banks had been in a correspondent relationship with the acquiring bank in order to get around state branching laws. The Court found that "under the correspondent associate program that had been continuously in effect, no real competition had developed or was likely to develop among the [acquired] banks, or between these and [the acquiring bank]."[51]

Thus, after nine decisions in 12 years, the Supreme Court had only given two indications of the competitive effect of concern, one clearly stating a concern with coordinated effects (*Alcoa*), the other hinting at a concern with unilateral action by the merged firm (*Continental Can*). The Court recognized that a host of market factors were relevant to the likelihood of this effect in a given case. Perhaps because of the concern in Congress over the rising tide of economic concentration, market concentration data were accorded particular evidentiary significance. The plaintiffs' prima facie case could be established through evidence of market concentration data. Other evidence, if brought forward by defendants, remained relevant. But how relevant that evidence would be, and how it would be analyzed, remained one of the riddles of antitrust.

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[49] *See Citizens & Southern*, 422 U.S. at 120.

[50] *Id.*

[51] *Id.* at 121.

II. Enforcement agency guidelines and statements

The initial thrust of government enforcement agency guidelines and statements about horizontal mergers merely replicated the confusion left by the Supreme Court's decisions. Later versions, however, gave a more complete articulation of the competitive effects of concern and attempted to treat more systematically the relevance of various market factors, including market concentration.

A. 1968 DOJ Merger Guidelines

Merger Guidelines issued in 1968 by the Department of Justice were the first enforcement agency statement on merger review standards.[52] In the 1968 Guidelines, the Department of Justice stated that

> the primary role of Section 7 enforcement is to preserve and promote market structures conducive to competition. Market structure is the focus of the Department's merger policy because the conduct of the individual firms in a market tends to be controlled by the structure of that market.[53]

The only indication of the conduct feared was a single sentence that stated

> a concentrated market structure, where a few firms account for a large share of the sales, tends to discourage vigorous price competition by the firms in the market and to encourage other kinds of conduct, such as use of inefficient methods of production or excessive promotional expenditures of an economically undesirable nature.[54]

The 1968 Guidelines took much the same tack as the early Supreme Court precedent in the treatment of concentration. Mergers above certain concentration thresholds were to be challenged. If the market was "highly concentrated" (CR4 at least 75), the

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[52] *See* Department of Justice, Merger Guidelines (1968), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,101 [hereinafter 1968 Guidelines].

[53] 1968 Guidelines § 2.

[54] *Id.*

DOJ would "ordinarily challenge mergers between firms accounting for, approximately the following percentages of the market":[55]

Acquiring firm	*Acquired firm*
4%	4% or more
10%	2% or more
15% or more	1% or more

If the market was "less highly concentrated" (CR4 less than 75), the DOJ would "ordinarily challenge mergers between firms accounting for, approximately the following percentages of the market":[56]

Acquiring firm	*Acquired firm*
5%	5% or more
10%	4% or more
15%	3% or more
20%	2% or more
25% or more	1% or more

The only exception was if technological change made "current market boundaries and market structure of uncertain significance."[57]

B. 1982 DOJ Merger Guidelines

The 1982 DOJ Merger Guidelines sharply changed the focus of the Department's merger policy. There, for the first time, the Department stated that "the unifying theme of the Guidelines is that mergers should not be permitted to create or enhance market power or to facilitate its exercise."[58] Market power was defined as the "ability of one or more firms profitably to maintain prices

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[55] *Id.* at § 5.

[56] *Id.* at § 6.

[57] *Id.* at § 2.

[58] 1982 Guidelines § I.

above competitive levels for a significant period of time."[59] Market power was the focus of the 1982 Guidelines apparently because the result of an exercise of market power "is a transfer of wealth from buyers to sellers and a misallocation of resources."[60]

Single firm conduct could be either that of a monopolist or of a firm well short of monopoly.[61] As for multifirm conduct, the 1982 Guidelines made frequent references to the prospects for postmerger "collusion."[62] The concerns were much broader, however, than merely express collusion. The 1982 Guidelines explained the concern with multifirm exercise of market power noting that "[w]here only a few firms account for most of the sales of a product, those firms can in some circumstances *coordinate*, explicitly or implicitly, their actions in order to approximate the performance of a monopolist."[63]

The DOJ's 1982 Merger Guidelines provided for a more detailed analysis but still rested heavily on market concentration data. The DOJ's Explanation and Summary of the Merger Guidelines indicated that the purpose of the new guidelines was to reflect the "need for evidence of harm or potential harm to competition before a merger will be challenged."[64] The explanation also noted that concentration remained relevant because "it is much easier to raise prices above a competitive level and keep them there in a highly concentrated market."[65] The 1982 Guidelines themselves went further asserting that "[o]ther things being equal, concentration affects the likelihood that one firm, or a

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[59] *Id.*

[60] *Id.*

[61] *See id.* at §§ I (monopolist) and III.A.2. (leading firm proviso applying to the largest firm in the market with a share of at least 35%).

[62] *See, e.g., id.* at § III.C.

