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New Merger Review and FERC's Market Power Analyses

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In September 2009, the U.S. Department of Justice and the Federal Trade Commission announced that they intend to revise their Horizontal Merger Guidelines, which were last updated in 1992. The agencies' reasons for updating them were that the guidelines no longer reflected true agency practice, and were not an accurate guide to the business community of how the agencies actually conducted a merger review.

The existing guidelines suggest that the agencies begin with market definition, market shares and market concentration. But in a recent speech, DOJ Chief Economist Carl Shapiro said that the agencies were conducting "workshops [that] will explore whether the Guidelines should be updated to reflect the fact that investigations often do not begin with, or focus on, market definition and concentration."

The agencies issued a set of 20 questions and asked for public comments about whether new issues should be introduced, including those relating to defining geographic markets, unilateral effects, entry, the impact of large buyers (who might be economically more powerful than the sellers), remedies, and the standards for issuing second requests.

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Since September, interested parties have submitted written comments regarding revisions to the Merger Guidelines and the agencies held a series of five workshops in Washington, DC, New York, Chicago and California. Almost 100 expert panelists participated in the workshops.

But of all the issues for agency review in the proposed revisions, none is more significant than the agencies' comments on the use of the Herfindahl-Hirschman Index ("HHI").

According to the Merger Guidelines, mergers involving HHIs greater than 1,800 "potentially raise significant concerns" and an HHI increase of 50 is presumptively anticompetitive. But in actual practice, the agencies rarely challenge mergers with HHIs of less than 2,500.

More importantly, under the Merger Guidelines, HHIs were never used as a substantive end in themselves. They were used only to decide whether a potential acquisition needed further investigation. And, in that investigation, there were many other factors that could determine the outcome, including the critical question of whether entry was possible or not.

For years, the heads of antitrust agencies made clear that the HHIs were not ends in themselves. Former FTC Commissioner Thomas Leary said in 2002 that "Statistical calculations of concentration have, if anything, become progressively less significant as we move from 1982, through 1984 and 1992, and into the present day."

His successor, Tim Muris, noted "I hope the data we [recently] released ... will finally put to rest the notion that HHI levels have any specific significance, except at very high levels ... Thus, the preeminence that some would continue to give to concentration or HHI numbers is misplaced. State-of-the-art merger analysis has moved well beyond a simplistic causality of high concentration leading to anticompetitive effects."

And Charles James, former head of the Antitrust Division, stated: "Over time, economic research seriously undermined fears of low market share mergers and questioned the overly simplistic reliance on market structure as the [sic] both the beginning and end of competitive analysis. These new concepts were embraced by the Supreme Court in *United States v. General Dynamics*, where the Court held that high market shares alone were insufficient to block a merger and required a deeper inquiry into the actual, future competitive effects of a merger."

In 1996, the Federal Energy Regulatory Commission began to use the Merger Guidelines as a "basic framework" for reviewing certain deal approvals where public utility mergers and acquisitions result in significant combinations of owned or controlled jurisdictional assets in the same market. The HHI is used as part of the "competitive analysis screen" applied in these situations.

FERC noted when it began to rely on the Merger Guidelines that FERC's analysis "should be generally consistent" with that of the DOJ and the FTC; however, it did not attempt to make the analysis identical. In the case of market-based rate proceedings, the HHI is used as part of FERC's market power analysis for applicants that do not pass FERC's screen tests.

This article is intended only as a general discussion of these issues. It is not considered to be legal advice. We would be pleased to provide additional details or advice about specific situations. For additional information on this important topic, please feel free to call upon your Dewey & LeBoeuf relationship partner.

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Although the Merger Guidelines and their use of the HHI have influenced FERC's evaluation of market power in the market-based rate context, FERC emphasizes that its analyses are not identical to the agencies:

"[W]hile the HHI thresholds contained in the DOJ/FTC 1992 Horizontal Merger Guidelines provide useful measures for analyzing market conditions, these thresholds are based on the antitrust agencies' obligations to prohibit mergers that substantially lessen competition ... Our standards are based on the Commission's statutory obligation under section 205 [rate provisions] of the FPA [Federal Power Act] to ensure that wholesale rates are just and reasonable."

But a change to the FTC and DOJ policies on HHI may result in FERC revisiting its approach to use of HHI in both the market-based rate and M&A context.

The agencies held their final workshop on the Merger Guidelines on Jan. 26, 2010. As that revision process draws to a close, interested parties should monitor the changes to the Merger Guidelines and FERC's response to any changes.