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Horizontal Mergers, Market Structure, and Burdens of Proof *

Herbert Hovenkamp and Carl Shapiro[†]

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ABSTRACT

Since the Supreme Court's landmark 1963 decision in *Philadelphia National Bank*, antitrust challengers have mounted *prima facie* cases against horizontal mergers that rested on the level and increase in market concentration caused by the merger, with proponents of the merger then permitted to rebut by providing evidence that the merger will not have the feared anticompetitive effects. Although the way that concentration is measured and the triggering levels have changed over the last half century, this basic approach has remained intact. This longstanding *structural presumption*, which is well supported by economic theory and evidence, has been critical to effective merger enforcement. We suggest some ways to strengthen it further. We also respond to those who would weaken or eliminate the structural presumption. Our analysis applies to the present legal world, where protection of consumer welfare is the point of merger enforcement.

We also consider a promising recent legislative proposal that aims to strengthen and expand the structural presumption. We offer some guidance concerning how this proposal could be improved so as to strengthen merger enforcement, primarily by making it easier for the government to establish its *prima facie* case, while staying true to the fundamental goal of antitrust, which is to promote competition.

Introduction

Since the Supreme Court's landmark merger decision in *Philadelphia National Bank*,¹ challengers have mounted *prima facie* cases against horizontal mergers that rested on the level and increase in market concentration caused by the merger. The merging parties can then rebut this *structural presumption* by showing that the market shares do not accurately predict competitive effects. Most generally, they do this by showing that the proposed market is poorly defined or that market shares exaggerate the merger's anticompetitive potential, that entry into

* Forthcoming, *Yale Law Journal*. We thank participants at the "Unleashing the Promise of Antitrust" conference at American University, and the editors at the *Yale Law Journal*, for valuable input on an earlier draft. The most recent version of this paper may be found at <http://faculty.haas.berkeley.edu/shapiro/structuralpresumption.pdf>.

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¹ *United States v. Philadelphia Natl. Bank*, 374 U.S. 321 (1963).

the market will discipline any price increase, or that the merger produces offsetting efficiencies sufficient to keep prices at premerger levels or otherwise offset the anticompetitive effects.

The *Philadelphia National Bank* burden-shifting approach has been critical for effective horizontal merger enforcement by the Department of Justice and the Federal Trade Commission. While the technical analysis of markets or the size of the relevant numbers has shifted somewhat over time, the basic structural presumption, burden-shifting framework remains alive and well.² We strongly support the application of the structural presumption in merger cases and suggest below how to broaden the set of situations in which the presumption operates.

Our approach is highly pragmatic: given that horizontal merger enforcement is typically a predictive exercise, which is conducted after mergers are proposed but before they are consummated, what facts can the government realistically establish in court? We argue that considerable uncertainty is the norm, as to both the likely competitive effects of the merger and the specific manner in which those effects will manifest themselves in the market. We thus embrace the structural presumption for very practical reasons, notwithstanding difficulties associated with defining the relevant market, as well as certain valid criticisms that have been made regarding market definition. Ultimately, we argue that market shares are often highly informative, despite the fact that one can only measure market shares after defining the relevant market, which can be messy. Plus, importantly, the structural presumption is rebuttable.

Two important economic ideas underlie the structural presumption. The first idea is that the loss of a significant competitor in a concentrated market is likely to lead to the creation of enhancement of market power. The second idea is that entry barriers in concentrated markets often are significant. Both of these economic ideas have been challenged over the past half-century, most notably by the Chicago School. We argue that both of these fundamental economic ideas remain valid as bases for the burden-shifting approach associated with the structural presumption. In our view, both ideas find strong support in how companies themselves formulate and execute competitive strategy, and indeed in how they evaluate proposed mergers and select merger partners. In contrast, the Chicago School view that small firms are just as effective competitors as large firms, or that entry will typically and promptly occur in response to prices modestly above competitive levels, finds much less empirical support. Importantly, if those conditions do apply in particular markets, the structural presumption can be rebutted with industry-specific evidence.

Our response to those who criticize the structural presumption because of its reliance on market definition is three-fold. First, we suggest that the courts, whenever practical, assess whether the market shares that underlie the government's structural presumption are sensitive to the precise boundaries of the relevant market. If not, then many of the criticisms based on market definition melt away and the structural presumption deserves greater weight. If so, then the court should ask which set of market shares more accurately reflects the likely competitive effects of the proposed merger for the overlap products. Direct evidence of the likely competitive effects, such as the extent of direct competition between the merging parties, will be important for this

² For a robust defense of the use of presumptions in merger analysis, see Steven Salop, *The Evolution and Vitality of Merger Presumptions: A Decision-Theoretic Approach*, 80 ANTITRUST L. J. 269, 276 (2015).

purpose. However, the fact that the market shares vary with the boundaries of the market does not make those shares uninformative or require the abandonment of market definition altogether.

Second, the government is entitled to the structural presumption if the merger causes the requisite increase in concentration in *any* properly defined relevant market. Even if the defense can identify an alternative relevant market (be it broader or narrower) in which the level or increase in concentration is insufficient to trigger the structural presumption, that showing does not negate or rebut the presumption. This observation is especially important because the accepted method of defining relevant markets in horizontal merger cases, namely the hypothetical monopoly test (“HMT”) generally leads to relatively narrow markets.³ Under the HMT, a group of products is tested as a “candidate market” to determine whether it qualifies as a relevant antitrust market. Any candidate market for which the court concludes that a perfectly functioning cartel would lead to a significant price increase qualifies as a relevant market. The objection that the merger leads to only a modest increase in concentration in some broader market is not responsive, so long as the market identified by the challenger satisfies the HMT. As we note below, this is particularly pertinent in unilateral effects analysis.⁴

Third, we argue that in some cases the government should be able to prevail *without* invoking the structural presumption, at least not in the way it is commonly stated, based on a more direct showing of the likely competitive effects of the proposed merger. As a result, market definition need not be a gating factor for the government, and the court’s decision need not rest on market definition, especially in cases where it is unclear which relevant market would be most informative regarding the merger’s likely competitive effects. Allowing this route for the government would harmonize horizontal merger law with other areas of antitrust law, where the courts have shown an increasing willingness to look at *direct evidence* of the likely effect of challenged conduct, relying less on indirect evidence based on a firm’s market share.⁵ We also consider briefly whether the now existing statutory language permits an approach that avoids market definition altogether.⁶

Developing these ideas further, we discuss how the courts should evaluate evidence of market structure alongside more direct evidence of likely competitive effects. In cases where the government alleges effects arising solely due to the loss of direct competition between the two merger firms, so-called “unilateral effects,” alternative metrics such as diversion ratios or upward pricing pressure can complement and supplement the more traditional measures of market shares and HHIs without necessarily displacing them.⁷ In cases where the government alleges

³ See, for example, Joseph Farrell and Carl Shapiro, *Improving Critical Loss*, ANTITRUST SOURCE (Feb. 2008).

⁴ See discussion *infra*, text at notes ___.

⁵ E.g., *FTC v. Actavis, Inc.*, 570 U.S. ___, 133 S. Ct. 2223 (2013) (permitting market power to be inferred from a large exclusion payment)

⁶ See discussion *infra*, text at notes ___.

⁷ The HHI, or Herfindahl-Hirschman Index, is a widely used index of market concentration, measured as the sum of the squares of the market shares of all firms in the market. On the use of diversion ratios and upward pricing pressure in merger analysis based on unilateral effects, see Carl Shapiro, *The 2010 Horizontal Merger Guidelines: from Hedgehog to Fox in Forty Years*, 77 ANTITRUST L.J. 49 (2010).

coordinated effects, the role of market definition and concentration measures such as the HHI is much more fundamental.