[63] *Id.* at § I (emphasis supplied).

[64] U.S. Department of Justice, Explanation and Summary of the Merger Guidelines at 3, *reprinted in* Trade Reg. Rep. (CCH) No. 546 at 58 (June 16, 1982).

[65] *Id.* at 8, 62.

small group of firms, could successfully exercise market power."[66] In the case of single firm conduct, the 1982 Guidelines explained, "[t]he smaller the percentage of total supply that firm controls, the more severely it must restrict its own output in order to produce a given price increase, and the less likely it is that an output restriction will be profitable."[67] The same was true about collective exercise of market power but an additional constraint also applied: "[a]s the number of firms necessary to control a given percentage of total supply increases, the difficulties and costs of reaching and enforcing consensus with respect to the control of that supply also increase."[68]

For the first time, market concentration was measured by the HHI and used to establish "safe harbor" ranges in which challenge was unlikely.[69] Challenge was unlikely if the postmerger HHI was below 1000; if the postmerger HHI was between 1000 and 1800 and the change in the HHI attributable to the merger was less than 100; and if the postmerger HHI was above 1800 and the change in the HHI attributable to the merger was less than 50.[70]

Above these levels the likelihood of challenge varied. In the mid-range (postmerger HHI between 1000 and 1800), the Department was "more likely than not to challenge mergers in this region that produce an increase in the HHI of more than 100 points," although in making this decision the Department would take into account the postmerger HHI, the change in the HHI and the presence or absence of "other factors relating to ease of entry and the ease and profitability of collusion."[71] In the highly con-

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[66] 1982 Guidelines § III.A.

[67] *Id.*

[68] *Id.*

[69] The HHI is calculated by summing the squared market share of all market participants. The change in the HHI attributable to the merger is calculated by taking twice the product of the market shares of the merging firms. *See* 1982 Guidelines § III.A. and n.30.

[70] *See id.* at § III.

[71] *Id.* at § III.A.1.(b).

centrated range (postmerger HHI over 1800), for a change in the HHI of between 50 and 100, the decision to challenge would be based on the postmerger HHI, the change in the HHI and the presence or absence of "other factors relating to ease of entry and the ease and profitability of collusion."[72] For a change in the HHI of 100 points or more, the 1982 Guidelines flatly stated that challenge was likely without referencing any particular factors to be considered.[73] However, earlier in the Guidelines, language suggested that in all cases beyond the specified concentration levels the Department would proceed to examine a variety of factors, other than market concentration, relevant to the likely competitive impact of a merger.

These concentration thresholds appear to be addressed to DOJ's concern over postmerger coordinated interaction. In a separate section captioned "Leading Firm Proviso," DOJ indicated that "mergers may create or enhance market power of a single dominant firm" and that notwithstanding the generally applicable standards, DOJ was also likely to challenge the merger of

> any firm with a market share of at least 1 percent with the leading firm in the market, provided that the leading firm has a market share of at least 35 percent and is approximately twice as large as that of the second largest firm in the market.[74]

As before, however, other market factors remained relevant.

In the case of the leading firm proviso, only one other market factor was relevant to the DOJ's analysis, ease of entry into the market. This same factor was also relevant where the competitive effect of concern was coordinated interaction but the DOJ also considered a host of other factors "as they relate to the ease and profitability of collusion."[75] The Guidelines went on to note that "[w]here relevant, the factors are most likely to be important where the Department's decision whether to challenge a merger is

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[72] *Id.* at § III.A.1.(c).

[73] *See id.*

[74] *Id.* at § III.A.2.

[75] *Id.* at § III.C.

otherwise close."[76] The factors included the nature of the product and its terms of sale, information about specific transactions and buyer market characteristics, and conduct of the firms in the market. In each case, the 1982 Guidelines suggested factors that would make the DOJ more likely to challenge a transaction.

C. 1982 FTC Statement on Horizontal Mergers

The 1982 FTC Statement made a less direct statement of the FTC's view as to the competitive effect of concern in merger analysis than was contained in the concurrently released 1982 DOJ Guidelines. Although there is passing reference to "Congress' concern with overall social and political ramifications of economic concentration attributable to merger activity," the clear implication of the 1982 FTC Statement was that the FTC's focus would be on "the extent to which the merger would confer market power on the acquiring firm or enhance the ability of firms to collude, either expressly or tacitly."[77] Nowhere, however, did the FTC define the concept of "market power."[78]

The FTC Statement expressed some skepticism of the asserted link between market concentration and competitive effects in merger analysis. The FTC Statement noted that

> the courts, the Commission and the Antitrust Division traditionally have looked to market share data and derivative concentration ratios as the principal indicators of market power. Their reliance on such evidence was founded on early empirical economic literature indicating a significant positive relationship between concentration levels, industry performance and profits. . . . More recent empirical research and well over a decade of practical experience in analyzing and evaluating horizontal mergers, however, have led the Commission to conclude

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[76] *Id.*

[77] 1982 FTC Statement § II.

