LEGAL UPDATES

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New Draft Merger Guidelines Complicate Deal Outlook

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Consistent with the Biden administration's whole-of-government approach to address perceived consolidation in a variety of industries, the Federal Trade Commission (FTC) and U.S. Department of Justice (DOJ) Antitrust Division (collectively, the Agencies) are continuing to make good on their promise to increase scrutiny of mergers and acquisitions through newly proposed rules and revised merger guidelines.

The Agencies published their draft Merger Guidelines on July 19, 2023, just weeks after the FTC issued newly proposed rules under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (HSR). The new draft Merger Guidelines represent a significant departure from the 2010 Horizontal and Vertical Merger Guidelines, and the recently proposed HSR rules represent the first time the HSR process has been substantively updated in over 40 years. If implemented in their current form, both will have the effect of making the merger review process lengthier, more complicated, and more burdensome. The Agencies are seeking comments on the Merger Guidelines through September 18, 2023, and the FTC is currently accepting comments on the proposed HSR rules until September 27, 2023.

Key takeaways from the draft Merger Guidelines include:

Decrease in market concentration threshold used to evaluate whether a transaction presumptively violates antitrust law.

Increased focus on vertical mergers and increased likelihood that many different types of vertical transactions may be reviewed.

Continued efforts by DOJ and FTC to review mergers for effects on workers and labor markets.

Private equity acquisitions and rollups are specifically mentioned in the Merger Guidelines.

Proposed HSR rules are more expansive and burdensome

Representing the first part of the Agencies' one-two punch, on June 27, the FTC proposed HSR rules that represent the first major overhaul of the HSR premerger notification requirements in more than 40 years. Given that the proposed HSR rules require more information from the parties, it is expected that the additional information could result in longer reviews and an increased number of formal investigations by the Agencies.

The FTC's proposed HSR rules mirror some of the newly announced Merger Guidelines and will require HSR filers to submit additional or new information as follows:

Areas of actual or potential competition, vertical supply relationships, and strategic rationale for the transaction

Detailed information about the post-transaction structure and the parties' organization, including more information about minority interest holders

Disclosure of both parties' acquisitions going back 10 years where there is horizontal overlap

More expansive disclosure of HSR Item 4(c) and 4(d) documents, including those of supervising deal team leaders and drafts

Disclosure of foreign entity or government subsidies

Disclosure of labor market data

Guidelines' lower market concentration threshold means more merger investigations, challenges

The Agencies' draft Merger Guidelines double down on their aggressive stance toward mergers. Each of the Merger Guidelines (of which there are 13) provide the roadmap used by the Agencies to evaluate whether a proposed transaction violates Section 7 of the Clayton Act. Section 7 prohibits transactions that "may substantially lessen competition or tend to create a monopoly" in a relevant geographic and service/product line market.

The draft Merger Guidelines, similar to previous versions, summarize the market concentration thresholds necessary for the Agencies to assert a presumption of anticompetitive harm under Section 7 of the Clayton Act—but Merger Guideline 1 differs in that it reduces the market concentration threshold necessary to assert anticompetitive harm. This presumption of harm means that the merger is inherently likely to substantially lessen competition and must be blocked in the absence of evidence clearly showing that the merger is not likely to have anticompetitive effects.

Guideline 1 explains that market concentration reflects the number and size of competing firms and is measured using the Herfindahl-Hirschman Index (HHI)—this analysis is similar to prior versions of the Merger Guidelines. Notably, however, the draft Merger Guidelines reduce the HHIs (market concentration thresholds) to pre-2010 levels so that a market with a post-merger HHI of more than 1,800 is considered highly concentrated.[1] A merger triggers the presumption of harm when it results in a post-merger HHI greater than 1800 and the increase in the HHI is greater than 100 points.

Guideline 1 also provides that instead of using the market concentration thresholds, the Agencies may examine the market share of the merged firm. A firm with over 30% market share in a relevant market presents an "impermissible threat of undue concentration regardless of the overall market concentration."[2]

It seems likely that the Agencies will open more merger investigations and possibly increase the number of litigated merger challenges given that the new Merger Guidelines allow them to assert that a transaction presumptively harms competition where the merged firm has a combined market share of just over 30% and can scrutinize markets where concentration levels are lower.

Increased focus on vertical mergers

Draft Merger Guidelines 5, 6, and 7 (among others) could impact companies looking to partner with or acquire a company where the acquiring party will have control over a product, service, or customer(s) used by its rivals to compete, whether or not they involve traditional vertical supply and distributor relationships—this represents an expansion by the Agencies of what may constitute a problematic vertical transaction.

Guideline 6 states that vertical mergers or acquisitions will not be allowed to substantially lessen competition under Section 7 by giving a buyer this type of control or by raising a rival's costs of or excluding or limiting a rival's access to a related product/service. The Agencies go on to state that the relevant market for this analysis can be the market in which the merged firm competes with its rivals, while the product, service, or customer that rivals use to compete in that market is termed the "related product" or "related service."

