Comments of the Center for Democracy & Technology on the Justice Department - Federal Trade Commission Draft Merger Guidelines

September 18, 2023

The Center for Democracy & Technology ("CDT") submits these comments to the Department of Justice Antitrust Division and the Federal Trade Commission ("the Agencies") for consideration as you finalize the draft update to the Merger Guidelines released for review on July 19.[1] CDT is a non-profit organization founded almost 30 years ago, when the commercial internet was just getting underway, to fight for democratic values and human rights in the digital age. Protecting and enabling an online marketplace where competition can thrive, and enhance choice for all and encourage innovation, is essential to that objective, as well as to the broader objective of fostering a strong economy and widely-shared prosperity.

The draft Guidelines make significant updates and improvements to reflect developments in the economy and in our economic understanding since the Guidelines were last updated in 2010. For CDT, the most significant updates, such as the new Guideline 10, address the challenges to competition posed by the increasing presence and importance of digital platforms for commerce and communication – a topic not even mentioned in the 2010 Guidelines.

Below we highlight some parts of the draft that are particularly important and useful for the digital marketplace, as well as the broader economy, and offer some suggestions to make these parts even stronger and clearer. Some of these suggestions, and other recommended clarifications, are shown in the attached redline copy of the draft Guidelines, with specific line-by-line suggestions for your consideration.

<u>General Observations</u>

As the Agencies recognize, the Guidelines have two main purposes. First, they should provide meaningful guidance, to lawyers, economists, and courts who will be dealing

[1] https://www.ftc.gov/news-events/news/press-releases/2023/07/ftc-doj-seek-comment-draft-merger-guidelines.

with specific mergers and acquisitions, on how the agencies understand the antitrust laws and the considerations and understandings they will bring to bear in applying them to those specific situations. Second, they should illuminate for the broader public, including policymakers, academics, news media, public interest advocates, businesses, suppliers, workers, and consumers, how merger enforcement under the antitrust laws protects competition and the many benefits it provides in undergirding economic liberty and a free society.

In this regard, the draft Guidelines are well-written and clear. They are sound and accurate for guidance to antitrust practitioners. They are grounded in caselaw authority, highlighting core legal tenets from leading precedents – a useful addition to the economics grounding in previous version of the Guidelines. At the same time, they are written to be more accessible to a wider public readership beyond the insular community of lawyers, economists, and scholars who are steeped in antitrust principles and terminology. Below and in the attached redline copy, we recommend ways to make them even more accessible by removing technical economics and legal terminology in favor of more commonly understood words.

The draft Guidelines now combine horizontal and vertical merger guidelines into one unified set. This is a sensible approach. Many of the analytical considerations apply to both – as the 2020 Vertical Merger Guidelines themselves make clear. And many mergers have both horizontal and vertical aspects. We recommend explaining the reasons for this combination briefly in the Overview.

Although these Guidelines will replace the current 2010 Horizontal Merger Guidelines, as well as the 2020 Vertical Merger Guidelines, there is a great deal of continuity with those Guidelines. The presentation of the draft Guidelines has been reorganized, with the more accessible matter coming first, with much of the more technical matter placed in later sections and appendices. This has perhaps naturally resulted in some details of the current Guidelines being omitted. Some of the omitted details from 2010 or 2020 do not add much in the way of illuminating the analysis, and some could even be limiting or are even misguided, and are just as well omitted. In a few places, we suggest adding back some of those details, where they are illuminating and should not be lost.

One criticism some have voiced is that the draft Guidelines are not balanced enough in their presentation, and almost seem to imply that every merger and acquisition is a fair target for challenge. Under a fair reading, that criticism is not well-founded. But it can be easily addressed, and we recommend doing so. The 2010 Guidelines state, at the beginning of their overview, that the Agencies "seek to identify and challenge competitively harmful mergers while avoiding unnecessary interference with mergers that are either competitively beneficial or neutral." The new Guidelines should make a similar statement. Because merger enforcement is about mergers that create significant competition risks, the draft Guidelines properly focus on illuminating how those risks are identified; it is not necessary to extensively catalog the ways in which mergers and acquisitions can be benign or even increase competition, except where particularly helpful in describing and distinguishing an anticompetitive effect, or in describing when truly procompetitive effects can result in a merger not likely to substantially lessen competition.

Another criticism is that the underlying economics have been deemphasized. That is not the case; they are still there; the more technical details have just been moved to the back. That is a sensible arrangement, allowing the initial presentation to be more readable, more accessible to the broader audience. But it could help to add a few more references to the appendices, as the economics explanations are important. Even in the appendices, the economics explanations should be as accessibly written as possible. Importantly, the economics serve the law; they are not divorced from it, they inform it.