[78] The 1982 FTC Statement does, however, include a general statement that "the Department of Justice's 1982 revisions to the 1968 Guidelines will be given considerable weight by the Commission and its staff in their evaluation of horizontal mergers and the development of the Commission's overall approach to horizontal mergers." 1982 FTC Statement § I.

> that proper consideration of market realities justifies some revision of market share benchmarks [from the 1968 Guidelines] and greater consideration of evidence beyond mere market shares when such evidence is available and in a reliable form.[79]

The FTC Statement did not offer specific concentration thresholds but did conclude that "while the Commission will continue to look to market share data as an important indicium of the likely competitive effects of a merger, a more refined treatment of that [sic] data is in order."[80] Consistent with that conclusion, the FTC devoted nearly three times as much space to nonmarket-share considerations relevant to unilateral or coordinated exercise of market power.[81]

D. 1984 DOJ Merger Guidelines

The 1984 revisions to the DOJ's 1982 Guidelines did not alter the treatment of competitive effects. The focus on market power, its definition, and the means by which it might be exercised were discussed in identical terms.[82] But the 1984 Guidelines moved even further away from reliance on market concentration data.

The DOJ's Statement Accompanying Release of the 1984 Guidelines stated that the revisions were motivated in part by a desire to clarify that "the Department will not challenge a merger solely on the basis of concentration and market share data without considering other relevant factors."[83] Consistent with this objective, language was added to the Guidelines stating that "market share and concentration data provide only the starting point for analyzing the competitive impact of a merger. Before determining whether to challenge a merger, the Department will consider all other relevant factors that pertain to its competitive impact."[84]

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79 *Id.* at § II.

80 *Id.* at § III.

81 *See id.*

82 *Compare* 1984 Guidelines § 1.0 with 1982 Guidelines § I.

83 Statement Accompanying Release at 8.

84 1984 Guidelines § 3.11.

But the Guidelines still retained language asserting a link between concentration and the likelihood of adverse competitive effects. Moreover, some changes in the language of the Guidelines appeared to give market concentration data a more prominent rather than less prominent role in the analysis. It was now stated that "the Department is likely to challenge" mergers exceeding certain market concentration thresholds "unless the Department concludes, on the basis of the post-merger HHI, the increase in the HHI, and the presence or absence of the [other factors discussed in the Guidelines], that the merger is not likely substantially to lessen competition."[85] At the highest levels of concentration, a postmerger HHI substantially above 1800 and a change in the HHI above 100, "only in extraordinary cases [would] such factors establish that the merger is not likely to lessen competition."[86]

Other changes from the 1982 Guidelines appeared to give less weight to market concentration data. Prior to introducing these concentration standards, the 1984 Guidelines added the caution that "because concentration and market share data present a historical picture of the market, the Department must interpret such data in light of the relevant circumstances and the forward-looking objective of the Guidelines—to determine the likely *future effects* of a given merger."[87] In addition, the discussion of nonmarket-concentration factors was expanded to add such factors as changing market conditions, the financial condition of firms in the relevant market, special factors affecting foreign firms, and the ability of small or fringe sellers to increase sales.[88] The 1984 Guidelines also added that the enumerated factors "among others" were relevant to the decision whether to challenge a particular merger.[89]

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[85] *Id.* at § 3.11(b). This standard applied in two situations: (a) where the postmerger HHI was between 1000 and 1800 and the change in the HHI was greater than 100 and (b) where the postmerger HHI was greater than 1800 and the change in the HHI was greater than 50.

[86] 1984 Guidelines § 3.11(c).

[87] *Id.* at § 3.1 (emphasis supplied).

[88] *See id.* at §§ 3.2, 3.43.

[89] *Id.* at § 3.4.

E. 1987 NAAG Guidelines

The National Association of Attorneys General (NAAG) took a slightly different tack in their own merger guidelines issued in 1987.[90] NAAG stated that

> [t]he central purpose of the law is to prevent firms from attaining market or monopoly power, because firms possessing such power can raise prices to consumers above competitive levels, thereby effecting a transfer of wealth from consumers. . . . [P]reserving allocative efficiency is generally considered an additional benefit realized by the prevention of market power, because the misallocative act of restricting output has the concomitant effect of raising prices to consumers. It is counterintuitive, however, to primarily base merger policy on the analysis of these efficiency effects, which are inconsequential in the statutory scheme, and are insignificant in relation to the wealth transfers associated with the exercise of market power.[91]

Market power was defined as "the ability of one or more firms to maintain prices above a competitive level, or to prevent prices from decreasing to a lower competitive level, for a significant period of time."[92] Multifirm conduct could take the form of either "active collusion" or "implicit[ ] coordinat[ion]."[93] It is unclear what form single firm conduct could take short of monopoly but there is one reference to a concern with "oligopolistic behavior" which NAAG regarded as "plausible in a market comprised of ten or fewer firms of roughly equal size."[94] NAAG also indicated that

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[90] *See* Horizontal Merger Guidelines of the National Association of Attorneys General (March 16, 1987), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,405 [hereinafter 1987 NAAG Guidelines]. The NAAG Guidelines were revised in 1993 but, except as noted, the revisions did not materially alter the treatment of competitive effects or the relevance of market concentration data. *See* National Association of Attorneys General, 1993 Horizontal Merger Guidelines, *reprinted in* Trade Reg. Rep. (CCH) No. 256 (March 31, 1993) [hereinafter 1993 NAAG Guidelines].