We begin in Part I by explaining that a considerable body of economic evidence supports the proposition that a merger combining two firms with substantial market shares in a concentrated market is likely to reduce competition and harm customers. This evidence has become stronger over the past 10 to 20 years, as economies of scale have become more significant in many industries. This shift, primarily driven by technological change, further strengthens the economic basis for the structural presumption, because firms with small market shares, and new entrants, are less likely to be as effective competitors as firms that have proven their capabilities by achieving a substantial market share. Part II argues that the structural presumption is deeply established in the case law, and has been a central element of the Horizontal Merger Guidelines for a full 50 years. Part II also explains how the DOJ and the FTC can use the structural presumption more aggressively under existing case law. We also respond to those who would weaken or eliminate the structural presumption. Part III discusses how the structural presumption can most effectively be applied in cases where the primary concern is with the loss of direct competition between the merging firms, i.e., with unilateral effects.⁸

Part IV relates the structural presumption to the fundamental goal of antitrust law and policy. The structural presumption and the associated burden shifting framework, as they have developed over the past 50 years, rely importantly on the assumption that the goal of merger policy is to protect consumers against high prices or reduced output, product variety, product quality, or innovation, i.e., to promote “consumer welfare.” Our analysis in Parts I, II, and III assumes that the goal of merger enforcement policy is to promote consumer welfare. If the goal is something else, such as deterring industrial concentration to control corporate political power, or protecting small firms from larger competitors, then the structural presumption must be viewed differently or may not apply at all.

In Part V we briefly consider a legislative proposal that aims to strengthen and expand the structural presumption. We offer some guidance concerning how this proposal could be improved so as to strengthen merger enforcement, in part by making it easier for the government to establish its prima facie case.

I. The Economic Case for the Structural Presumptions

The structural presumption has its roots in empirical evidence indicating that more concentrated markets tend to have higher prices and higher price/cost margins, all else equal. During the 1970s and 1980s, that evidence came to be seen as less convincing, leading to a weakening of the structural presumption. But the economic case for the structural presumption remains strong. Indeed, the most recent economic evidence supports a strengthening of the presumption.

Building on the work of Joe S. Bain during the 1950s and 1960s, industrial organization economists devoted considerable attention to the empirical relationship between various

⁸ As distinct from unilateral effects, “coordinated effects” involve harm to competition arising from coordination between the merged firm and its remaining rivals. See 2010 Horizontal Merger Guidelines Sections 6 and 7.

measures of market structure and market performance.⁹ Schmalensee (1989) reviews the resulting large literature of inter-industry studies.¹⁰ The central finding of this literature was that more concentrated industries tended to perform poorly in serving consumers, as they displayed higher prices, higher price/cost margins, and higher profits than less concentrated industries.

These research results greatly influenced antitrust thinking during the 1960s. For example, in his important 1960 paper on mergers, Derek Bok wrote: “Lawyers have also learned that, within a market, changes in the number and relative size of firms are among the most important determinants of competition and monopoly.”¹¹ In *Philadelphia National Bank*, the Supreme Court stated: “That ‘competition is likely to be greatest when there are many sellers, none of which has any significant market share,’ is common ground among most economists, and was undoubtedly a premise of congressional reasoning about the antimerger statute.”¹²

The *Brown Shoe* case in 1962, *Von’s Grocery* case in 1966, and the 1968 Merger Guidelines, can now be seen as the high-water marks relating to merger enforcement based on measures of market concentration. In *Brown Shoe*, the Supreme Court, relying heavily on its view that Congress intended to halt consolidation in its incipiency, stated: “If a merger achieving 5% control were now approved, we might be required to approve future merger efforts by Brown’s competitors seeking similar market shares. The oligopoly Congress sought to avoid would then be furthered and it would be difficult to dissolve the combinations previously approved.”¹³ In *Von’s Grocery*, the Court enjoined a merger between two firms with a combined share of 7.5% in the market for retail groceries in the Los Angeles area. Noting these shares and the many acquisitions that had taken place in that market, the Court stated: “These facts alone are enough to cause us to conclude contrary to the District Court that the Von’s-Shopping Bag merger did violate §7.”¹⁴

Reflecting these decisions by the Court, the 1968 Merger Guidelines placed great emphasis on the overall “market structure” as the “focus” of the Department’s query.¹⁵ Those Guidelines identified two overall market concentration levels, and merging firm market shares, that would “ordinarily” trigger a challenge. In “highly concentrated” markets, those with a four-firm concentration ratio exceeding 75%, the Department would challenge a merger if each firm had a premerger market share exceeding 4%. For a firm with a share of 10%, the Government would

⁹ See especially JOE. S. BAIN, *BARRIERS TO NEW COMPETITION* (1956). Prior to Bain’s work, most empirical research in industrial organization involved case studies of specific industries.

¹⁰Richard Schmalensee, “Inter-Industry Studies of Structure and Performance,” in *HANDBOOK OF INDUSTRIAL ORGANIZATION*, Ch. 16 (Richard Schmalensee and Robert Willig, eds., 1989). See also Leonard Weiss, “The Concentration-Profits Relationship and Antitrust,” in *INDUSTRIAL CONCENTRATION: THE NEW LEARNING* (H. J. Goldschmid, H.M. Mann, and J.F. Mason, eds., 1974).

¹¹ Derek Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 *HARV. L. REV.* 226, 238.

¹² *Philadelphia National Bank*, 374 U.S. at 363.

¹³ *Brown Shoe, Co., Inc. v. United States*, 370 U.S. 294, 343 (1962); *United States v. Von’s Grocery*, 385 U.S. 270 (1966).

¹⁴ 384 U.S. 270, at 273.

¹⁵ Department of Justice, 1968 Merger Guidelines, available at <https://www.justice.gov/archives/atr/1968-merger-guidelines>. The 1968 Guidelines were issued only by the Department of Justice.

challenge the acquisition of a firm with a share of at least 2%. In less concentrated markets, the Department would challenge a merger if each firm had a premerger market share exceeding 5%; if the acquiring firm's share was 10%, the Government would challenge the acquisition of a firm with a share of at least 4%.¹⁶ Further, the 1968 Merger Guidelines followed *Brown Shoe* in applying harsher scrutiny if the market had exhibited a "trend" toward increased concentration.¹⁷

In 1982, the Merger Guidelines were updated to apply a dramatically less strict structural presumption than found in the 1968 Merger Guidelines. They considered markets unconcentrated if the HHI is below 1000, moderately concentrated if the HHI is between 1000 and 1800, and highly concentrated if the HHI is above 1800.¹⁸ They stated that the government was likely to challenge mergers that raise the HHI by at least 100 points and lead to a post-merger HHI of more than 1800.¹⁹ The 10% plus 4% merger that would have triggered a challenge under the 1968 Merger Guidelines would cause the HHI to rise by only 80 points, and thus would not create a presumption under the 1968 Merger Guidelines, regardless of the shares of the other firms. The set of mergers that trigger the structural presumption was reduced further to reflect actual Agency practice when the Horizontal Merger Guidelines were updated most recently in 2010. They define markets to be highly concentrated if the HHI is greater than 2500, and then apply the following structural presumption: "Mergers resulting in highly concentrated markets that involve an increase in the HHI of more than 200 points will be presumed to be likely to enhance market power."¹⁹ For example, in a market with five 20% firms, a merger between two of those firms would raise the HHI from 2000 to 2800, triggering the presumption. However, in a market with four 20% firms and two 10% firms, a merger between a 20% firm and a 10% firm would not trigger the presumption: the HHI would increase from 1800 to 2200, so the post-merger market would only be moderately concentrated. Following the Guidelines, such a merger would "warrant scrutiny" but would not be presumed to be likely to enhance market power.²⁰

This weakening of the structural presumption over time in the Horizontal Merger Guidelines properly reflects advances in economic learning during the intervening 50 years. As Steven Salop puts it: "This evolution to a weaker presumption based on market shares and concentration is consistent with and was likely caused by the parallel evolution of economic analysis."²¹ In

¹⁶ *Ibid.* §5.