Yet another criticism is that many of the cases cited for authority are decades old. Agency officials have pointed out that these are the leading cases, still being regularly cited in more recent cases. We recommend adding, along with the cite to the leading case, a cite to one of those more recent cases citing it.

Draft Guideline 4 emphasizes a key but often overlooked premise of merger enforcement as promoting healthy competition – the preference for a company that wants to grow or enter a new market to do so on its own, rather than by acquiring another company. – to build it, not buy it. To compete with the other company, not combine with it. A merger may be a convenient, easy short-cut. But internal growth is generally more beneficial to the economy than external acquisition. And as Guideline 4 makes clear, external acquisition can be particularly problematic when the acquired company is a potential entrant. Making a company stronger faster does not justify making the marketplace weaker. Merging companies often cause confusion by describing their merger as making them "more competitive" when the real effect would be to make them "more powerful" – which does ***not*** equate to improved competition.

The draft Guidelines also more clearly emphasize that merger enforcement is about assessing how a merger will change the structure of the market and the profit-making incentives of the merged companies and the other companies in the market, and their capabilities. The intentions of the merging companies at the time of the merger may be relevant, but they are not determinative.

Platform Markets

Of all the important updates being made in the draft Guidelines, perhaps the most important, particularly for digital marketplaces, is the new Guideline 10, which explains how the Agencies assess mergers involving multi-sided platforms. Platforms are not mentioned at all in the 2010 Horizontal Merger Guidelines, nor in the 2020 Vertical Merger Guidelines. Digital platforms were already a major presence in the economy in 2010, but that presence has only continued to increase, in both commerce and communications. Guideline 10 will be very useful to practitioners and courts as they analyze how to address effects on different sides of multi-sided markets.

Sometimes the effects on the different sides can be addressed individually. Other times they may be inseparately intertwined. This can create particular challenges for ensuring, as section 7 of the Clayton Act requires, that a merger not be likely to substantially lessen competition or tend to create a monopoly "in any line of commerce or in any activity affecting commerce." Anticompetitive effects on one side are not excused or outweighed by advantages on another side.

Guideline 10 emphasizes the critical importance of network effects as a barrier to competitive entry and growth in a platform market, magnifying the anticompetitive effects of high market concentration. When a centralized platform that connects providers and consumers of, and other contributors to, products, services, and information achieves market dominance, the network effects act as a gravitational pull of everyone finding it more useful to be on the same platform where everyone else is participating.

For a digital platform, the network effects can be even more self-reinforcing than in offline marketplaces, because of the importance to functionality of the platform of data collected by and fed into it. The role of data is referred to in Guideline 10, but we recommend that its importance as an asset be more fully explained – both as to how it can create market power and barriers to entry and growth, and as to how it can be leveraged to impede competition.

Incipiency Standard

The draft Guidelines give greater emphasis to the "incipiency standard" in section 7 – Congress's intent, as recognized by the Supreme Court in *Brown Shoe Co., Inc. v. United States*, 370 U.S. 294, 317-18 (1962), to ensure that trends toward harmful market concentration could be stopped before it is too late, and the anticompetitive harm is occurring and too locked in to be easily reversed – "provid[ing] authority for arresting mergers at a time when the trend to lessening of competition in a line of commerce is still in its incipiency … to brake this force at its outset and before it gathered momentum."

As the draft Guidelines make clear, the incipiency standard is in keeping with the proper understanding of the importance of "may" in section 7 – "where the effect … may be substantially to lessen competition, or to tend to create a monopoly." Hopefully giving the incipiency standard increased emphasis will help hesitant courts overcome any inclination to require the Agencies to prove with exacting precision harm that will imminently result; or any inclination to consider each merger in isolation, disregarding unmistakable trends until they have demonstrably reached the brink of serious and irreversible harm, and leaving no margin of safety. To be effective, merger enforcement must not just focus solely on the immediate result, but must look down the road, and give appropriate consideration to foreseeable effects under market conditions that may now be only on the horizon, but are clearly enough in view to take into account.

<u>Consumer Welfare Standard</u>

Some have criticized what they say is a de-emphasis on consumer welfare as the proper focus of merger enforcement, and of antitrust more broadly. True, the draft Guidelines do not mention the consumer welfare standard by name. But neither do the 2010 or 2020 Guidelines they will replace. Nor do any of the previous versions of the Guidelines, aside from one tangential reference in the 1982 Guidelines, made without further explanation.