[91] 1987 NAAG Guidelines § 2.

[92] *Id.* at § 2 n.9. The 1993 NAAG Guidelines delete the temporal dimension of this definition but add the notion that the ability to limit output or entry also constitutes market power. *See* 1993 NAAG Guidelines § 2 n.8.

[93] 1987 NAAG Guidelines § 2.11.

[94] *Id.* at § 4.1 n.32.

the law had "several subsidiary purposes" but did not identify them.[95]

The NAAG Guidelines moved back to a closer linking of market concentration and competitive effects, akin to the 1960s era Supreme Court decisions.

> The predominant concern of the Congress in enacting section 7 was the prevention of high levels of industrial concentration because of the likely anticompetitive consequences. Foremost among these likely anticompetitive effects of high concentration is the exercise of market power by one or more firms through monopolization, collusion or interdependent behavior in an oligopolistic market.[96]

In addition to drawing this linkage because Congress before it had done so, NAAG asserted, without authority, that

> the predominant focus of scholarly economic inquiry into the competitive consequences of merger has been the correlation of concentration levels with various indicia of competition. Other theories which predict the competitive effects of mergers based upon factors other than market concentration, though valuable, have not nearly reached the level of precision which is necessary for them to form the basis for responsible policy decisions.[97]

With that foundation, NAAG states that challenge is likely if the postmerger HHI is between 1000 and 1800 and either (a) the change in the HHI is more than 100 or (b) the change in the HHI is more than 50 and during the 36 months prior to the merger the HHI has increased by more than 100.[98] Challenge is unlikely in either case if assessment of entry and/or efficiencies "clearly compel the conclusion that the merger is not likely substantially to lessen competition."[99] Where the postmerger HHI is above

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[95] *Id.* at § 2.

[96] *Id.* at § 4.

[97] *Id.*

[98] *See id.* at § 4.2. The trend toward competition provision has been deleted from the 1993 NAAG Guidelines.

[99] 1987 NAAG Guidelines § 4.2. The 1993 NAAG Guidelines require that the parties "demonstrate . . . that the merger is not likely significantly to lessen competition" in order to avoid a challenge.

1800, challenge is likely if either (a) the change in the HHI is more than 50 or (b) the change in the HHI is more than 25 and during the 36 months prior to the merger the HHI has increased by more than 50. Challenge is unlikely only if assessment of entry, but not efficiencies, "clearly compel the conclusion that the merger is not likely substantially to lessen competition."[100] Other than ease of entry, the NAAG Guidelines do not admit to any other factors that might counsel against challenging a particular transaction.

III. The 1992 DOJ and FTC Horizontal Merger Guidelines

The 1992 Horizontal Merger Guidelines retain the market power focus of the 1982 and 1984 Guidelines and also maintain the same definition of market power. But the discussion of the potential adverse competitive effects of concern—the means by which market power may be exercised, and the circumstances in which such conduct is likely to be successful—are substantially revised. Equal emphasis is placed on exercise of market power through both coordinated interaction and unilateral conduct of the merged firm.

Market concentration, while still a significant component of the analysis, is less determinative of enforcement agency action than in previous guidelines. The 1992 Guidelines abandon the notion that the Agency is "likely to challenge" transactions above certain concentration levels. Instead, the Guidelines provide an analytical framework for evaluating concentration and nonconcentration evidence in determining whether a merger is likely to have adverse competitive consequences.

The 1992 Guidelines provide an analytical process of five steps to be applied in all horizontal merger analyses. The five steps are each necessary and together sufficient to determine whether a merger is likely to have adverse competitive conse-

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100 1987 NAAG Guidelines § 4.3.

quences.[101] The five steps are (1) market definition, measurement, and concentration, (2) competitive effects, (3) entry analysis, (4) efficiencies, and (5) failing firm and failing division. Consistent with the focus of the remainder of the article, this section will focus only on the first two steps of the 1992 Guidelines' analytical process.[102]

A. Market definition, measurement, and concentration

Like the predecessor versions, the 1992 Guidelines begin with market definition, measurement, and concentration. The three parts of this analysis are more clearly distinguished in the 1992 Guidelines than in previous versions. Market definition focuses solely on demand-side factors—i.e., likely consumer responses to the now familiar "small but significant and nontransitory increase in price" (a.k.a. SSNIP). The relevant market is defined in both its product and geographic dimension.[103]

Market measurement, by contrast, focuses on likely supply-side factors including likely responses by firms not presently producing or selling products in the relevant market to a SSNIP.[104]

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[101] *See generally* Rill, *Sixty Minutes With the Honorable James F. Rill*, 61 ANTITRUST L.J. 229 (1992); Denis, *Practical Approaches: An Insider's Look at the New Horizontal Merger Guidelines*, 6 ANTITRUST 6 (1992).