¹⁷ *Ibid.*, §7. The idea of increased scrutiny in antitrust cases where the industry in question had exhibited a trend toward concentration first appeared in an exclusive dealing decision. *Standard Oil Co. of California v. United States*, 337 U.S. 293, 317 n.1 (1949). It migrated to merger law in *Brown Shoe Co. v. United States*, 370 U.S. 294, 332 (1962), which identified the concern in the legislative history of the 1950 amendments to §7. See also *United States v. Philadelphia National Bank*, 374 U.S. 321, 325, 331, 363 (1963); *United States v. Von's Grocery Co.*, 384 U.S. 270, 277-278 (1966).

¹⁸ Department of Justice and Federal Trade Commission, *1982 Horizontal Merger Guidelines*, available at <https://www.justice.gov/archives/atr/1982-merger-guidelines>.

¹⁹ Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines*, Section 5.3, p. 18, available at <https://www.justice.gov/sites/default/files/atr/legacy/2010/08/19/hmg-2010.pdf>.

²⁰ *Id.* at 19.

²¹ Steven Salop, *The Evolution and Vitality of Merger Presumptions: A Decision-Theoretic Approach*, 80 ANTITRUST L. J. 269, 276 (2015).

particular, serious issues were raised regarding the quality of the data and the econometric methods used by the inter-industry studies that had shown a relationship between concentration and profits. Schmalensee summarizes: “The relation, if any, between seller concentration and profitability is weak statistically, and the estimated concentration effect is usually small. The estimated relation is unstable over time and space and vanishes in many multivariate studies.”²² However, important findings relating market structure to performance remain valid. In particular, the empirical evidence does show a positive relationship between seller concentration and prices or price/cost margins. On this point, Schmalensee reports: “In cross-section comparisons involving markets in the same industry, seller concentration is positively related to the level of price.”²³ Such intra-industry comparisons are especially relevant for merger control policy, and indeed are often used in merger analysis.²⁴ Michael Salinger reached the same conclusion as Schmalensee in his own review of the evidence on the relationship between market concentration and price/cost margins, stating: “The inappropriate inferences used to justify an active antitrust policy have given way to equally incorrect inferences that have been used to justify a relaxed merger policy.”²⁵

Economic thinking also has greatly evolved over the past 50 years as regards the *interpretation* of the empirical evidence relating market concentration to various measures of market performance. Two key ideas stand out.

First, since at least the 1970s, antitrust economists have recognized that, in markets where there are substantial economies of scale, the process of competition often leads quite naturally to high levels of concentration. In such markets, the most efficient firms typically incur large fixed costs, including R&D costs. In the long run, these firms will only make the necessary investments if they anticipate that future price/cost margins will be sufficiently large to allow them to earn an acceptable risk-adjusted rate of return on those investments. So, observing high levels of concentration and high price/cost margins does not, in and of itself, indicate any failure of the competitive process. Indeed, such a pattern is to be expected in industries where the firms regularly make large R&D investments or incur other large fixed costs.

Second, quite apart from economies of scale, the process of competition can and often does cause a few firms to have large market shares if they are simply more efficient than their rivals.²⁶ So, observing a few firms growing, and even driving smaller or less efficient firms out of business, also does not, in and of itself, indicate any failure of the competitive process.

²² Schmalensee, *Inter-Industry Studies*, *supra* note __, Stylized Fact 4.5, p. 976.

²³ *Id.*, Stylized Fact 5.1, p. 988.

²⁴ As a leading example from 20 years ago, see *FTC v. Staples*, 970 F. Supp. 1066 (D.D.C. 1997) and Jonathan Baker, *Econometric Analysis in FTC v. Staples*, 18 J. PUBLIC POLICY & MARKETING 11 (1999).

²⁵ Michael Salinger, “The Concentration-Margins Relationship Reconsidered,” *Brookings Papers on Economic Activity: Microeconomics*, 1990, p. 287.

²⁶ One of the robust empirical findings in empirical industrial organization is that competing firms differ greatly in their efficiency. See, for example, Nicholas Bloom and John Van Reenen, *Why Do Management Practices Differ Across Firms and Countries*, 24 J ECON. PERSP. 203 (2010) and the references therein.

For both of these reasons, which are very important in today's economy, high levels of concentration and high price/cost margins can result quite naturally from the process of competition playing out in ways that benefit consumers.

This critical observation has very important policy implications. Efforts to proactively *deconcentrate* industries can easily be counterproductive – by disrupting economic efficiency and harming consumers – if they force the breakup of the most successful and efficient firms, if they prevent firms from achieving the available economies of scale, or if they discourage firms from competing and growing for fear that they will later be broken up. These dangers were quite relevant back in the 1960s, when proposals were floated to actively deconcentrate American industry. Most noticeable was the 1968 “Neal Report,” which proposed passage of a “Concentrated Industries Act.”²⁷ This Act would have directed the Attorney General “to affirmatively search out all ‘oligopoly industries’ in the United States ... and bring legal proceedings against all ‘oligopoly firms’ with the aim of reducing the share of each oligopoly firm to no more than 12%.”²⁸

More generally, modern industrial organization economics strongly supports the view that antitrust policy must always be careful not to discourage firms, even large firms, from competing on the merits to attract more customers and thus grow. This idea is captured well by what has become the mantra of modern antitrust policy: “the goal of antitrust is to protect competition, not competitors.”²⁹ The United States has not only led the way in recognizing this important principle; we have spent decades exporting this core principle to competition authorities around the world.

What does all this mean for merger enforcement in the United States?

First and foremost, economic theory and a wide range of economic evidence support the conclusion that horizontal mergers that significantly increase market concentration are likely to lessen competition and harm consumers by raising price, reducing output, or limiting product quality or innovation. We have in mind here not only the intra-industry studies on market concentration and price/cost margins noted above, but also decades of experience with merger enforcement at the DOJ and the FTC and in the courts, as well as evidence regarding how business executives evaluate competition and make strategic decisions, and other evidence such as how reducing trade barriers and thus allowing foreign rivals to compete in a domestic market

²⁷“Report of the White House Task Force on Antitrust Policy,” July 1968. Phil Neal was the Chairman of the Task Force.

²⁸ Ibid., p. 2. See Herbert Hovenkamp, *The Neal Report and the Crisis in Antitrust*, 5 COMPETITION POLICY INT’L 217 (April 30, 2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1348707

²⁹ *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962), and repeated often. E.g., *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 906 (2007); *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 337 (1990)

leads to lower prices.³⁰ Importantly, as shown especially by John Kwoka, the evidence from merger retrospectives strongly supports the structure presumption.³¹

Second, the modern view that the competitive process often leads to highly concentrated markets makes it *all the more important* not to let the victors emerging from that process to join forces by merging. If two firms are efficient because they have achieved a large scale of operations, or because they have learned how to run their operations efficiently, consumers benefit greatly when they compete vigorously against each other. So, logically, the empirical regularities cited above – that large firms are often the most efficient and that the efficiency achieved at the leading firms is difficult for other firms to imitate or for new entrants to achieve – very much warn against allowing two incumbents with large market shares, the best simple indicator of success, to merge. Growth by smaller firms, and entry, cannot in general be relied upon to replace the competition lost through such a merger. This conclusion applies not only to price competition but also to other forms of competition that may be more important in the long run, namely competition to develop and introduce new and improved products and services. Indeed, one of the most important roles for merger enforcement is to prevent established incumbents from acquiring mavericks, disruptive entrants, or other firms that threaten their position. For that reason, it is important to be forward-looking when estimating the markets shares of such firms.

