Is 5-to-4 the new 4-to-3? A view from the United States

Nicholas Hill & Keith Waehrer
Bates White, LLC

1. Introduction

In late 2017, in its administrative court, the Federal Trade Commission (FTC) filed a complaint alleging that Tronox's proposed acquisition of Cristal's titanium dioxide assets would substantially reduce competition to supply chloride titanium dioxide in North America. While that court's decision was still pending in the summer of 2018, the FTC filed a petition in the DC District Court requesting a preliminary injunction to prevent the parties from closing before the administrative court issued its decision. On 5 September 2018, the District Court granted that petition. In late December, the administrative court issued its decision, agreeing with the District Court that the proposed merger would likely substantially reduce competition and blocking its consummation, pending appeal.

The Tronox court decisions were striking because, according to the FTC's own proposed findings of fact, the merger would have left four significant competitors in the North American market for chloride titanium dioxide.[1] The decisions were an example of what is commonly referred to as a "5-to-4"—a horizontal merger that reduces the number of players in a relevant antitrust market from five to four.[2] Successful litigation to block such mergers is rare. While litigation to block (or remedy) 2-to-1 and 3-to-2 proposed mergers is common, litigation to block even 4-to-3 proposed mergers is not.[3] Thus, 4-to-3 proposed mergers can be seen as lying on the frontier of enforcement: some such mergers are challenged, while others are allowed to close without modification.

But in the Tronox-Cristal matter, two separate courts agreed that a 5-to-4 merger was likely to substantially harm competition. This surprising pair of decisions arrived when the US antitrust orthodoxy was under attack from an intellectual movement that argues that antitrust enforcement in the United States has grown too lax. Had this new movement, known as neo-Brandeisian by its adherents and Hipster Antitrust by its opponents, succeeded in already moving the goal posts?[4] Is 5-to-4 destined to replace 4-to-3 as the frontier of enforcement?

It is entirely possible that the frontier of antitrust enforcement may shift and become more aggressive. But attempting to detect such a shift by examining how often 5-to-4 or 4-to-3 mergers are challenged is unlikely to be fruitful. This is because focusing on the number of remaining competitors misunderstands profoundly where the frontier of enforcement in the United States is actually located. The frontier that separates mergers that are highly unlikely to be challenged from those

1 Complaint Counsel's Post-Trial Proposed Findings of Fact and Conclusions of Law, *In re Tronox Ltd. et al*. Docket No. 9377, Aug. 14, 2018, https://www.ftc.gov/system/files/documents/cases/081418ccfindingsoffactconclusionsoflaw591858.pdf, p. 89, specifically the section title that reads "There are Five Major Producers in the Relevant Market." See also ¶ 376.

2 The discussion in this essay applies only to horizontal mergers.

3 The Department of Justice's litigation challenging Dean Food's acquisition of two processing plants in Wisconsin is one example.

4 Without declaring ourselves either its adherent or its opponent, we shall refer to the movement using the more polite neo-Brandeisian title.

that may be is demarcated not by the number of firms that would remain, but by whether the merger runs afoul of the structural presumption defined in the US Horizontal Merger Guidelines.[5]

2. The structural presumption or bust?

The two principal US antitrust agencies, the Department of Justice (DOJ) and the FTC, have an enviable track record in recent horizontal merger litigations.[6] They have racked up victories in a string of recent litigations, including (1) Sysco/US Foods, (2) Aetna/Humana, (3) Anthem/Cigna, (4) Hershey Medical Center/PinnacleHealth System, (5) Advocate/NorthShore, (6) Energy Solutions/Waste Control Specialists, (7) Sanford Health/Mid Dakota Clinic, and (8) Wilhelmsen Maritime Services/Drew Marine Group.

The successes of the DOJ and the FTC reflect the fact that they have a solid merger litigation playbook. This playbook rests on two pillars: (1) establishing a relevant market, and (2) showing that the structural presumption applies in that market. There are good reasons for the agencies to rely on this strategy. First, it is well supported by favorable case law in a number of US jurisdictions and thus has largely been successful.[7] Second, each pillar can typically be constructed using current or historical information, which simplifies establishing it.[8] By way of contrast, other key substantive areas such as competitive effects, entry, and efficiencies all typically involve predicting the future to some degree.[9]

Looking at some of the litigations that the agencies have lost in the recent past underscores the importance of the playbook pillars. In its challenge to the Steris/Synergy Health merger, the FTC could not rely on the structural presumption and instead had to argue that (competitive) entry was likely but for the merger. The judge found for the defense, a rare loss for the agency during a period in which it enjoyed a string of victories.