[102] For an overview of the entire analytical process see James, *An Overview of the 1992 Horizontal Merger Guidelines*, 61 ANTITRUST L.J. 447 (1993); Rill, *supra* note 101; Denis, *supra* note 101. For a more detailed look at specific issues *see, e.g.*, Ordover & Baker, *Entry Analysis Under the 1992 Horizontal Merger Guidelines*, 61 ANTITRUST L.J. 139 (1992); Denis, *Analysis of Uncommitted Entry Under the New Horizontal Merger Guidelines*, 17 ANTITRUST LITIGATOR 6 (Sept. 1992); Willig, *The Role of Sunk Costs in the 1992 Guidelines Entry Analysis*, 6 ANTITRUST 23 (1992); Yao & Arquit, *Applying the 1992 Horizontal Merger Guidelines*, 6 ANTITRUST 17 (1992). Other articles are included in J. Clark and M. Steptoe (eds.), *The Antitrust Division and the FTC Speak on Current Developments in Federal Antitrust Enforcement 1992* (Practicing Law Institute No. 795).

[103] *See* 1992 Guidelines §§ 1.1, 1.2.

[104] *See id.* at § 1.3.

All firms presently producing or selling products in the market (including vertically integrated firms) plus all firms likely to do so within 1 year in response to a SSNIP, and without expenditure of significant sunk costs of entry and exit, are regarded as market participants and assigned a market share as part of the process of market measurement.[105] Firms that meet the latter criteria are termed "uncommitted entrants" because their entry into the relevant market does not commit them to remain in it, inasmuch as they did not and will not expend significant sunk costs to enter and exit that market. These uncommitted entrants are included as market participants because their ability to make such quick uncommitted supply responses likely influenced the market premerger and likely would influence it postmerger.[106] Uncommitted entrants may include firms engaged in production substitution, firms engaged in production extension utilizing assets currently on hand, or de novo entrants obtaining new assets for production or sale of the relevant product.[107]

After the market is defined, its participants identified, and their size measured through assignment of market share, the Guidelines determine market concentration. While the numbers look much the same as in the 1984 Guidelines, the role of market concentration is much changed. No longer is the Agency "likely to challenge" based on market concentration data alone. Such an assertion was inconsistent with both sound enforcement as a theoretical matter and actual practice at the DOJ and FTC as a practical matter. If actually practiced, it would cause the agencies to

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105 Sunk costs are defined as "the acquisition costs of tangible and intangible assets that cannot be recovered through the redeployment of these assets outside the relevant market, i.e., costs uniquely incurred to supply the relevant product and geographic market." Sunk costs are regarded as "significant" if they "[c]ould not be recouped within one year of the commencement of the supply response, assuming a 'small but significant and nontransitory' price increase in the relevant market." 1992 Guidelines § 1.32.

106 *See id.* at § 1.0.

107 For a more detailed discussion, *see* Denis, *supra* note 102.

block efficiency-enhancing mergers, wasting Agency resources and deterring future efficiency-enhancing transactions.

Instead of being claimed to play such a determinative role in the analysis, concentration levels in the 1992 Guidelines define safe harbors within which mergers are deemed unlikely to have adverse competitive effects. Mergers falling outside the concentration safe harbors (i.e., those that result in postmerger concentration between 1000 and 1800 with a change in the HHI of more than 100 and those that result in a postmerger HHI of more than 1800 with a change in the HHI of more than 50) are said to "potentially raise significant competitive concerns depending on the factors set forth in [the remainder] of the Guidelines."[108] At the highest levels of concentration (postmerger HHI above 1800 and a change in the HHI above 100), adverse effects are presumed, although "the presumption may be overcome by a showing that the factors set forth in [the remainder] of the Guidelines make it unlikely that the merger will create or enhance market power or facilitate its exercise, in light of market concentration and market shares."[109]

The choice of the term "presumption" to define the significance of market concentration at the highest levels is significant. It intentionally invokes Federal Rule of Evidence 301 and rejects the notion that market concentration data alone are sufficient to establish that a merger is likely to have adverse competitive effects.[110] As an analytical matter it is still necessary to complete all five steps of the Guidelines' analysis. But as an evidentiary matter, in the absence of any contrary evidence, adverse effects can be presumed from market concentration data alone. Like any other presumption, the presumption arising from market concentration data in the 1992 Guidelines does not shift the burden of

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[108] 1992 Guidelines § 1.51.

[109] *Id.* at § 1.51(c).

[110] *See* James, *supra* note 102, at 450–51; Rill, *supra* note 101, at 235. *See also* United States v. Baker Hughes, Inc., 908 F.2d 981, 991–92 (D.C. Cir. 1990); United States v. United Tote, Inc., 768 F. Supp. 1064, 1068–69 (D. Del. 1991).

proof from the plaintiff to the defendants. It merely shifts to the defendants the burden of coming forward with contrary evidence to rebut the presumption. The ultimate burden of persuasion remains with the plaintiff.