Those who call for weakening or abandoning the structural presumption are effectively arguing that recent market success is not a good predictor of future market success. But this is just not what the evidence shows. In the presence of economies of scale, which are likely to be present in a concentrated market, a small incumbent firm (or an entrant) is unlikely to be as effective a competitor as the larger firm that is being acquired. If firms differ greatly in their efficiencies, and if it is hard for the less efficient firms to imitate their more efficient rivals, as is common, we will see a strong correlation between efficiency and market share. Again, if a firm with a large market share is acquired, it is unlikely that smaller, less efficient firms (or entrants) will be able to replace the lost competition in a timely manner. Likewise, if the merging firms own valuable specific assets that are difficult to replicate, such as brand names or established relationships with customers, or important intellectual property, entry is unlikely to protect consumers from the loss of competition resulting from the merger.

In short, the structural presumption fits well not only with the economic evidence but also with business reality: as a general rule, firms with large market shares are more effective competitors

³⁰ For a discussion of some of this evidence, see Carl Shapiro, “Competition and Innovation: Did Arrow Hit the Bull’s Eye?” in *THE RATE & DIRECTION OF INVENTIVE ACTIVITY REVISITED* (Josh Lerner and Scott Stern, eds., 2012).

³¹ See, most recently, John Kwoka, “The Structural Presumption and the Safe Harbor in Merger Review: False Positive, or Unwarranted Concerns,” forthcoming, *Antitrust Law Journal*. For a comprehensive look at merger retrospectives, see John Kwoka, *Mergers, Merger Control, and Remedies: A Retrospective Analysis of U.S. Policy*, MIT Press, 2015. Michael Vita and David Osinski critique part of Kwoka’s book in “John Kwoka’s Mergers, Merger Control and Remedies: A Critical Review,” December 2016, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2888485. Kwoka responds to this critique in “Mergers, Merger Control and Remedies” A Response to the FTC Critique,” March 2017, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2947814.

than firms with small market shares, and when two of them merge, it takes time for the competition lost due to the merger to be effectively replaced by smaller firms or by entrants.³²

II. Structure and Presumptions in the Case Law and Guidelines

The structural presumption is very well established in the case law. As a result, the challenges facing the courts tend to fall into two categories: (a) what evidence is sufficient to establish the presumption, and (b) once established, what must defendants show to rebut the presumption?

The decision most identified with merger laws driven by structural presumptions is *Philadelphia Bank*, where the Supreme Court appeared to make market structure almost decisive.³³ The Court observed that private business needed to be able to engage in planning, requiring that merger rules be predictable. As a result, the courts should “simplify the test of illegality” in the “interest of sound and practical judicial administration.”³⁴ With that, the Court held that a merger producing a firm that controls an “undue percentage share” of the market and that “results in a significant increase in the concentration of firms in that market” is “inherently likely to lessen competition substantially.” As a result, it must be enjoined, at least “in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects....”

The Court then found such “undue” concentration based on the merging firms’ premerger market shares of 17 and 13 percent and a four-firm concentration ratio of around 70 percent.³⁵ These numbers exceeded the standards for illegality in merger cases of that era,³⁶ although they would not necessarily generate a challenge today. Beyond condemning the merger in this case, the Supreme Court did not specify the size of an “undue” percentage or the amount of a “significant” increase, and said nothing about overall market concentration levels. The last observation is perplexing because it suggests that Court was apparently not worried about overall market concentration as such, but mainly about the market shares of the merging partners. The court

³² While in theory sufficient merger-specific synergies could make up for the loss of competition resulting from the merger, so consumers gain rather than lose from the merger, we are aware of no economic evidence indicating that such efficiencies are common. Certainly there is no such evidence sufficient to undermine the structural presumption as a general matter. In any event, the structural presumption is rebuttable, and one means by which the merging parties might be able to rebut the presumption is through an efficiencies defense. While the Supreme Court has never recognized such a defense, lower courts have been open to evidence about efficiencies. See 4A PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW, Ch. 9E (4th ed. 2016) (analyzing cases).

³³ *United States v. Philadelphia Natl. Bank*, 374 U.S. 321 (1963). See the symposium on *Philadelphia National Bank* at 50, 80 *Antitrust L.J.* 189 (2015).

³⁴ *Id.* at 362-363.

³⁵ The four-firm concentration ratio, or CR4, consists of the sum of the market shares of the market’s four largest firms. The 1968 Merger Guidelines employed the CR4, but the index was replaced in the 1982/1984 Merger Guidelines by the Herfindahl-Hirschman index (HHI), which is measured by the squares of the market shares of all firms in the market. Steven Salop estimates that the merger between PNB and Girard would have increased the HHI from 1459 to 2037 in the market for loans, and from 1442 to 2059 in the market for deposits. Salop, *op. cit.*, Table 1.

³⁶ E.g., *United States v. Von’s Grocery Co.*, 384 U.S. 270, 277 (1964) (premerger CR4 of 24.4, and merging partner shares of 4.7% and 4.2%). Other cases leading to condemnation on low market shares and/or concentration included *United States v. Aluminum Co. (Rome Cable)*, 377 U.S. 271 (1964); *United States v. Continental Can Co.*, 378 U.S. 441 (1964); *United States v. Pabst Brewing Co.*, 384 U.S. 546 (1966); *United States v. Third Natl. Bank in Nashville*, 390 U.S. 171 (1968); *United States v. Phillipsburg Natl. Bank & Trust Co.*, 399 U.S. 350 (1970).

also made clear that the market share-based conclusion was presumptive. It applied only “in the absence of evidence” suggesting showing that the merger would not have the feared anticompetitive effects. The decision did not decide how burdens of proof should be assigned.

The Supreme Court’s first major qualifier of *Philadelphia Bank* came in 1974 in its *General Dynamics* decision.³⁷ In brushing aside the government’s challenge, the Supreme Court concluded that the government’s reliance on the merging firms’ historical market shares in the production and sale of coal in certain geographic areas exaggerated the merger’s anticompetitive effects. The district court had found the alleged market to be too narrowly defined, given that coal was steadily losing market share to oil and natural gas.³⁸ Further, the companies’ depleted reserves strongly suggested that historical market shares would not be a reliable predictor of future competitive presence. The Supreme Court affirmed, focusing largely on the second ground.³⁹

The Supreme Court’s *General Dynamics* analysis was not an attack on the structural presumption as such. It is better read as a caution about how market shares should be measured and understood to determine whether the structural presumption applies.⁴⁰ The D.C. Circuit’s opinion in *Baker Hughes* over-read *General Dynamics* on this point. However, the *Baker Hughes* decision also emphasized the esoteric nature of the market in that case, the U.S. market for hardrock hydraulic underground drilling rigs, which were characterized by a very small number of transactions and, as a result, wide annual variations in market share data based on sales.⁴¹ While a low number of annual sales can make market share data noisy, which suggests measuring market shares over a longer period of time, we do not see why it reduces the danger of collusion. One might as well conclude to the contrary.⁴² A low number of large sales for which suppliers bid could just as easily have served to make collusion more rather than less likely. The *Baker Hughes* opinion also produced a startling conclusion about the burden-shifting framework – namely, that “imposing a heavy burden of production” on defendants’ rebuttal to structural evidence would be “anomalous where, as here, it is easy to establish a prima facie case.”⁴³ The court appeared to be saying that where high market shares make the government’s prima facie structural case strong, and thus easy to make,⁴⁴ some sense of justice requires that the defendant’s case be correspondingly easy to make as well. This would make little sense to us.

³⁷ United States v. General Dynamics Corp., 415 U.S. 486, 497-498 (1974).

³⁸ 341 F.Supp. 534, 538-540 (N.D. Ill. 1972).

³⁹ *General Dynamics*, 415 U.S. at 501-502.

⁴⁰ See PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶962a (4th ed. 2015).

⁴¹ United States v. Baker Hughes, Inc., 908 F.2d 981 (D.C.Cir. 1990).

⁴² See George Bittlingmayer, *Decreasing Average Cost and Competition: A New Look at the Addyston Pipe Case*, 25 J.L. & ECON. 201 (1982) (on relationship between lumpiness of sales and propensity toward collusion).