The two pillars work in conjunction with one another. Defining a market is a necessary precursor to establishing that the structural presumption applies, since the structural presumption, as defined in the 2010 joint DOJ-FTC Horizontal Merger Guidelines, depends on the post-merger level and increase in market concentration.[10] In particular, the Guidelines state that any merger in a relevant antitrust market that results in a highly concentrated market (i.e., the post-merger Herfindahl-Hirschman Index (HHI) is 2,500 or above) and substantially increases concentration (i.e., the increase in the HHI is 200 or more points) is "presumed to be likely to enhance market power."[11]

Court opinions confirm that the proposed mergers or acquisitions discussed at the beginning of this section met the requirements necessary for the structural presumption to apply and that this was important.[12] But a demonstrative taken from one

5 US Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines*, Aug. 19, 2010, https://www.ftc.gov/sites/default/files/attachments/merger-review/100819hmg.pdf. The Guidelines identify structural changes in market concentration that are large enough that a merger is presumed to be anticompetitive. Specifically, a horizontal merger is presumed to be anticompetitive if it increases the HHI in a relevant market by 200 points or more and results in a post-merger HHI of 2,500 or more.

6 Indeed, some critics argue that the Agencies' success rate indicates that it brings too few cases.

7 US case law is organized at a regional level, and different regions can have different precedents.

8 Market definition is about demand, and most market definition questions can be (and are) addressed using data or documents pertaining to past consumer behavior. Similarly, market shares are typically calculated using historical sales.

9 Consummated mergers are often an exception to this statement, including the famous Evanston decision that reinvigorated hospital merger enforcement in the United States. *See* Case Summary, Evanston Northwestern Healthcare Corporation and ENH Medical Group, Inc., FTC Matter/File No. 0110234, Docket No. 9315, Apr. 29, 2008, https://www.ftc.gov/enforcement/cases-proceedings/0110234/evanston-northwestern-healthcare-corporation-enh-medical-group.

10 US Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines*, Aug. 19, 2010, https://www.ftc.gov/sites/default/files/attachments/merger-review/100819hmg.pdf.

11 *See Id.*, p. 19.

12 For Sysco/US Foods, *see* Memorandum Opinion, *Federal Trade Commission v. Sysco Corporation et al.*, No. 1:15-cv-00256 (APM), June 29, 2015, https://www.ftc.gov/system/files/documents/cases/150623syscomemo.pdf, pp. 67–81, especially 67, 72, and 81; for Aetna/Humana, *see* Memorandum Opinion, *United States et al. v. Aetna Inc., et al.*, No. 16-1494 (JDB), Jan. 23, 2017, https://www.justice.gov/atr/case-document/file/930696/download, p. 59; for Anthem/Cigna, *see* Memorandum Opinion, *United States et al. v. Anthem, Inc., et al.*, No. 16-1493 (ABJ), Feb. 21, 2017, https://www.justice.gov/atr/case-document/file/940946/download, p. 3; for Hershey/Pinnacle, *see* Federal Trade Commission, *Commonwealth of Pennsylvania v. Penn State Hershey Medical Center, Pinnacle Health System*, No. 16-2365, Sept. 27, 2016, https://www.ftc.gov/system/files/documents/cases/160927pinnacledecision.pdf, pp. 31–32; for Advocate/NorthShore, *see* Redacted Memorandum Opinion and Order, *Federal Trade Commission and State of Illinois v. Advocate Health Care et al.*, No. 15-C-11473, Mar. 16, 2017, https://www.ftc.gov/system/files/documents/cases/advocate_health_care_opinion_granting.pdf, p. 17; for Energy Solutions/Waste Control, *see* Opinion, *United States v. Energy Solutions, Inc., et al.*, No. 16-1056-SLR, July 12, 2017, https://www.justice.gov/atr/case-document/file/1007831/download, p. 43; for Sanford/Mid Dakota, *see* Introduction, *Federal Trade Commission and State of North Dakota v. Sanford Health et al.*, No. 1:17-cv-133, Dec. 15, 2017, https://www.ftc.gov/system/files/documents/cases/1710019_sanfordpiorder.

of these cases is the most eloquent voice on this subject.

Figure 1 is a slide taken from the direct examination of the DOJ's economic expert on the proposed Aetna-Humana merger.[13] The points on the graph are markets at issue in that litigation. More specifically, they are counties in the United States in which the DOJ alleged that the proposed merger would substantially reduce competition. The graph has two axes. The horizontal axis displays the post-merger HHI in each market (at the time of the merger). The vertical axis displays the increase in the HHI in each market that would have resulted from the merger (likewise).

The figure shows that the structural presumption was met in every one of the 350 plus markets in which the DOJ alleged competition would be substantially reduced. In some of these markets the merger would have reduced the number of significant competitors from two to one, in some it would have reduced the number from three to two, and in some it would have reduced the number from four to three. But what all these markets had in common is that the structural presumption applied.