What this will mean in practice, of course, depends on the predilections of those in charge at the respective federal enforcement agencies. But at a minimum it should stem any misperception that some may have been taken from previous versions of the guidelines regarding the role of market concentration in antitrust merger analysis. By adopting the presumptive approach, the 1992 Guidelines underscore the importance of other market factors, as well as market concentration, in the agencies' assessments or the likely competitive effect of mergers. In doing so, the 1992 Guidelines bring stated policy back in line with the richer analysis of the Supreme Court's *General Dynamics* and *Citizens & Southern* decisions in the 1970s and away from the rigid structuralist approach of *Philadelphia National Bank* and the 1960s.

B. Competitive effects

The second step in the analytical framework of the 1992 Guidelines is to consider the possible adverse competitive effects of the transaction and evaluate whether market conditions are such that any of these effects are likely as a result of the transaction.[111] The treatment of competitive effects in the 1992 Guidelines is notable in several respects. First, the existence of a competitive effects section is itself a substantial development that should focus merging parties and the enforcement agencies on precisely what predicted postmerger conduct motivates enforcement action. Second, the 1992 Guidelines make clear that the competitive effect of concern extends beyond simply postmerger collusion. All forms of coordinated interaction, as well as the unilateral exercise of market power by the merged firm, are explicitly recognized as competitive effects of concern. Third, the competitive effects section of the 1992 Guidelines provide an analytical framework linking real-world market factors to the likelihood of adverse competitive effects. Fourth, the 1992 Guidelines capture

[111] *See* 1992 Guidelines § 2.

the notion underlying *General Dynamics* and *Citizens & Southern* that the merger must result in some change in the market that makes things worse from the competitive perspective.[112]

1. COORDINATED EFFECTS Coordinated interaction is defined as "actions by a group of firms that are profitable for each of them only as a result of the accommodating reactions of the others."[113] The concern expressed in the 1992 Guidelines is that a merger will make coordinated interaction more likely, more successful, or more complete.

The definition of coordinated interaction goes beyond notions of collusion and makes clear that there remains a possible competitive effect of concern even when firms cannot collude.[114] The concept of coordination also includes various forms of tacit conduct that may or may not be lawful in and of themselves. But coordinated interaction does not include all forms of oligopolistic conduct. By definition, oligopolistic conduct is interdependent since oligopoly is defined as "a market structure within which firms are aware of the mutual interdependence of sales, production, investment and advertising plans."[115] The distinction between coordinated interaction and other forms of oligopolistic interdependence is that coordinated interaction requires accommodation by rivals. Other forms of oligopolistic interdependence, e.g., the behavior of firms in the classic Cournot model of oligopoly, do not include accommodation.

In addition to clarifying the scope of this competitive effect of concern, the 1992 Guidelines provide a framework for analyzing its likelihood in a given situation. The 1992 Guidelines define three necessary conditions for successful coordination: reaching

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[112] See the discussion of *United States v. General Dynamics*, and *United States v. Citizens & Southern National Bank*, *supra* n.45 in section I, *supra*.

[113] 1992 Guidelines § 2.0.

[114] *See generally* Denis, *supra* note 26.

[115] THE MIT DICTIONARY OF MODERN ECONOMICS 309 (D. Pearce 3d ed. 1989).

terms of coordination, detecting deviations from those terms, and maintaining a credible threat of punishment to deter deviation.[116] Specific market factors are identified as conducive to or hindering each of the three necessary elements of successful coordinated interaction. For the most part, those factors are largely the same factors identified as relevant to merger analysis in the 1984 Guidelines. But now each factor is put in the context of the specific element of the analysis to which it relates.

The specific factors noted in the 1992 Guidelines were not chosen out of some textbook or out of the blue. Instead, they reflect issues frequently considered by the agencies. The factors listed are by no means the exclusive factors that are relevant to assessing the likelihood of coordinated interaction. But these factors and all other factors that might be brought to bear are important only insofar as they inform the analysis of what has been referred to as "a single fundamental point" in the analysis of coordinated interaction:

> The stability of any coordination rests on each participant's balance of the net gains to be reaped from undetected deviations from the terms of coordination, the probability and speed of detection of those deviations, and the net losses from any ensuing punishment.[117]

Whereas the 1984 Guidelines discussed several factors as facilitating "consensus [terms of coordination in the parlance of the 1992 Guidelines] and detecting deviation," and others as facilitating detection and retaliation, the 1992 Guidelines isolate the market factors regarded as conducive to reaching terms of coordination, those conducive to detecting deviations from those terms,

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[116] *See* 1992 Guidelines § 2.1. Even if the Guidelines were not understood to make these three conditions necessary, it is straightforward to prove by contradiction that they are, in fact, necessary conditions to successful coordinated interaction. Assume that any one of these three conditions was not present. It is inconceivable that coordination could sustain supracompetitive pricing because it would be contrary to each firm's economic interests to coordinate.

