In the Matter of the FTC-DOJ Draft Merger Guidelines

Matter Number P859910

Comments by the *American Consumer Institute*

ACI

The American Consumer Institute
Center for Citizen Research

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The Proposed Merger Guidelines delineate theories that the Federal Trade Commission (FTC) and the Department of Justice (DoJ) have been using when considering mergers and acquisitions. Given the track record of losses before the courts when attempting to use these novel theories in complaints, the agencies should consider revising their strategy rather than doubling down through new guidelines.

The draft guidelines appear to be unnecessarily restrictive when compared to previous agency merger guidelines. Guidelines 1 to 4 and 6 to 8 are concerned solely about market structure and not whether a merger would result in a "reasonable probability of substantially lessening competition," which would support the claim of a Section 7 violation, consistent with prior court decisions.[1] The draft merger guidelines omit the important qualifying terms – "reasonable probability" and "substantially lessening."[2] That omission serves to make merging firms an easy target for investigations, based on market structure, instead of anticompetitive conduct.

In its request for comments, the FTC states that even a "small increase" in concentration can lessen competition, and immediately cites, as support, a statement by the United States Supreme Court 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 market, 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."[3] To be clear, a small increase in concentration, as noted by the FTC in its draft guidelines, is not the same as a significant increase in concentration, as mentioned by the Supreme Court.

An overall lacking theme in both recent enforcement and the proposed guidelines is a measurement of harm. Both agencies wish to move away from the consumer welfare standard (CWS), with the belief that it has resulted in the underenforcement of current law. However, the agencies and these guidelines fail to provide a consistent

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[1] Comments by a former FTC official, now at the Mercatus Institute, say that both the legislative history and Supreme Court decisions use "reasonable probability" and "substantially lessening competition" to justify a Section 7 violation. See Gregory J. Werden, Comments on Draft Merger Guidelines, August 12, 2023.
[2] Ibid.
[3] Request of Comments, p. 16, emphasis added.

alternative measure of harm. A key strength of the CWS is that it provides a goalpost with which to measure the often vague wording of antitrust laws.

Without a clear standard against which to measure mergers and acquisitions, the agencies will likely struggle to win in court. The goal of reinvigorating antitrust enforcement is only possible if the agencies win. Focusing on the consumer and established economic theories have proven a winning strategy in the past, and the agencies should return to that tradition.

To summarize, our comments will respond to each of the proposed guidelines with a focus on how they will likely replicate existing difficulties the agencies are facing in court.

Guideline 1: Mergers Should Not Significantly Increase Concentration in Highly Concentrated Markets.

- ***Overview of Economic Theory and Empirical Evidence: Proposed Guidelines Omit That Concentration Can Be Desirable***

There is no justification for a blanket statement that concentration or mergers involving large firms are a problem. Innovation, economies of scale, and intellectual property all result in levels of concentration with clear consumer benefits.

Any new product starts as an initial monopoly due to its novel nature. Patents are awarded to protect intellectual property and incentivize creators. Such protections also provide initial monopoly rights. Preventing firms from being "first to market" harms consumers and society as a whole. Similarly, if a merger leads to new products in the market, there will always be market concentration, but no consumer harm. Therefore, concentration is not necessarily a problem. In the end, there needs to be an assessment of the impact on consumer or social welfare.

While economic textbooks show that monopolies can reduce consumer welfare, countless economic empirical studies have failed to conclude that high concentration is a problem that government intervention needs to solve or that government remedies produce optimal results compared to imperfect markets. As Professors Blackstone, Darby and Fuhr write:

> *The economic literature addressing the relationship between market structure, conduct, and performance is voluminous. It is generally inconclusive and*

lamentably bereft of guidance for policymakers faced with decisions about what if any, elements of market conduct should be constrained by the power of the state.[4]

A survey of empirical studies by well-known industrial organization economists has also conveyed the lack of established causal relationship that market structure determines market conduct and that determines market performance.[5] Nobel Prize winner Professor George Stigler summed it up this way:

No one has the right, few the ability, to lure economists into reading another article on oligopoly theory without some advanced indication of its alleged contribution.[6]

The fact is that there is no conclusive empirical evidence that concentration is undesirable, nor does it justify regulatory intervention. The FTC's fixation on concentration is not aligned with well-accepted economic thought.