With this stark example at hand, we can return to our starting point, the Tronox opinions. In Tronox, the FTC alleged that the post-merger HHI in the North American market for chloride titanium dioxide would exceed 3,000 and that the increase in the HHI would exceed 700.[14] Far from being a harbinger of more aggressive enforcement, then, the Tronox matter instead fit snuggly into the orthodoxy that is so vividly illustrated in Figure 1.

3. Change is afoot

The emphasis that the Agencies place on the structural presumption derives from the deference that courts and antitrust practitioners give to the Guidelines. Given this deference, the Agencies are unlikely to cross the frontier and begin regularly litigating cases that do not qualify for the structural presumption.[15] A relevant question then

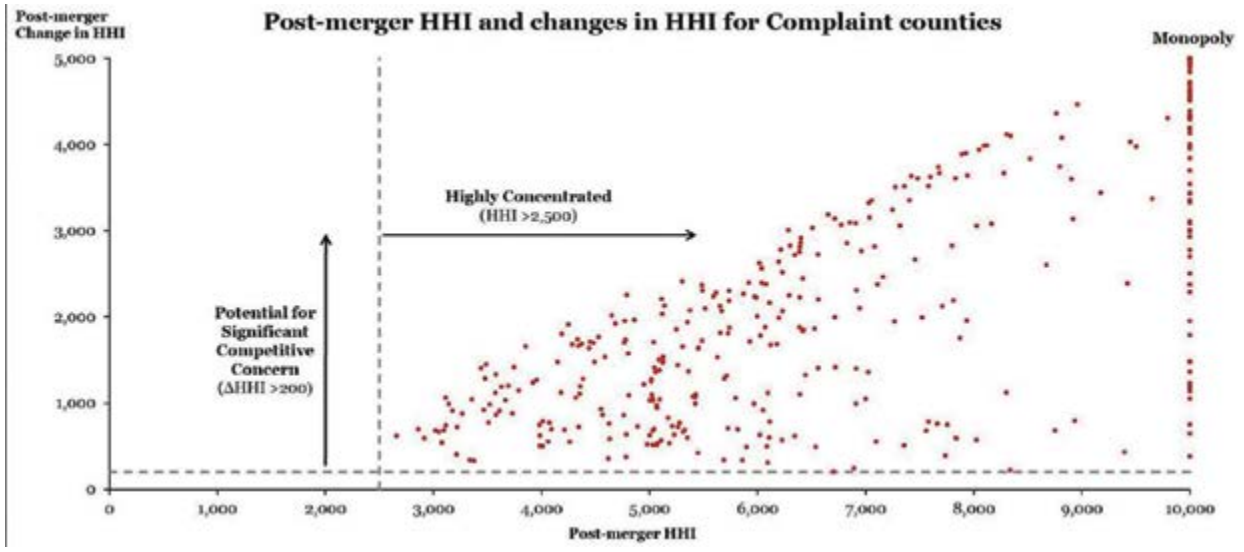
pdf, pp. 25–26; for Wilhelmsen/Drew Marine, *see* Memorandum Opinion, *Federal Trade Commission v. Wilh. Wilhelmsen Holding ASA et al.,* No. 18-cv-00414-TSC, Sept. 28, 2018, https://www.ftc.gov/system/files/documents/cases/wss_public_opinion.pdf, pp. 34–41.

13 Aviv Nevo, "US and Plaintiff States v. Aetna Inc. and Humana Inc." (demonstrative used in testimony), https://www.justice.gov/atr/page/file/918706/download, slide 58.

14 Complaint Counsel's Post-Trial Proposed Findings of Fact and Conclusions of Law, *In re Tronox Ltd. et al*. Docket No. 9377, Aug. 14, 2018, https://www.ftc.gov/system/files/documents/cases/081418ccfindingsoffactconclusionsoflaw591858.pdf, ¶ 393.

15 There may be occasions on which it happens. For example, the DOJ was reportedly planning to litigate the proposed merger between Comcast and Time Warner Cable in 2015. That merger would likely not have qualified for the structural presumption. However, the Federal Communications Commission was also reportedly planning to litigate, and no merger it has challenged has ever been consummated.

Figure 1 *- Aetna-Humana demonstrative on the structural presumption*



Source: Aviv Nevo, "US and Plaintiff States v. Aetna Inc., and Humana Inc." (presentation, Department of Justice, n.d.), available at https://www.justice.gov/atr/page/file/918706/download

is whether the Guidelines will be revised to tighten the structural presumption.