[117] Rill, *supra* note 101 at 237.

and those conducive to punishing deviations.[118] Product and firm homogeneity, standardization of pricing or product variables, and access to key information about rival firms and the market are noted as conducive to reaching terms of coordination.[119] Transaction-specific price and quantity data, firm-specific price and output data on a pattern of sales that are frequently regular and small as compared to total output are noted as conducive to detecting deviations.[120]

Little is said in the 1992 Guidelines about punishment, perhaps because this concept is not so well developed in the economics literature. The 1992 Guidelines merely note that deviations will be deterred when the threat of punishment is credible, and that credible punishment "may need not be any more complex than temporary abandonment of the terms of coordination by other [nondeviating] firms in the market."[121] Of course, the reality of individual markets may be more complex. Firms may need to make some binding commitment, perhaps in the form of a sunk investment in excess capacity, in order to make the threat of punishment credible. Absent a binding commitment, the firm or firms threatening punishment may find it more profitable to ignore the past deviations and ratify the old terms of coordination. In such a circumstance, threats of punishment lack credibility.

Putting aside the issue of commitment, and therefore credibility, the abandonment notion of punishment may be inadequate in some circumstances. In all cases in which the merger has an adverse unilateral effect, the notion of abandonment is less threatening than it was prior to the merger because it raises the noncoordinated equilibrium price. The punishment of abandonment, therefore, is less severe than prior to the merger and, in some circumstances, might be inadequate to deter deviations. Abandon-

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[118] *Compare* 1984 Guidelines §§ 3.411 and 3.42 with 1992 Guidelines §§ 2.11 and 2.12.

[119] *See* 1992 Guidelines § 2.11.

[120] *See id.* at § 2.12.

[121] *Id.*

ment may also be inadequate to deter deviations where demand is falling. When present sales are large relative to future sales, punishment that is meted out in the future may lack the necessary deterrent effect.

At times the 1992 Guidelines, like some leading textbooks,[122] fail to keep the three necessary conditions separate and confuse the issue of reaching mutually beneficial terms of coordination with reaching such terms that are sustainable or enforceable. The treatment of heterogeneity (and conversely, homogeneity) is one such example. The 1992 Guidelines make it relevant to both reaching terms of coordination and detecting deviations from those terms.[123] In fact, however, heterogeneity should be no impediment to reaching terms of coordination if the extent of the differences among firms is known to all members of the coordinating group. But heterogeneity will have an impact on the ability of firms to detect deviations from terms of coordination and, therefore, is relevant to the issue of *sustainable* terms of coordination.[124]

A prime example of clearly and accurately putting issues in context is the treatment of large buyers. In recent years, arguments about large, powerful, or sophisticated buyers have become the focus of published decisions in merger cases, although the precise relevance of their size, might or sophistication was not always clear from the opinions.[125] The 1992 Guidelines recognize

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[122] *See, e.g.*, SCHERER & ROSS, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE (3d ed. 1990).

[123] *See* 1992 Guidelines § 2.1.

[124] For additional discussion of the impact of heterogeneity on deterring deviations *see* Baker, *Two Sherman Act Dilemmas: Parallel Pricing, the Oligopoly Problem, and Contemporary Economic Theory*, 38 ANTITRUST BULL. 143 (1993).

[125] *See, e.g*, United States v. Baker Hughes, Inc., 908 F.2d 981, 983 (D.C. Cir. 1990); United States v. Syufy Enterprises, 903 F.2d 659 (9th Cir. 1990); United States v. Archer-Daniels-Midland Co., 781 F. Supp. 1400, 1422–23 (S.D. Iowa 1990); United States v. Country Lake Foods, 754 F. Supp. 669, 675 (D. Minn. 1990); FTC v. R.R. Donnelley & Sons, 1990-2 Trade Cas. (CCH) ¶ 69,239 (D.D.C. 1990). For a further discussion of the issue *see* Steptoe, *The Power-Buyer Defense in Merger Cases*, 61 ANTITRUST L.J. 493 (1993); Denis, *supra* note 26.

that the buyers were relevant to specific aspects of merger analysis. In particular, the size of buyers is relevant to the incentive of firms to adhere to any supracompetitive terms of coordination. Particularly in circumstances where long-term contracting is possible, the volume and profitability of the business associated with large buyers' contracts might be sufficient to make deviation more profitable than adhering to the terms of coordination.

The power buyer issue is but one of the many market factors treated in the coordinated effects section. The factors discussed in the 1992 Guidelines, however, are not intended to be exhaustive. What is intended is that any analysis of whether a merger is likely to lessen competition through coordinated interaction should relate actual market factors to the incentives of firms to enter into and maintain some price-elevating and output-limiting terms of coordination.