- ***Measuring the Significance of Concentration***

The proposed guideline deviates from previous horizontal merger guidelines by evaluating anti-competitiveness on concentration levels alone instead of effects on consumers. The 2010 Horizontal Merger guidelines stated that "regardless of how enhanced market power likely would be manifested, the Agencies normally evaluate mergers based on their impact on customers." Indexes used by the agency like Herfindahl-Hirschman Index (HHI) and the "small but significant and non-transitory" tests, where price increases were indicators of anti-competitiveness but not determinants. In the new guidelines, the concentration level is the sole determinant for presumptions of anti-competitiveness.

When claiming that when a merger presents even a small increase in concentration in a highly concentrated market it should be presumed anticompetitive, the FTC cites a line from *United States v. Philadelphia National Bank.*[7] The cited section states that a merger that results in "a significant increase in concentration of firms in that

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[4] Erwin A. Blackstone, Larry F. Darby, and Joseph P. Fuhr, "The Case of Duopoly: Industry Structure is Not a Sufficient Basis for Imposing Regulation," Regulation, Winter 2011-2012, p. 12.

[5] For example, see Timothy Bresnahan, "Empirical Studies of Industries with Market Power," in Handbook of Industrial Organization, Vol. 1, edited by Richard Schmalensee and Robert Willig, Elsevier, 1989; and Donald A. Hay and Derek J. Morris, Industrial Economics and Organization: Theory and Evidence, Oxford University Press, 1991.

[6] George Stigler, "A Theory of Oligopoly," Journal of Policy Economy, Vol. 72, 1964.

[7] United States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963).

market” would be presumed anticompetitive. The “significant increase in concentration” clarifier contradicts the FTC’s claim that this case supports their position that even small increases in concentration are problematic.

Guideline 2 – Mergers should not eliminate substantial competition between firms.

This guideline rests on the false premise that mergers between competitors are automatically anticompetitive. Combined with the bias against mergers and size leaves little comfort that the qualifier “substantial” will guide enforcement.

While not inevitable, mergers can achieve significant efficiencies, improve economies of scale, and lead to a reduction in per-unit costs. That, in turn, provides an opportunity for lower consumer prices, which is a good thing.

To clarify this point, in a dynamic market, if a merger, even between competitors, leads to improvement in operational productivity and supply chain process improvements, which leads to lower end-user prices and the exit of an inefficient firm, then social welfare has improved. If this occurs, then the merger works to improve competition by disciplining the market and driving out waste. This is a legitimate reason for mergers.

The government’s purpose is not to protect inefficient firms or to prevent bigness, but to protect consumers’ interests. Hence, the assumption that mergers should never eliminate a competitor is an improper role for the government to undertake.

Guideline 3 – Mergers Should Not Increase the Risk of Coordination; and Guideline 7 – Mergers should not entrench or extend a dominant position.

- ***Contradictions in the Role of Switching***

Guideline 3 proposes a multitude of methods for determining if a market is at risk of coordination between firms. One of the methods for determining this likelihood is the market’s competitive responses. One factor increasing the chances of a quick response is the ease with which consumers can switch between suppliers. Within this guideline, ease of switching is viewed as an anticompetitive signal. However, in guideline 7, instead of ease of switching being a sign of anticompetitive coordination, an increased cost of switching is a sign of anticompetitive entrenchment. These two guidelines essentially consider both sides of the spectrum as anticompetitive, thus leaving very little room for legal operations.

- ***Measurement of Dominance is Subjective***

The draft merger guideline's explanation for guideline 7 defines a merging firm as being dominant if its market share is at least 30%. This measure is completely arbitrary. It is possible that in an industry with only three firms the smallest could be deemed as being dominant.

While market share is not a perfect measure of dominance, 60% has commonly been the threshold for what is regarded as dominant.[8] For example, AT&T, once a monopoly provider for long-distance services, was deemed nondominant about the same time as its market share dipped below 60%.[9] By setting the threshold at 30%, the draft merger guidelines widen the funnel as to what should be considered dominant, and that invites more investigations and more government intervention.

Guideline 4: Mergers Should Not Eliminate a Potential Entrant in a Concentrated Market.

The FTC offers a wide range of potential evidence for proving that a firm was "reasonably probable" to enter a market if not for its acquisition of a firm already in said market. This includes "evidence that the firm has sufficient size and resources to enter," which was used in the FTC's complaint against Meta for its acquisition of Within. The court accepted much of the agency's theory but rejected its application to this case because size and resources alone were not enough to determine whether entry into a market was likely.

Creating a guideline based on potential competition that mirrors prior complaints does not act as a substitute for the threshold of evidence needed to make this argument succeed in court.