The Guidelines were last extensively revised in 2010, 13 years after the previous revision. This fact, and the history of prior revisions, shows that a revision in the near future would not be unduly rapid.[16] Should the neo-Brandeisian movement gain traction, it would therefore not be surprising if the Guidelines were revised and the structural presumption adjusted to lower the enforcement threshold.

Handicapping whether any such change in enforcement regime will occur soon likely depends upon the outcome of the 2020 US presidential election: the current political leadership at the DOJ and FTC does not adhere to the neo-Brandeisian movement and seems unlikely to fully adopt its desire for more rigorous enforcement.[17] This could change were the Democratic party to win in 2020, and antitrust enforcement has indeed already emerged as an issue in the race for the Democratic nominee.[18]

But the Guidelines need not change for the neo-Brandeisian movement to affect the aggressiveness of horizontal merger policy. For while the structural presumption may demarcate a frontier that is rarely crossed, many horizontal mergers that qualify for the structural presumption are not litigated. Some of these presumptively harmful proposed mergers are remedied by divestiture agreements (satisfaction not guaranteed), but others are determined by the Agencies to either be unlikely to be harmful—because of some combination of entry, efficiencies, or the lack of a credible competitive effects theory—or to present unacceptably high litigation risk (for the same reasons) despite the presumption.

This means that the Agencies could stiffen the enforcement regime without a revision to the Guidelines. Such a movement to more aggressive enforcement would result in challenges to mergers that qualify for the structural presumption but that the Agencies presently allow to close without a challenge (i.e., the de facto litigation threshold would be relaxed). If such a change were made, some of the mergers that were challenged under the new enforcement regime—but that would not have been under the old—could be 5-to-4 mergers, which would create the appearance that 5-to-4 mergers are the new 4-to-3 mergers, even if being 5-to-4 had little to do with the change in their fate.

The rise of the neo-Brandeisian movement has been fueled by a perception that the market power of firms is growing and harming consumers. This perception is in turn driven by reports of record profits in some consumer-facing industries (see, e.g., the US airline industry), new concerns about cross-firm ownership,[19] and general uneasiness about the growth of tech titans like Amazon, Apple, Facebook, and Google. If the belief that firms are gaining power at the expense of consumers strengthens, pressure to act will build and the de facto litigation standard may be softened.

A weakening of the de facto litigation standard could also occur without the Agencies' standards changing. The likelihood that an Agency attempts to block a proposed merger depends on the results of that Agency's internal analysis, and changes in economic conditions could lead the Agencies' analysis to find that more mergers meet the present de facto litigation standard. Suppose, for example, that firms begin to earn higher variable margins in certain well-defined antitrust markets. The US Horizontal Merger Guidelines intimate that higher margins (all else equal) increase the likelihood that an agency will determine that a merger in a differentiated products market is likely to be harmful.[20] Thus, more proposed mergers may be challenged, even without the standard shifting, due to changing economic conditions. We caution, though, that a rise in variable margins may have several effects, not all of which will lead to more aggressive enforcement, and that any change in

16 The 1997 Guidelines were themselves a revision of the 1992 Guidelines, which were a revision of the 1984 Guidelines, which were a revision of the original 1958 Guidelines.

17 Such things are difficult to predict, however. The FTC recently created a new section to investigate mergers and conduct in the technology sector.

18 *See, e.g.*, Astead W. Herndon, "Elizabeth Warren Proposes Breaking Up Tech Giants Like Amazon and Facebook," *New York Times*, Mar. 8, 2019, https://www.nytimes.com/2019/03/08/us/politics/elizabeth-warren-amazon.html.

19 Jose Azar, Martin C. Schmalz, and Isabel Tecu, "Anti-Competitive Effects of Common Ownership," *Journal of Finance* 73, no. 4 (2018): 1513–65; Daniel P. O'Brien and Keith Waehrer, "The Competitive Effects of Common Ownership: We Know Less Than We Think," *Antitrust Law Journal* 81, no. 3 (2017):729–76.

20 US Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines*, Aug. 19, 2010, §6.1. https://www.ftc.gov/sites/default/files/attachments/merger-review/100819hmg.pdf.

economic conditions is only likely to be relevant if it occurs within a relevant market.

In conclusion, there are three ways that merger enforcement in the United States could become more aggressive in the near future. Such a shift could result from a tightening of the structural presumption, more aggressive enforcement of cases that meet the structural presumption (i.e., a lowering of de facto litigation thresholds at the agencies), or simply a shift in economic conditions (e.g., higher margins) that means more proposed mergers meet the current de facto litigation threshold. Whether such a shift occurs will depend on a host of variables, both political and economic. Were it to occur, one might well see more 5-to-4 mergers challenged, but it would likely not be due to heightened concern about the number of firms left in a market after a merger.

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