⁴³ *Baker Hughes*, 908 F.2d at 992.

⁴⁴ See *Id.* at 983 & n. 3. The pre-merger markets shares were 41% and 17.5%, and in one year the two firms enjoyed a combined share of 76%.

At that point the court launched an attack at the “role of statistics” in §7 actions, referring expressly to the HHI.⁴⁵

Notwithstanding *Baker Hughes* analytic shortcomings, the decision has attained considerable importance in merger litigation, most of which takes place in Washington, D.C., giving rise to what is commonly called the “*Baker Hughes* presumption.” As formulated in the D.C. Circuit’s *Heinz* decision:

First the government must show that the merger would produce a firm controlling an undue percentage share of the relevant market, and [would] result [] in a significant increase in the concentration of firms in that market. Such a showing establishes a presumption that the merger will substantially lessen competition. To rebut the presumption, the defendants must produce evidence that show[s] that the market-share statistics [give] an inaccurate account of the [merger’s] probable effects on competition in the relevant market. If the defendant successfully rebuts the presumption [of illegality], the burden of producing additional evidence of anticompetitive effect shifts to the government, and merges with the ultimate burden of persuasion, which remains with the government at all times.⁴⁶

In fact, the widely followed *Heinz*’ statement⁴⁷ of the burden shifting framework is not very different from what the Supreme Court stated in *Philadelphia Bank*. There the Court wrote:

we think that a merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that mark is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects.⁴⁸

Beginning with the 1992 Horizontal Merger Guidelines, some version of the burden-shifting framework has also been included in Agency enforcement policy. The 1992 Guidelines make market share thresholds presumptive, together with languages indicating that the “presumption may be overcome by a showing that factors set forth [elsewhere in 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.”⁴⁹ Those Guidelines also state, however, that they do not “attempt to assign the burden of proof” or of coming forward with the evidence on any

⁴⁵ *Id.* at 992.

⁴⁶ *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 715 (D.C. Cir. 2001) (quoting *United States v. Baker Hughes, Inc.*, 908 F.2d 981, 982–83 (D.C. Cir. 1990)) (citations and quotations omitted).

⁴⁷ *See also Saint Alphonsus Med. Ctr.-Nampa Inc. v. St. Luke’s Health Sys.*, 778 F.3d 775, 783 (9th Cir. 2015) (similar); *In re Se. Milk Antitrust Litig.*, 739 F.3d 262, 271–72 (6th Cir. 2014), cert. denied, 135 S. Ct. 676 (2014) (similar, dicta); *FTC v. Univ. Health*, 938 F.2d 1206, 1218–19 (11th Cir. 1991); *United States v. Bazaarvoice, Inc.*, No. 13-CV-00133-WHO, 2014 WL 203966, *64 (N.D. Cal. Jan. 8, 2014) (similar); *United States v. H & R Block, Inc.*, 833 F. Supp. 2d 36 (D.D.C. 2011).

⁴⁸ *Philadelphia Bank*, 374 U.S. at 364.

⁴⁹ Department of Justice and FTC, Horizontal Merger Guidelines §1.51(c) (Issued 1992, revised 1997), available at <https://www.justice.gov/atr/horizontal-merger-guidelines-0>.

particular issues.⁵⁰ The 2010 Guidelines actually come the closest to stating the presumption as it was originally articulated in *Philadelphia Bank*:

The Agencies give weight to the merging parties' market shares in a relevant market, the level of concentration, and the change in concentration caused by the merger.... Mergers that cause a significant increase in concentration and result in highly concentrated markets are presumed to be likely to enhance market power, but this presumption can be rebutted by persuasive evidence showing that the merger is unlikely to enhance market power.⁵¹

The courts have been quite receptive toward changing structural standards in the Guidelines as they have evolved from the first set, issued in 1968, to the current 2010 Guidelines. Both the structural thresholds and the weight to be given to them have varied, and the courts have gone along – implicitly agreeing that as evidence and theory in this area change the agencies have the discretion to respond accordingly.⁵²

III. The Structural Presumption in Unilateral Effects Cases

As noted above, in *Philadelphia National Bank* the Supreme Court determined that a merger that “results in a significant increase in the concentration of firms in that market” is “inherently likely to lessen competition substantially.” The Court said that “elaborate proof of market structure market behavior, or probable competitive effects” was unnecessary, because of the deep concern expressed by Congress in 1950 when it amended the Clayton Act about the “rising tide of economic concentration in the American economy.”⁵³ The Court also sought to “simplify the test for illegality,” noting that “unless businessmen can assess the legal consequences of a merger with some confidence, sound business planning is retarded.”⁵⁴ Importantly, the structural presumption was not originally based on any particular mechanism by which a merger would lessen competition, but rather on the general notion that competition is strongest when there are many firms, none with a large market share. The 1968 Merger Guidelines adopted this highly structural approach to merger review and enforcement, stating that “the primary role of the Section 7 enforcement is to preserve and promote market structures conducive to competition.”⁵⁵

All that changed when new Merger Guidelines were issued in 1982. Those Guidelines succeeded in taking merger enforcement in a different direction, giving much less weight to

⁵⁰ Id. at §0.1.

⁵¹ Department of Justice and FTC, Horizontal Merger Guidelines §2.1.3 (Aug. 19, 2010), available at <https://www.ftc.gov/sites/default/files/attachments/merger-review/100819hmg.pdf>.

⁵² Noting the gradual evolution of standards, several apart and commenting on different sets of Guidelines are Donald I. Baker & William Blumenthal, *The 1982 Guidelines and Preexisting Law*, 71 CAL. L. REV. 311 (1983) (1982 Guidelines); and Thomas B. Leary, *The Essential Stability of Merger Policy in the United States*, 70 ANTITRUST L.J. 105 (2002) (1992 Guidelines, as revised in 1997); Dennis W. Carlton, *Revising the Horizontal Mergers Guidelines*, 6 J. COMP. L. & ECON. 619 (2010) (2010 Guidelines)

⁵³ PNB at 362 citing *Brown Shoe*.

⁵⁴ PNB at 362 citing *Brown Shoe*.

⁵⁵ 1968 Merger Guidelines, Section 2.

market concentration and much more weight to the predicted competitive effects of a merger. The 1982 Merger Guidelines state: “The unifying theme of the Guidelines is that mergers should be permitted to create or enhance ‘market power’ or facilitate its exercise.”⁵⁶ Under the 1982 Merger Guidelines, the predicted competitive effects of a proposed merger were generally evaluated based on whether that merger would make cartel-like coordination more likely or more effective. That approach fit well with the structural presumption, applying George Stigler’s theory that the HHI metric of market concentration also measures of the risk of collusion.⁵⁷

Ten years later, merger enforcement shifted again with the release of the 1992 Horizontal Merger Guidelines, which introduced “unilateral effects” into the analysis. Unilateral effects arise because the merger will eliminate competition between two merging firms; the concern is that the merged firm will “unilaterally” raise the price for this reason, even if it does not coordinate with its remaining rivals. Now, 25 years later, the clear majority of merger investigations focus on unilateral effects; only a minority focus on coordinated effects.⁵⁸ Overall, this has been a positive development, reflecting a shift in the U.S economy away from commodities and manufacturing and toward differentiated products and services. But this shift has posed a challenge for the structural presumption, since unilateral effects largely depend on the extent of direct competition, or “diversion,” between the merging firms, not by the overall level of market concentration. Indeed, the 2010 Horizontal Merger Guidelines state: “The Agencies rely much more on the value of diverted sales than on the level of the HHI for diagnosing unilateral price effects in markets with differentiated products.”⁵⁹

Despite the shift in merger enforcement toward unilateral effects, the *Philadelphia National Bank* presumption based on structural evidence plus opportunity to rebut remains alive and well in horizontal merger analysis. As articulated in the 2010 Horizontal Merger Guidelines, the basic contours of the presumption have been adapted to unilateral effects analysis, where the primary inquiry is not based on overall market concentration, but rather on the relative degree of substitution between the merging firms’ output and the predicted impact of the merger on the post-merger firm’s prices, not necessarily on the prices charged by its rivals.⁶⁰

The extent to which the structural presumption operates in unilateral effects cases invites an additional concern: to what extent can a “structural” presumption be said to apply when a particular type of merger analysis does not require a market definition at all? Economic analysis

⁵⁶ 1982 Merger Guidelines, Section I.