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[8] Richard Makadok, "Interfirm differences in scale economies and the evolution of market shares," *Strategic Management Journal*, 20:10, October 1999, 935–952.

[9] "In the Matter of Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier," Federal Communications Commission, CC Docket No. 79-252, Order Adopted November 30, 1995.

Guideline 5: Mergers Should Not Substantially Lessen Competition by Creating a Firm That Controls Products or Services That Its Rivals May Use to Compete.

The key to this guideline is whether the firm need only possess the means to restrict a product or need the incentive to do so. In the FTC's complaint against Microsoft's acquisition of Activision, they claim that because Microsoft could restrict PlayStation's access to Call of Duty, the merger is anticompetitive. The courts rejected this and held that an incentive must also be present, which the FTC has already conceded to in their draft guidelines.

In the FTC's guidelines regarding valid incentives, they notably discount the incentive not to withhold products due to reputational backlash. However, the potential for backlash was a key defense in the Microsoft complaint. Regardless of whether the guidelines consider backlash, the courts do.

Guideline 6: Vertical Mergers Should Not Create Market Structures That Foreclose Competition.

Deviating heavily from prior guidelines,[10] the FTC now proposes that firms with over a 50 percent market share after foreclosure are acting anticompetitively when engaging in vertical mergers. Due to vertical mergers often having positive effects on consumers, past guidelines have not imposed hard presumptions based on market concentration.

Vertical mergers can increase optional efficiency, which can lower per-unit costs of production and lead to lower consumer prices. Lower prices, in turn, can increase market competition. These efficiency benefits can result from increases in scale and scope, improvements in the supply chain, and the combining of assets and other business inputs, thereby saving production costs.

Guideline 8: Mergers should not further a trend toward concentration.

The proposed guidelines cite *United States v. Phila. Nat'l Bank*, as an example of streamlining enforcement to "simplify the test of illegality." Such presumptions of illegality have also been justified by Willard K. Tom and Chul Pak when the streamlined

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[10] U.S. Department of Justice and The Federal Trade Commission, "Vertical Merger Guidelines," June 30, 2020, https://www.ftc.gov/system/files/documents/reports/us-department-justice-federal-trade-commission-vertical-merger-guidelines/vertical_merger_guidelines_6-30-20.pdf.

enforcement and resultant cost savings from such a presumption outweigh the costs when such a presumption is wrong.[11] This is not the case with the lowered presumption found in guideline 8.

The FTC draft merger guidelines appear to be written in a way that sharply increases the agency's propensity for intervention, even though the draft guidelines and its explanation provide no evidence to show a public interest need for that increased intervention.

For instance, there appears to be a bias against market concentration. When compared to previous merger guidelines, the draft guidelines set a higher HHI for what businesses should be considered as being "very concentrated." This increase in HHI is completely arbitrary and is not based on any empirical evidence. Moreover, there is no empirical evidence proving that high HHI's are a reliable indication of market conduct or market performance. An HHI is merely an indicator of market concentration.

Using a concentration measure to determine market conduct and performance is without well-accepted economic and empirical support. Therefore, increasing the HHI threshold for what is deemed to be "very concentrated" is subjective, and it does not provide a sufficient justification for imposing regulations or government remedies.

Guideline 9: When a merger is part of a series of multiple acquisitions, the agencies may examine the whole series.

The impact of this rule largely depends on the timeframe in which mergers and acquisitions are considered. Opening a firm to relitigate all past deals would create a logistical burden. It may be reasonable to consider concurrent deals or ones that happened within the past few years, but there should be time limits.

Focusing on long-established mergers makes it impossible to distinguish from growth due to the merger versus internal growth. For example, when Google acquired Android it was struggling for funding and nowhere near its current size.[12] Today, it is one of the leading mobile operating systems competing against Apple. Despite that the growth originated with an acquisition, it was the following internal development that turned it into a major player. Reconsidering the deal would be impossible due to the

[11] Willard K. Tom and Chul Pak, "Toward a Flexible Rule of Reason," *Antitrust Law Journal*, 68:2, 2000, pp. 391-428), https://www.jstor.org/stable/40843476.
[12] Chet Haase, "Excerpt: How Google Bought Android—according to folks in the room," ars technica, August 13, 2021, https://arstechnica.com/information-technology/2021/08/excerpt-the-history-of-android-as-written-by-a-longtime-android-developer/.

inability to determine what growth of Google was from Android versus what growth of Android was from Google.