The Agencies also expand their reach into vertical transactions by stating in Guideline 6 that if the foreclosure share is above 50%, this factor alone is a sufficient basis to conclude that the effect of the merger may be to substantially lessen competition, subject to any rebuttal evidence. The "foreclosure share" is the share of the related market that is controlled by the merged firm, such that it could foreclose rival's access to the related product or service on competitive terms. If it is 50% or below, then the Agencies state they will review certain "plus factors," including any trends toward vertical integration, the purpose of the merger, whether the relevant market is already concentrated, and the extent to which the merger increases barriers to entry.

Expansion and entrenchment of dominance

For companies and organizations that currently have at least a 30% market share (considered "dominant" by the Agencies), Guideline 7 cautions that the Agencies will evaluate whether a merger involving an "already dominant firm may substantially reduce the competitive structure of the industry." The Agencies also will evaluate whether the merger may extend that dominant position into new markets, thereby substantially lessening competition in those markets. To identify whether one of the merging firms already has a dominant position, the Agencies look to whether (i) there is direct evidence that one or both merging firms has the power to raise price, reduce quality, or otherwise impose or obtain terms that they could not obtain but for that dominance, or (ii) one of the merging firms possesses at least 30% market share.

Labor market effects

While the Agencies have been requesting labor market information as part of their merger investigations, the Merger Guidelines and proposed HSR rules underscore that they will continue their efforts to protect workers. The proposed HSR rules require submission of labor market data as part of a HSR filing and Merger Guideline 11 outlines the Agencies' analysis of potential labor market effects.

In Guideline 11, the Agencies emphasize that "[l]abor markets are important buyer markets. The same general concerns as in other markets apply to labor markets where employers are the buyers of labor and workers are the sellers." The Agencies will consider whether workers face a risk that the merger may substantially lessen competition for their labor. Where a merger between employers may substantially lessen competition for workers, the Agencies will evaluate whether the reduction in labor market competition may lower wages or slow wage growth, worsen benefits or working conditions, or result in other degradations of workplace quality. When assessing the degree to which the merging firms compete for labor, the Agencies take the position that any one or more of these effects may demonstrate that substantial competition exists between the merging firms.

Notably, the Agencies also take the position that the level of concentration at which competition concerns arise may be lower in buyer markets, including labor markets, than in seller markets, due to the unique features of certain buyer markets.

Continued scrutiny of private equity

The Merger Guidelines allow the Agencies to investigate a series of smaller deals made by a company or organization, as well as minority investments. This is consistent with the Agencies' recent statements that they have concerns with "roll-up transactions" and similar acquisition strategies commonly used by investors. The Agencies state in Guideline 9 that if a firm that engages in an anticompetitive pattern or strategy of multiple small acquisitions in the same or related business lines may violate Section 7, even if no single acquisition on its own would risk substantially lessening competition or tending to create a monopoly. In these situations, the Agencies state they may evaluate the series of acquisitions as part of an industry trend (Guideline 8) or evaluate the overall pattern or strategy of serial acquisitions by the acquiring firm under Guidelines 1-7.

Guideline 12 underscores the recent concern of the Agencies that an acquisition of less-than-full control may still influence decision-making at the target firm or another firm in ways that may substantially lessen competition. The Agencies may examine whether acquisitions of partial ownership or other minority interests may give the investor rights in the target firm, such as rights to appoint board members, observe board meetings, veto the firm's ability to raise capital, or impact operational decisions, or access to competitively sensitive information. The Agencies have concerns with both cross-ownership, which refers to holding a non-controlling interest in a competitor, as well as common ownership, which occurs when individual investors hold non-controlling interests in firms that have a competitive relationship that could be affected by those joint holdings.

What this means to you

For companies evaluating growth and expansion opportunities, the proposed HSR rules and the Agencies' more complex Merger Guidelines will increase deal timelines, the merging parties' time and expense, and the potential risk that the transaction will be reviewed by the Agencies. While not yet in place, the Agencies are already evaluating transactions with an eye towards labor market effects, dominance, and vertical concerns. Given that the Agencies are using the draft Merger Guidelines in practice, companies and organizations should carefully consider risk shifting provisions, the antitrust clearance strategy, their appetite to defend against a litigated merger challenge, possible remedies, and settlement options at the beginning of a proposed transaction.

Contact us

Husch Blackwell continues to monitor the evolving HSR rules and Merger Guidelines and their implications for our clients. Should you have any questions, please do not hesitate to contact Wendy Arends, Mark Tobey, Victoria Sitz, or your Husch Blackwell attorney.

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[1] The HHI for a market of 5 equal firms is 2,000 (5 x 202 = 2000) and for 6 equal firms is 1,667. Markets between 1,000 and 1,800 are "concentrated" under the draft Merger Guidelines.

[2] *See U.S. v. Phila. Nat'l Bank*, 374 U.S. 321, 364-5.