⁵⁷ George Stigler, “A Theory of Oligopoly,” 72 *Journal of Political Economy* 44-61 (1964). William Baxter, the Assistant Attorney General who issued the 1982 Merger Guidelines, was strongly influenced by Stigler’s work.

⁵⁸ See Malcolm B. Coate and Shawn W. Ulrick, *How Much Does the Choice Between the Theories of Collusion and Unilateral Effects Matter in Merger Analysis* (government “merger investigations studied under a unilateral effects theory grew, with some ups and downs, from 16 percent in fiscal years 1989- 1992, to more than half in 1999-2000, to 76 percent in 2011-2014.” (SSRN Working Paper, 22 July 2017), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2995679).

⁵⁹ 2010 Horizontal Merger Guidelines, p. 21. See Shapiro (2010) op. cit. for an extended discussion of the analysis of unilateral price effects in markets with differentiated products.

⁶⁰ See, e.g., *FTC v. Sysco Corp.*, 113 F. Supp. 3d 1, 23 (D.D.C. 2015) (permitting rebuttal to prima facie unilateral effects case but agreeing with FTC on merits); *FTC v. CCC Holdings, Inc.*, 605 F. Supp. 2d 26, 44 (D.D.C. 2009) (similar, focusing on evidence of historic entry by new firms).

of unilateral effects can proceed without defining a relevant market, although there is some question about whether such analysis is permitted by the statute. The language of §7 requires those challenging a merger to identify some “line of commerce” and “section of the country” in which the anticompetitive effects of a merger will be felt. In *Brown Shoe* the Supreme Court intuited that the term “line of commerce” referred to a relevant product market, and the term “section of the country” referred to a relevant geographic market.⁶¹

The legislative history of §7 is not entirely clear on the issue, but more likely than not the two phrases were never intended to have that precise a meaning. The phrase “line of commerce” was in widespread use by both business persons and courts to describe a particular “line” that a seller might sell, often including non-substitutable goods.⁶² The phrase “section of the country” was very likely intended to be jurisdictional – that is, to insure that the statute reached only anticompetitive effects felt within the United States.⁶³ By 1950, when the amendments to §7 were drafted, courts had already begun to use the term “relevant market,”⁶⁴ and if that is what Congress meant they very likely would have used it. The effect of this reading is not particularly important in a traditional concentration-increasing merger where the threat is of collusion or collusion-like behavior. For example, use of the HHI also requires that a relevant market be identified before concentration can be assessed. The requirement can become an unnecessary and counterproductive encumbrance, however, in unilateral-effects cases, which examine diversion of sales as between specific pairs of firms. In unilateral effects cases involving differentiated products, drawing an artificial boundary between products that are close enough substitutes to be “in the market” and those that are not, is simply not a part of the economic analysis of likely competitive effects.⁶⁵ Put differently, in most cases, unilateral effects can be estimated without the need to define a relevant antitrust market, and the legal requirement that it be done can only get in the way. This is the consensus view among antitrust economists.

In any event, *Brown Shoe* not only equated the two statutory phrases with relevant markets, it also stated that

Congress neither adopted nor rejected specifically any particular tests for measuring the relevant markets, either as defined in terms of product or in terms of geographic locus of competition, within which the anti-competitive effects of a merger were to be judged.⁶⁶

61 *Brown Shoe Co. v. United States*, 370 U.S. 294, 324 (1962) (“The ‘area of effective competition’ must be determined by reference to a product market (the ‘line of commerce’) and a geographic market (the ‘section of the country’”). Accord *United States v. Gen. Dynamics Corp.*, 415 U.S. 486, 491 (1974); *FTC v. Whole Foods Mkts., Inc.*, 548 F.3d 1028, 1036 (D.C. Cir. 2008).

62 E.g., *Gilbert v. Citizens’ Nat’l Bank of Chickasha*, 61 Okla. 112, 160 P. 635 (Okla. 1916) (contract interpretation depends upon the customs or usage of trade of “those engaged in that line of commerce”).

63 See Herbert Hovenkamp, *Markets in Merger Analysis*, 57 ANTITRUST BULL. 887 (2012), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1945964 (discussing other decisions).

64 *United States v. Columbia Steel Co.*, 334 U.S. 495, 508 (1948) (disagreeing with government on selection of relevant market); *United States v. Aluminum Co. of America*, 148 F.2d 416 (2d Cir. 1945) (using the term “market”).

65 Various methods are available to evaluate competitive effects, including looking at diversion ratios, calculating upward pricing pressure, and performing merger simulation, but none of these rely on market definition.

66 *Brown Shoe*, 370 U.S. at 320-321.

A completely acceptable reading of this language is that any grouping of sales identified as experiencing a non-cost-justified price increase can be considered a “relevant market” for the purpose of merger analysis. Happily, from the perspective of economists, this approach lines up very well with relevant markets defined using the Hypothetical Monopolist Test: if the merged firm would find it profitable to significantly raise price unilaterally after the merger, then the HMT as applied to the merging firms products will be satisfied.⁶⁷ It does not matter if conventional market definition criteria (*Brown Shoe* criteria) would also have identified a broader grouping of products as a relevant market. Thus, for example, if a merger of firms A and B with harmful unilateral effects would lead to a significant price increase, then post-merger the products sold by firm AB becomes the grouping of products over which the effects of that merger are to be judged. It does not matter that firms A and B may also sell in a larger product market that also includes products sold by other firms.⁶⁸ *Brown Shoe* rather awkwardly gave some credence to this approach by acknowledging that even when a market is defined, relevant “submarkets may exist which, in themselves, constitute product markets for antitrust purposes.”⁶⁹ The term “submarket” has been widely criticized as permitting narrow markets to be defined that are in fact not relevant groupings for determining a firm’s ability to increase price. But the point here is that under unilateral effects analysis the term is being applied to a grouping of sales over which the post-merger firm *does* have the power to increase price. Indeed, that is how most courts interpret the term today: a relevant submarket, just like a relevant market, is a grouping of sales capable of profitably sustaining a non-cost-justified price increase.⁷⁰

We suggest that courts either drop the awkward and unnecessary “submarket” label, since properly defined “submarkets” are themselves relevant markets, or simplify matters by explicitly stating that a merger harming competition in a “submarket” is illegal.⁷¹ In speaking to this issue, the district court in *Oracle* observed that *Brown Shoe* really suggested that “the technical definition of a relevant market in an antitrust case may be smaller than a lay person would normally consider to be a market.”⁷² In any event, while some courts have employed the term “submarkets” in their analysis of unilateral effects cases,⁷³ most of them, including *Oracle*, have generally rejected the idea that a “submarket” is a different concept from a market. We reiterate, however, that in a unilateral effects merger case calling the two-firm grouping over which a price increase is threatened a “market” need not do any harm to the concept of market definition. It also does not preclude a finding that some larger grouping of sales including these two firms is

⁶⁷ The converse is not true, since the HMT takes as given the prices of all products outside the candidate market and assumes no entry into the relevant market, which makes it more likely that the price increase in question will be profit-maximizing for the merged firm.

⁶⁸ See the discussion above about the HMT and our point that a merger violates Section 7 if it is likely to harm competition in any relevant market.

⁶⁹ *Id.* at 325.

⁷⁰ See 2B PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶522 (4th ed. 2015).

⁷¹ See 4 *Id.* ¶913.