Guideline 10: When a merger involves a multi-sided platform, the agencies examine competition between platforms, on a platform, or to displace a platform; and Guideline 11: When a merger involves competing buyers, the agencies examine whether it may substantially lessen competition for workers or other sellers.

Despite current beliefs of the agency regarding the shortcomings of the consumer welfare standard, the standard provides a much-needed focus with which to measure harm. Rules 10 and 11, as they are currently written, expand the focus of antitrust beyond practical considerations.

There is a logistical reason for focusing antitrust enforcement on consumer impact. It is impossible to weigh the impacts of diverse and overlapping groups such as workers, buyers, sellers, competitors, and consumers in a way that creates legal clarity and certainty. The consumer represents the most comprehensive of these groups and as a result, is the best measure of competitive impact.

While workers, consumers, and businesses benefit from a competitive marketplace, separately considering all participants with equal weight will create conflicts of interest.

Guideline 12: When an acquisition involves partial ownership or minority interests, the agencies examine its impact on competition.

Applying existing law to partial mergers is consistent with protecting consumers. However, if the framework used to interpret law mirrors that described in the proposed guidelines, then the same problems already discussed in these comments will apply.

Guideline 13: Mergers should not otherwise substantially lessen competition or tend to create a monopoly.

Guideline 13 is duplicative of Section 7 of the Clayton Act, making it superfluous.

Conclusion

The FTC has demonstrated a clear disregard for well-accepted economic thought, lacks clearly defined reasons for these changes, and displays an bias toward litigation. Keeping all of this in mind, we cannot endorse the proposed guidelines and go as far as to recommend complete recension and total reexamination considering our comments and others like them. The FTC merger guidelines are meant to be a trusted source of information on the status of merger litigation, not a legal case for the revision of the *status quo*. As these guidelines hold little legal and economic justification, it is inappropriate for the FTC to have used them as an appropriate standard for judging how merger law ought to be. We hope future guidelines will better reflect the realities of merger law.

Appendix 4: Calculating Market Shares and Concentration

The concept of "rapid entry" creates a notion of phantom rivals, which invites more and unnecessary government actions when there is no obvious competitive harm. The draft guidelines point to the possibility that a merger could serve as a competitive threat to future rivalry, referred to as the potential for "rapid entry." The vague definition of the term could allow any firm in any market to be a potential entrant. The draft merger guidelines also add that "firms that are active in the relevant market but not in the relevant geographic market may be rapid entrants."[13] In effect, any merger could be found to impact a would-be rival somewhere.

This broad notion of potential rivalry could be used to block any merger, regardless of its merits and benefits to consumers. In fact, from a contestable market theory perspective, if a market can be challenged by having so many potential rivals (due to rapid entry), there is no need for government intervention at all. After all, if rapid entry points to many additional potential rivals, then the relevant market is much broader and less concentrated than it may first appear. The FTC appears often to be trying to have it both ways – a narrow definition of a concentrated market, but a broad definition of potential rivalry. It would appear, from this guideline, that the FTC would be able to challenge many mergers regardless of their consequences to the public.

Overarching Theory Concerns

- ***Economies of Scale and Scope***

Economies of scale occur when a firm's average costs per unit decline as its output increases.[14] Capital-intensive firms, those with high fixed costs, often require high volumes of business to reduce per-unit costs sufficiently to be profitable. For this reason, some markets, like large commercial airlines, computer chip manufacturers, and automakers, have few competitors. For these markets, requiring more competitors would lead to higher per-unit costs and, therefore, higher prices for consumers. In fact, regulation that would require atomistic markets would mean that none of these products would ever be produced.