Conceptually, consumer welfare has served as a helpful point of focus in some antitrust analysis, as a check to help ensure that antitrust enforcement actions taken to address anticompetitive concerns somewhere upstream from the final retail sale do not have the effect of ***harming*** consumers. But making it the ***only*** focus too readily obscures the full range of ways competition can be harmed.

Importantly, many who would employ the consumer welfare standard do not appreciate or honor its full breadth. Indeed, some theorists have used a constricted view of consumer welfare to focus narrowly on measuring the potential for consumers to obtain a lower retail price in the immediate term. And then to use, as a supposedly easier-to-quantify proxy, the potential for a company to save money by cutting costs, on the premise that if the company saves money, it will pass those savings on to consumers – a premise that doesn't hold up when there's not enough competition to create the incentives for the company to do so.

Properly understood, consumer welfare encompasses not just a lower price in the immediate term; it encompasses all the benefits that come from having meaningful choice. As the Supreme Court stated in *National Society of Professional Engineers v. United States*, 435 U.S. 679, 695 (1978), "All elements of a bargain – quality, service, safety, and durability – and not just the immediate cost, are favorably affected by the free opportunity to select among alternative offers." Moreover, meaningful choice for consumers depends on meaningful choice for all who seek to reach them, or who seek to contribute to reaching them, from any stage up and down supply and distributions chains, because that is how meaningful choice is generated for consumers.

It is not necessary for the new Guidelines to elaborate on the distortions that would be created by adopting an ill-conceived constricted view of consumer welfare. But there is no need to add consumer welfare to the Guidelines for the first time. The draft Guidelines already do a good job of describing the full breadth of benefits that competition brings to the marketplace. We would recommend, however, citing and quoting *National Society of Professional Engineers* for that important point.

<u>Efficiencies</u>

Merging firms routinely seek to justify their merger based on claims that it will result in efficiencies, or "synergies," that will make the merged firm "more competitive." But as the draft Guidelines state, efficiencies cannot used as a set-off to redeem a merger that violates section 7.

Section IV (3) appropriately cites *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 580 (1967) for this key point. We recommend you also cite *United States v. Anthem, Inc.*, 855 F.3d 345 (D.C. Cir. 2017) for that point. Anthem also has a more extensive description of when efficiencies are potentially relevant, on pages 353-368, that we recommend you cite, and consider distilling into the text of section IV (3). We also recommend that you consider citing the district court opinion in *Anthem*, 236 F. Supp. 3d 171 (2017), which also offers illuminating analysis of how to assess efficiency claims.

We also recommend you consider further explaining the requirement that efficiencies must benefit competition, not just the merged firm. (The draft Guidelines do sufficiently explain the other key requirements for taking claimed efficiencies into account: that they be verifiable and verified, and that they be merger-specific.)

For example, efficiencies must be more than just cost savings that naturally result from eliminating jobs and operations that the merging firms each need a full complement of when they are competing against each other, but that will become duplicative when they merge. Those savings are not generally a benefit to competition; they are [more accurately seen as] a byproduct of the ***reduction*** in competition that would result from the merger.

Thus, the merger must not simply make the merged firm stronger and improve its own bottom line; it must benefit competition in the market, by giving the merged firm increased incentive and ability to improve competition.

Two conceivable ways have been discussed where that might theoretically happen, with two different kinds of efficiencies.

The first way, by reducing costs, would only be only relevant if those costs are going to be passed along in benefits to consumers or otherwise into the market. That would only occur if the merger does not restructure the market so as to reduce the incentives for the merged firm to feel the need pass them along. And if the merger does not restructure the market in that way, it is not going to substantially lessen competition. So it is difficult to see how cost savings are even relevant for antitrust analysis.

One example of a dubious cost-saving efficiency, discussed extensively in the 2020 Vertical Merger Guidelines but rightly omitted from the new draft Guidelines, is the theoretical efficiency of eliminating double marginalization. This theory notes that, before the vertical merger, the two companies are operating at different stages of a supply and distribution chain. Each company obtains its profits by charging a margin – a mark-up above its costs – to the company it sells to. After they merge, so the theory goes, the upstream company will no longer have a reason to charge the downstream company a margin, because they will now be the same company. So it won’t, and the combined company will now be charging only one downstream margin instead of two.