⁷² *United States v. Oracle Corp.*, 331 F.Supp.2d 1098, 1119 (C.D. Cal. 2004).

⁷³ E.g., *FTC v. Staples, Inc.*, 970 F.Supp. 1066, 1075 (D.D.C. 1997).

also a relevant market. At the same time, however, at least some decisions appear to require a market definition in a unilateral effects case.⁷⁴

IV. Market Structure, Competition, and Consumer Welfare

Section 7 of the Clayton Act was originally passed in 1914, and has been subject to only one major amendment of its substance, which was the Celler-Kefauver act of 1950.⁷⁵ Most of the dramatic changes in merger policy that came soon after resulted more from the legislative history of that provision rather than from changes in the statute's text.⁷⁶ The text itself merely expanded §7 to cover vertical as well as horizontal mergers, and also to reach asset acquisitions as well as stock acquisitions.

In the subsequent economic and enforcement literature, market structure has never been a free-standing target of merger policy. Rather, market structure has been a way of getting at merger law's more fundamental concerns, which are higher prices or reduced output or other consumer harms that result from less competitive market structures. Joe S. Bain, the principal architect of the so-called "Structure-Conduct-Performance" (S-C-P) paradigm was clear about this already in the 1950s,⁷⁷ as were his followers.⁷⁸

Supreme Court merger policy has been less consistent, particularly in the 1960s. For example, although the *Brown Shoe* merger decision, which in 1962 was the first to interpret the 1950 amendments, emphasized the evils of high concentration, it actually condemned the merger based on district court fact findings that the post-merger firm would be in a position to undersell its rivals – offering either lower priced shoes or shoes of higher quality for the same price.⁷⁹ That is, the perceived evil of high concentration in that case was scale or scope economies⁸⁰ that

⁷⁴ *FTC v. Whole Foods Market, Inc.*, 548 F.3d 1028 (D.C. Cir. 2008). However, and somewhat mysteriously, the court suggested that a market definition would not necessarily be "crucial to the FTC's likelihood of success on the merits" in a case seeking a preliminary injunction. *Id.* at 1037.

⁷⁵ Celler-Kefauver Antimerger Act of 1950, Pub. L. No. 81-899, 64 Stat. 1225, codified as amended at 15 U.S.C. §18. In addition, the statute was amended in 1980 to reach mergers by firms other than corporations, and also acquisitions "in or affecting" commerce. Antitrust Procedural Improvements Act of 1980, Pub. L. No. 96-349, §6(a), 94 Stat. 1154 (codified as amended at 15 U.S.C. §18).

⁷⁶ Derek C. Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 HARV. L. REV. 226 (1960).

⁷⁷ E.g., JOE BAIN, *INDUSTRIAL ORGANIZATION* 408-410 (1959) (relationship between market structure and efficiency), 411-415 (relationship of market structure to price-cost margins, concluding that "high seller concentration tends to be connected with substantially higher rates of excess profit....")

⁷⁸ E.g., Leonard W. Weiss, *The Structure-Conduct-Performance Paradigm and Antitrust*, 127 UNIV. PA. L. REV. 1104, 1104-1104 (1979).

⁷⁹ *United States v. Brown Shoe Co.*, 179 F. Supp. 721, 738 (E.D. Mo. 1959), *aff'd*, 370 U.S. 294 (1962) (condemning merger because it gave the post-merger firm decisive advantages, resulting in "lower prices or in higher quality for the same price"; as a result, "the independent retailer can no longer compete ...").

⁸⁰ Most particularly, economies of distribution, resulting in condemnation of the vertical aspect of the merger from Brown's production facilities to Kinney's retail stores).

served to give a large firm a competitive advantage over its rivals. As then antitrust professor Derek Bok lamented, that concern was actually quite consistent with the legislative history.⁸¹

Except for that interlude, however,⁸² the Department of Justice and later the FTC have generally agreed that the concern of merger policy is high prices and other consumers harms, and that measuring concentration is a mechanism for assessing the risk of such harms.⁸³ Even the 1968 Merger Guidelines recognized this, concluding that “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.”⁸⁴ As noted above, the 1982 Merger Guidelines were quite explicit about the purpose behind the Department’s merger enforcement: “The unifying theme of the Guidelines is that mergers should not be permitted to create or enhance ‘market power’ or to facilitate its exercise.”⁸⁵ The fundamental concern with high prices and consumer harms rather than concentration as such is particularly clear when we consider unilateral effects tests under the more recent Guidelines, including those issued in 2010. Under unilateral effects analysis, market concentration and even market definition itself are at most secondary concerns. Rather, one seeks to measure anticipated price effects more directly.⁸⁶

One reason for the disconnect between current policy and the *Brown Shoe* concerns with the price-reducing potential of larger firms is the language of §7 itself. It speaks of mergers that may “lessen competition” without defining what competition means. Does “less competition” refer to lower output and higher price-cost margins, or rather to a market structure with fewer firms? If the former, then a merger creating a larger, more efficient firm that charges lower prices is welcome. If the latter, such a merger is unwelcome, especially if that firm will drive smaller, less-efficient firms out of business. Both of these are more-or-less consistent with the lay understanding of “competition.” Applying a consumer welfare standard favors the former, and that is clearly the underlying point of the 2010 Horizontal Merger Guidelines, which define competitive harm in terms of mergers that “encourage one or more firms to raise price, reduce

81 Bok, Section 7, *supra* note __.

82 *Brown Shoe* and other big 1960s era merger cases were brought by either the Antitrust Division or the FTC, not by private plaintiffs.

83 Prior to 1950 the Agency concerns were much more with high concentration as such. See, e.g., FTC, Report on the Merger Movement: A Summary Report (1948) (high concentration); Temporary National Econ. Comm. (TNEC), Final Report and Recommendations, S. Doc. No. 35 (1941) (observing trends toward greater concentration and recommending correctives).

84 1968 Merger Guidelines, *supra* note __, §2.

85 1982 Merger Guidelines, *supra*, note __, p.2.

86 Overall, the 2010 Guidelines, § 2.2.1. describe the relevant evidence as speaking to whether “the merging parties intend to raise prices, reduce output or capacity, reduce product quality or variety, withdraw products or delay their introduction, or curtail research and development efforts after the merger, or explicit or implicit evidence that the ability to engage in such conduct motivated the merger....”

output, diminish innovation, or otherwise harm customers as a result of diminished competitive constraints or incentives.”⁸⁷

V. Current Legislative Efforts to Strengthen Merger Enforcement

We believe that merger enforcement can be significantly strengthened through a combination of suitable enforcement actions taken by the Department of Justice, the Federal Trade Commission, and State Attorneys General, if the courts embrace the overall framework that the Supreme Court established in *Philadelphia National Bank*, updated to reflect the experience gained from merger enforcement and advances in industrial organization economics since that decision.

Legislative changes could, of course, go further and operate far more rapidly than can government enforcement actions and the resulting development of the case law. But legislative changes can also create new problems and have unintended effects, so caution is needed.

In September, 2017, Senator Amy Klobuchar of Minnesota, the ranking Democrat on the Senate judiciary antitrust subcommittee along with several Democrat co-sponsors, introduced the “Consolidation Prevention and Competition Promotion Act of 2017.” This bill is designed to make merger enforcement more aggressive. The bill seems unlikely to pass in the current Republican-controlled Congress, but together with the antitrust plank in the Democrat party platform attending the 2016 election⁸⁸ it reflects concerns that merger enforcement has not been aggressive enough in recent years.

First, the bill would substitute the word “substantially” lessen competition with the word “materially,” which the bill states to mean “more than a *de minimis* amount.” We welcome this change, which clearly intends to strengthen the government’s hand in court, although we are uncertain just how it will actually affect litigated merger cases.