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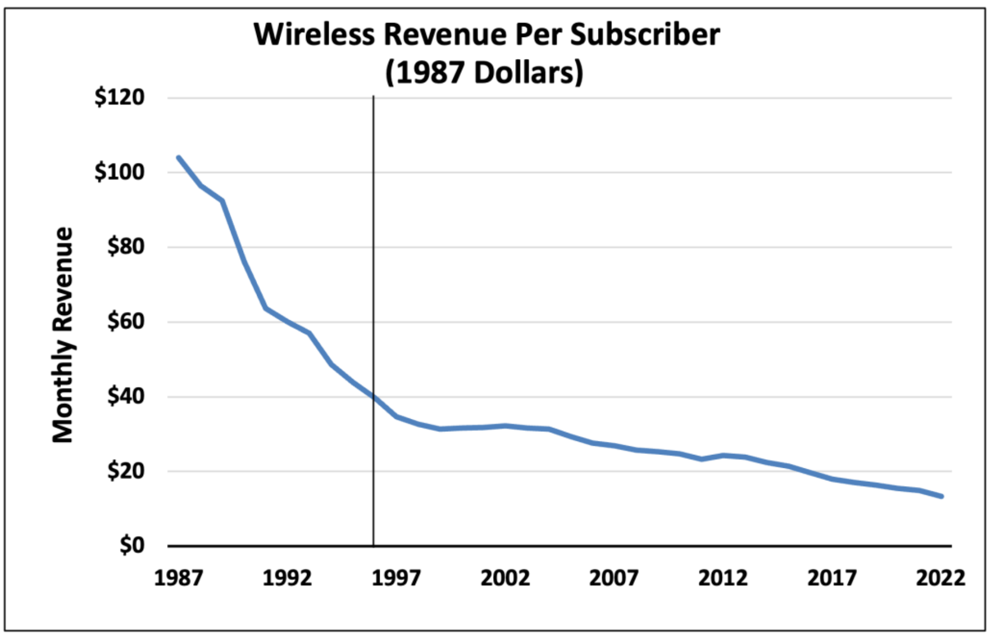
[13] FTC draft merger guidelines, p. 50.

[14] Organization for Economic Co-operation and Development, "Glossary of Terms: Economies of Scale." Available online: https://stats.oecd.org/glossary/detail.asp?ID=3203#:~:text=Economies%20of%20scale%20refers%20to,being%20produced%20by%20a%20firm.

Therefore, economies of scale should primarily be seen as beneficial. For businesses, economies of scale lead to greater operational efficiency and increased productivity; but, for consumers, it means lower prices.

For example, when cellular telephony was rolled out, consumer equipment costs were in the thousands of dollars per cell phone,[15] and wireless service costs, as shown in the chart below, averaged well over $100 per subscriber.[16] In the early rollout of cellular service in the U.S., there were only two providers, an "A" and "B" license. In a few short years, the networks invested, expanded their reach and eventually provided nationwide coast-to-coast services. This led to a sharp decline in price, which stimulated consumer demand. Increased demand further reduced per-unit costs and consumer prices, as shown below in 1987 (constant) dollars. By the end of 1995, there were more than 30 million subscribers. Year to date, real average revenue per subscriber continues to fall, and investments have vastly improved service quality and sharp increases in the use of broadband data services, thereby reflecting hedonic effects in addition to falling prices.



[15] Dennis Peng, "Cell Phone Comparison Timeline," Ooma, December 19, 2019, https://www.ooma.com/blog/home-phone/cell-phone-cost-comparison/. The $4,000 Motorola Dyna TAC would cost over $10,000 in current dollars.

[16] Average revenue per subscriber is used as a proxy for average price. These data come from published reports available from CTIA (https://www.ctia.org/) and update a chart published in Erwin A. Blackstone, Larry F. Darby, and Joseph P. Fuhr, "The Case of Duopoly: Industry Structure is Not a Sufficient Basis for Imposing Regulation," *Regulation*, Winter 2011-2012. They provide six examples of where duopolies operate as ineffective competition.

What the chart also shows is that, when the wireless market consisted of only two major end-to-end providers (a portion of the curve to the left of the horizontal line), prices fell the fastest, although prices continue to decline in real dollars. In other words, a duopoly provided sufficient competition to pass its reductions in per-unit costs along to consumers in the form of lower prices. Government intervention was not needed.

- ***Perfect Competition is Not Perfect***

While a natural monopoly is often characterized as lacking incentives to innovate, having concentrated markets can provide the means to finance research and development. Empirical evidence does not indicate otherwise. As industrial organization expert and Professor of the JFK School of Government at Harvard University, Frederic Scherer writes some market power "is conducive to invention and innovation."[17]

One often misused concept is the notion that perfect competition is an ideal economic model, compared to, say, an oligopoly. While perfect competition has many desirable outcomes in terms of efficiency and welfare maximization, it is simply a theoretical construct that won't work for virtually all markets. For example, perfect competition assumes that products are homogeneous and sold at the same price, which means that consumers cannot choose a differentiated product based on its quality. Also, technical change is assumed to be ubiquitously available to all producers at the same time, which means there is no advantage to innovating, automating, and process improvement. There is also no meaningful investment and benefits of economies of scale or scope. Perfect competition is not perfect, or as Sherer writes:

> *Schumpeter was right in asserting that perfect competition has no title to being established as the model of dynamic efficiency.*[18]

While the draft merger guidelines do not explicitly prohibit companies from taking advantage of economies of scale, the draft guidelines appear to make it harder for companies to achieve operational efficiencies that would otherwise have occurred from mergers and acquisitions. The reality is that firms can attain economies of scale by merging or acquiring other companies. Mergers can also allow an acquired company to have the resources and capital it needs to bring a product to the market, as well as speed its invocation and growth. For example, the 2005 merger by Google to acquire Android enabled competition with Apple. Preventing large companies from merging can inhibit market competition. Mergers can be beneficial.