Upon further examination, however, the eliminated double marginalization pass-through theory may be largely illusory in practice. For one thing, it depends on competition remaining strong enough after the merger, at both stages in the chain, for the merged firm to have sufficient incentive not to charge essentially the full "double" marginalization from before, and simply increase its profit margin. And if that competition does remain strong enough to incentivize the pass-through, the merger does not substantially lessen competition – without even taking double marginalization into account. So the posited elimination of double marginalization would seem to be potentially relevant in the merger analysis only when it is in fact not relevant, because there is no substantial lessening of competition at either stage of the supply chain. Thus, eliminating double marginalization cannot erase or mitigate an anticompetitive effect. In the absence of competition at either stage, it benefits the merged firm, but not those with whom it deals. It does not benefit competition.[2]

The second way an efficiency might give the merged firm increased incentive and ability to improve competition, by creating a capability in the merged firm that will increase competition in the market, by bringing new and improved products and services, is more of a possibility. That kind of an efficiency – often referred to by merging firms as a "synergy" – still needs to be verified – not vague, speculative, aspirational, or contingent on uncertain technological or market developments. And that kind of an efficiency is less likely to meet the requirement that it be merger-specific – not readily achievable except through the merger.

The 1982 Merger Guidelines succinctly explain the reason to regard efficiency claims in a merger subject to challenge with skepticism:

> In the overwhelming majority of cases, the Guidelines will allow firms to achieve available efficiencies through mergers without interference from the Department. Except in extraordinary cases, the Department will not consider a claim of specific efficiencies as a mitigating factor for a merger that would otherwise be challenged. Plausible efficiencies are far easier to allege than to prove. Moreover, even if the existence of efficiencies were clear, their magnitudes would be extremely difficult to determine.

Some courts have gone further, questioning whether efficiencies can ***ever*** be a valid defense to a merger challenge. *E.g.*, *FTC v. Penn State Hershey Med. Ctr.*, 838 F.3d 327, 348 (3d Cir. 2016); *Saint Alphonsus Med. Ctr.-Nampa Inc. v. Saint Luke's Health Sys., Ltd.*, 778 F.3d 775, 790 (9th Cir. 2015). The Agencies may want to give further attention to this threshold question.

[2] The above is a simplification of one aspect of some more complicated economics considerations. John Kwoka and Margaret Slade, Second Thoughts on Double Marginalization, 34 Antitrust 51 (Spring 2020) more fully describes some of the difficulties in considering elimination of double marginalization to be a potential mitigating factor in merger review.

New Entry

The draft Guidelines explain well the factors that go into evaluating merging firms' claims that new entry will replace the competition lost as a result of the merger. (We recommend a number of clarifications in our attached redline.)

In one important respect, however, the draft Guidelines miss the forest for the trees – that a new entry defense claim can amount to a sleight of hand. The claim is often made not with respect to a specific new entrant waiting in the wings, but in the theoretical abstract, that another viable competitor will surely be attracted and will enter. But if some unspecified company is being looked to to replace the competition lost by the merger of the two existing companies, by re-building the competition the merger takes out, why is the most obvious candidate to do that re-building not the company that is being acquired? An experienced current competitor is more reliably capable of competing than an untested new entrant. If the two merging current competitors are not both up to the challenge, why would some unknown new company be?

Market Power

The draft Guidelines opt to use the term "dominant position," a term borrowed from EU law, in lieu of "market power." This is a significant departure, as every version of the Guidelines, going back to the first version in 1968, has consistently used "market power," and has explained what it means. In footnote 62, you state matter-of-factly that there are many ways to describe power, and that the Guidelines opt to use "dominant position" instead of "market power." But you do not satisfactorily explain the departure.

You should give fresh consideration to what you are gaining, and what you are giving up, by switching terms. But assuming you decide to keep the switch, the Guidelines need to explain it fully – not just state that you are switching, but why the term "dominant position" is superior in your view to the term that has been used in the Guidelines consistently for 55 years, and in the courts for longer. The explanation should recite the understood meaning of market power – the ability to raise price or reduce output or degrade quality or delay innovation without losing profits. And for continuity, you should explain how that meaning is incorporated into the meaning of dominant position, so that it is at least co-extensive. And if you are intending to go beyond the long-stated goal of merger enforcement – to prevent the creation, increase, or entrenchment of market power – you need to explain what further goal is now encompassed.

Note also that "market power" is explained in previous versions of the Guidelines to include shared market power, exercised by companies in a concentrated market as the equivalent of power exercised by one company. "Dominant position" would ordinarily imply a single company with that power. Make sure that shared market power is still captured effectively in the draft Guidelines, either in your discussions of dominant position or elsewhere.

We appreciate the Agencies undertaking this timely update to the Merger Guidelines, and hope our comments and suggestions will be helpful as you finalize them.

Respectfully Submitted,

George P. Slover
Senior Counsel for Competition Policy
Center for Democracy & Technology