Another significant aspect of the treatment of competitive effects in the 1992 Guidelines is explicit incorporation into the Guidelines that the merger must somehow make things worse. Although this point may seem somewhat obvious given that the language of section 7 of the Clayton Act proscribes only mergers the effect of which may be substantially to lessen competition (i.e., make things worse), prior versions of the Guidelines were silent on this point. Under the 1992 Guidelines it is not enough to assert that market conditions are conducive to each of three necessary elements to successful coordinated interaction. In a coordinated effects case, there also needs to be some story as to how the merger enables firms "more likely, more successfully, or more completely" to engage in coordinated interaction postmerger.[126] The 1992 Guidelines are not explicit on how such a story might be told, but such a story can be inferred from the discussion of factors that might impede coordinated interaction. If premerger coordinated interaction was not possible because, for example, substantially incomplete information precluded firms from reaching terms of coordination, a merger that erased a portion of this informational gap could enable firms to engage in postmerger

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[126] 1992 Guidelines § 2.1.

coordinated interaction. Similarly, if coordinated interaction premerger was stymied or limited by the presence of a maverick firm—a firm with a substantially greater economic incentive to deviate from the terms of coordination than its rivals—acquisition of that maverick firm could "make things worse" by enabling or improving coordinated interaction postmerger. The variety of stories that may be told as to how a merger might make things worse is limited only by the number of market factors relevant to the success of coordinated interaction in the particular market setting.

2. UNILATERAL EFFECTS Unilateral or noncoordinated conduct is "conduct the success of which does not rely on the concurrence of other firms in the market or on coordinated responses by those firms."[127] The 1992 Guidelines recognize that the nature of unilateral exercise of market power, and the particular market factors relevant to the likelihood of successful unilateral exercise of market power, depend on the nature of characteristics that distinguish firms and shape the nature of their competition.

The unilateral effects section of the 1992 Guidelines replaces the near per se treatment accorded to mergers involving large firms under the leading firm proviso of the 1984 Guidelines.[128] The leading firm proviso clearly was based on the classic dominant firm model.[129] But the dominant firm model was based on homogeneous products and had no analogue in differentiated products. The 1992 Guidelines provide a framework for understanding unilateral effects in the differentiated products context as well as the homogeneous products context.

The 1992 Guidelines focus on two specific cases of unilateral effects that have sufficiently broad application that they might be applied in a number of contexts. First the 1992 Guidelines consider markets in which firms are distinguished primarily by differ-

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[127] *Id.* at § 0.1.

[128] *See* 1984 Guidelines § 3.12.

[129] For a treatment of the dominant firm model, *see* CARLTON & PERLOFF, MODERN INDUSTRIAL ORGANIZATIONS, 180–204 (1990).

entiated products.[130] The concern in these circumstances is that the merger will enable the combined entity unilaterally to raise price for the products of one or both merging parties. Then the 1992 Guidelines consider the case in which firms are distinguished primarily by their capacities because the products are relatively undifferentiated. The concern in these circumstances is that the merged firm unilaterally will suppress output thereby raising price.

In the differentiated products section, the 1992 Guidelines highlight the importance of the size of the merging firms (the Guidelines suggest that there is no concern until the combined share of the merging firms reaches 35%), the closeness of their products as substitutes for each other, and the ability of rival sellers to reposition their product lines to replace lost competition. The analysis stems from a recognition that sales or capacity-based market shares for differentiated products markets do not necessarily convey meaningful information about the likelihood of adverse competitive effects from a merger. A more searching inquiry into niches, strategic groups and the like, as well as actual consumer preferences among products, is necessary.[131]

Analogous considerations apply when firms are distinguished not by differentiated products but by their relative advantages in serving different buyers or groups of buyers.[132] This may occur, for example, in the provision of management consulting services where certain firms have a relative advantage over their rivals in serving a particular industry. It also may occur where government contractors compete to supply a customized product defined by the government and certain suppliers have a relative advantage over their rivals in providing particular product attributes.

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130 *See* 1992 Guidelines § 2.21.

131 For a detailed explanation of the theoretical underpinnings of differentiated products analysis, *see* Willig, *Merger Analysis, Industrial Organization Theory, and Merger Guidelines*, BROOKINGS PAPERS ON MICROECONOMIC ACTIVITY 281 (1991).

132 *See* 1992 Guidelines § 2.21 n.21.

Considerations are different, however, where firms are distinguished primarily by their capacities, for example, where their products and their customers are relatively undifferentiated. In this situation, the relevant issues are the size of the merged firm (the Guidelines suggest that there is no concern until the share of the merged firm reaches 35%) and the ability of rivals of the merged firm, in the aggregate, to expand output to make the unilateral output restriction of the merged firm unprofitable. Hence, capacity conditions among nonmerging firms are critical to the analysis, both the ability or inability of those firms to relax binding capacity constraints and the cost to those firms of utilizing currently unused capacity.

IV. Conclusion

With the release of the 1992 Horizontal Merger Guidelines, the Department of Justice and the Federal Trade Commission have clarified the concerns that underlie federal enforcement efforts and have offered a clear analytical framework relating specific market factors to the likelihood of specific adverse competitive effects. Experience with the 1992 Guidelines should demonstrate their utility in framing the inquiry for what has been and will continue to be a complex and demanding area of antitrust law.

The 1992 Guidelines are not meant to suggest that merger analysis is susceptible to mathematically precise implementation. But the logical structure of the analytical framework should focus merging parties and government enforcers alike on the proper relationship between market factors and the objective of section 7.