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[17] F.M. Scherer, *Industrial Market Structure and Economic Performance*, 1st ed., Rand McNally, 1970.
[18] Ibid.

The draft guidelines appear likely to interfere with firms attaining the optimal scale, and that would create inefficiencies that force consumers to pay more for goods and services. The fact is that regulators do not ever know the minimum efficient scale of an industry, market, product, or service. So, fixating on concentration and unnecessarily blocking mergers can be costly to social welfare. Concentration can be desirable.

- ***How to Judge Concentration***

The consumer welfare standard provides a perfect way to measure the harm or lack of harm that mergers can bring. Upon reviewing the thirteen guidelines in the draft update to the FTC's Merger Guidelines, there is a sense that the FTC sees the presence of market concentration, or even a slight increase in concentration, as completely undesirable. Guidelines one through eight declare that "mergers should not" concentrate the market, eliminate competition, or potentially deter market entry, among other things. These guidelines require an objective test.

How should the FTC judge the impact of a merger and potential risks from concentration? While these guidelines convey real concerns that the FTC should consider, they ignore the actual impact on consumers. For example, if consumers are found to be better off from the merger in question, there is no real harm to the public. Such positive outcomes may result in lower consumer prices, higher quality products, increased innovation, and ultimately increased competition. The fact is that a horizontal merger always eliminates a competitor and concentrates the market, but the FTC should be sophisticated enough to judge when consumers are harmed. The proper test is the consumer welfare standard.

- ***Brown Shoe Company Case is An Example to Avoid***

The FTC cites the United States v. Brown Shoe Company case seventeen times in the draft guidelines. If lowering consumer prices and improving U.S. business competitiveness is a desirable outcome, the Brown Shoe case is one that regulators should avoid citing as being virtuous. This is because this case is an example where the court erred by blocking a merger that would have resulted in increased operational efficiency and competition, and it would have led to lower prices and increased consumer welfare.[19] On this topic, the FTC provides a clear public statement on its website stating this very point:

> *But the Supreme Court ruled that the removal of even a relatively small competitor from the market presented a significant threat to competition. By*

[19] United States v. Brown Shoe Company, 370 U.S. 294 (1962).

blocking an acquisition in a unconcentrated market in order to protect small businessmen, the Court chose to ignore the possibility that a somewhat larger shoe store chain would be more efficient and result in lower prices for consumers.[20]

In the end, the Brown Shoe case prevented the merger between Kinney Shoes and the Brown Shoe Company. That merger would have would have increased U.S. productivity and lowered consumer prices. Today, the vast majority of shoes are manufactured overseas, and Kinney and the Brown Shoe Company are no longer in business, having closed 35 and 33 years ago, respectively.

It should not be the FTC's role to protect one competitor over another; it should protect consumers. It should not be the FTC's concern to defend weaker or smaller firms over larger and more efficient firms. To do so interferes with the ability of firms to reach their minimal efficient scale, which only works to raise consumer prices and, in the Brown Shoe case, makes the U.S. uncompetitive among its international competitors. If the FTC forces large U.S. technology companies into submission and breakups, it will find itself to be a very ineffective regulator of Chinese global online services.

Instead of protecting competitors, the FTC should focus on protecting competition and increasing the welfare of consumers. When judging whether a merger harms the public's interest, the consumer welfare standard should be the litmus test for mergers. Without this test, antitrust enforcement becomes subjective and ripe for abuse, rent-seeking by inefficient firms, and subject to political and ideological views, and biases.

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[20] Debra A. Valentine, "The Evolution of U.S. Merger Law, Public Statement, Prepared Remarks before INDECOPI Conference, Federal Trade Commission, August 13, 1996, downloaded from the FTC website on August 24, 2023, at https://www.ftc.gov/news-events/news/speeches/evolution-us-merger-law.