Second, the bill would substitute the phrase “monopoly or a monopsony” for the term “monopoly.” We are unclear why the drafters included this language, since Section 7 currently reaches mergers among buyers, as recognized by both the case law⁸⁹ and the 2010 Merger Guidelines.⁹⁰ But the language may help clarify and emphasize for the courts that harm to suppliers, such as farmers or workers, that results from a merger between their customers or employers, can violate Section 7.

In general, a merger that harms counterparties to the merging firms by restricting the competitive choices available to them can violate Section 7. In the “normal” case where two competing *sellers* are merging, the potentially harmed counterparties are their customers. The canonical harm comes in the form of higher prices charged by the merging firms, which restricts demand. These customers may themselves be businesses, or they may be final consumers. When two

⁸⁷ 2010 Guidelines, §1.

⁸⁸ See <https://www.democrats.org/party-platform>.

⁸⁹E.g., *United States v. Pennzoil Co.*, 252 F. Supp. 962 (W.D. Pa. 1965) (granting preliminary injunction)

⁹⁰ U.S. Dep’t of Justice & FTC, Horizontal Merger Guidelines §12 (2010), available at <http://www.justice.gov/atr/public/guidelines/hmg-2010.html>.

competing sellers merge, antitrust attorneys and economists usually refers to the impact on “consumers,” but it is more accurate to refer to the impact on “customers.”⁹¹ An important question in any such merger is whether the merging firms are two of only a few suppliers to which certain customers can turn. When two competing *buyers* are merging, the economic analysis is formally equivalent, but a different set of labels applies. The potentially harmed counterparties are the suppliers to the merging parties. Now the canonical harm comes in the form of *lower* prices paid by the merging firms for the input in question, which restricts supply.⁹² An important question in any such merger is whether the merging firms are two of only a few customers to which certain suppliers can sell. One reason there are relatively few buy-side merger challenges is that it is relatively rare for the merging firms to be two of only a few customers to which their suppliers can turn.

Third, under this bill, in a case brought by the DOJ, the FTC, or a State attorney general (but not private plaintiffs), a merger would be illegal if it “would lead to a significant increase in market concentration,” in any domestic market, “unless the acquiring and acquired person establish, by a preponderance of the evidence, that the effect of the acquisition will not be to tend to materially lessen competition or tend to create a monopoly or a monopsony.” This part of the bill appears to codify the *Philadelphia National Bank* structural presumption found in the case law, but it does not specify the level or increase in concentration required for the presumption to apply. This part of the bill also seems quite useful, as it would prevent the courts at all levels from undermining or otherwise weakening the structural presumption, as some have favored.⁹³ If desired, the bill could enable a more assertive merger enforcement policy by requiring clear and convincing evidence to rebut the structural presumption.

Fourth, the bill would permit one of the federal enforcement agencies or a state attorney general (but not private plaintiffs) to challenge a merger where, as a consequence, the acquiring firm’s interest in the acquired firm exceeds an adjusted value of \$5 billion; or one of the merging firms has assets, net annual sales, or market capitalization exceeding \$100 billion; or if as a result of the acquisition the acquiring firm would hold an aggregate of voting securities and assets of the acquired firm exceeding \$5 billion.⁹⁴ If one of these absolute value thresholds is exceeded, then the merger is presumptively unlawful and the burden shifts to the proponent of the merger to establish by a preponderance of the evidence that the merger will not have the stated anticompetitive result. This provision does not require that the merging firms be competitors or

⁹¹ When the direct customers of the merging parties are harmed, it may be presumed that some harm will flow downstream to final consumers as well, as the higher prices are passed through to some degree.

⁹² In the case of “classic monopsony,” the sole buyer reduces the quantity purchased and this drives down the equilibrium price. This situation applies when a single buyer purchases from many suppliers of a homogeneous good who are price-takers. In the more common situation in which the inputs are differentiated, or in which the buyer negotiates with its suppliers, the mechanism is different, and the lower price will tend over time to reduce the quantity, quality, or variety of the products supplied, as suppliers make various investment decisions.

⁹³ As a notable example, in its public comments on the proposed 2010 Horizontal Merger Guidelines, the Antitrust Section of the American Bar Association took the position that “market share presumptions should be removed from the Merger Guidelines.” Comments of the ABA Section of Antitrust Law, HMG Revision Project—Comment, June 4, 2010, p.4.

⁹⁴ The \$100 billion and \$5 billion limits would automatically be adjusted annually based on the growth of the U.S. gross national product.

potential competitors, or even in a supplier/customer relationship, provided the size thresholds are met. A merger between firms that do not compete does not increase market concentration.

We recommend that this part of the bill be revised to more accurately address competition concerns without encompassing mergers that pose no threat to competition. Assuming that this provision is motivated by a concern about market concentration and market power, and the obstacles that the government faces when challenging mergers in court, we would prefer to see this provision revised to target horizontal mergers. For example, the bill could provide that the government can establish a presumption that the merger violates Section 7 if the government can show that the merger would lead to a significant increase in concentration in any domestic market, so long as the alleged market is plausible. That would significantly reduce the burden on the government to define the relevant market in order to establish its prima facie case. Or the bill could specify that in order for the merging parties to rebut the government's presumption based on ease of entry, they must establish by clear and convincing evidence that entry will be timely, likely and sufficient to deter or counteract the feared anticompetitive effects.⁹⁵

Lastly, the bill also contains a provision requiring ongoing post-acquisition reporting for transactions resolved through a consent decree with the DOJ or the FTC. We strongly support this provision. The bill also would establish an "Office of the Competition Advocate" within the FTC. The Competition Advocate's principal duty would be to listen to various interest groups and prepare reports about areas meriting antitrust investigation. We very much support these activities, along with the Data Center called for within that Office. While the FTC already publishes numerous reports relating to general policy questions of this nature, the Office of Competition Advocate would have subpoena authority to collect the information it needs, even if no litigation is in prospect. This provision, if enacted, would fulfill a critical need by greatly improving the FTC's ability to perform merger retrospectives.

VI. Conclusion

Merger analysis is almost always a predictive exercise involving considerable uncertainty. As a result, burdens of proof matter a great deal. The structural presumption – that a merger is anticompetitive if it leads to a significant increase in market concentration – has therefore proven essential to effective merger enforcement. In our view, this presumption is strongly supported by economic theory and evidence, and by the experience gained in merger enforcement over the past 50 years. Furthermore, the existing case law, going back to the Supreme Court's landmark 1963 decision in *Philadelphia National Bank*, gives room for the DOJ, the FTC, State Attorneys General, and the lower courts to apply the presumption more broadly, and to make the presumption more difficult to rebut. In other words, while the structural presumption is by no means the only way for the government to successfully challenge a horizontal merger, it can be used more aggressively within current law.

⁹⁵ We assume that the bill is motivated by concerns about market power, rather than by other important concerns, such as the political power of large firms, a critical problem facing our democracy. We would strongly prefer that such concerns be addressed separately, e.g., through campaign finance reform, greater transparency, tougher ethics rules, or other legislation that addresses the problem more explicitly and more directly. Mixing up those concerns with competition concerns would, in our view, be counterproductive for solving both types of problems.

Looking more broadly, merger policy is one area where the courts have done a fairly good job of tracking prevailing economic thinking. This has been facilitated by the relatively general language of Section 7 of the Clayton Act. For example, both the rise and subsequent decline of structuralism in merger enforcement were accomplished without significant reliance on statutory amendment.⁹⁶ Section 7 also has proven quite able to accommodate “unilateral effects” theories, as they have developed over the past 25 years. And the courts have moved from a regime in which efficiencies were either irrelevant or mergers were actually condemned because they would make the merged firm a stronger competitor (the “efficiencies offense”) to one that contemplates an efficiency “defense.” The courts both recognized and then later pulled back on various theories of potential competition. In short, the current language of the provision has proven to be remarkably flexible. Given that the concerns of merger policy are fundamentally economic, this is a good thing.

⁹⁶ See HOVENKAMP, *OPENING OF AMERICAN LAW*, *supra* note ___, Ch. 11.