MERGER POLICY
Overview

• Context: you are helping a firm that wants to acquire a competitor
• Concepts: merger review process; efficiency and failing firm defense; unilateral and coordinated effects
• Economic principle: it’s not just the economics, stupid!
Outline

- Merger policy: general principles
- US and EU merger review processes
- Cases
Outline

• Merger policy: general principles
• US and EU merger review processes
• Cases
Merger policy

• If there are economies of scale, merger leads to lower cost; various synergies may create additional value

• But: greater concentration leads to greater market power
  – Unilateral effects
  – Collusion effects

• Merger policy is an attempt at measuring the pros and cons of each merger
  – Benefits and costs for firms
  – Benefits and costs for consumers
Economics analysis

- Relevant market definition
- Lower fixed cost: efficiency gained by firms
- Lower marginal cost: typically shared between firms, consumers
- Fewer competitors (lessening of competition):
  - Unilateral effects
  - Collusion
- Equilibrium readjustment
  - Number of firms (entry or exit)
  - Number of locations / varieties
  - Prices
Outline

• Merger policy: general principles
• US and EU merger review processes
• Cases
Process (US)

- Hart-Scott-Rodino Antitrust Improvement Act of 1976
- Notification system implemented in 1978
- If merger size is "big" ($200m+) then merging parties must notify FTC and DOJ. Wait for 30 days
- Either party may request additional information ("second request"). Clayton Act, Section 7A(e)
- If so, merging parties must provide information; agency then has another 30 days to respond
- Agency may negotiate remedies; may seek injunction in Federal District Court to prohibit merger; agency may also challenge merger ex-post, but that is rare
Historical data

- More than 95% of the filings are cleared during initial period
- More than 75% of the “second request” cases are “enforced”
### FTC approved mergers 1996–2007 (%)

<table>
<thead>
<tr>
<th>Post Merger HHI Range</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 - 1,799</td>
<td>59.4</td>
</tr>
<tr>
<td>1,800 - 1,999</td>
<td>38.2</td>
</tr>
<tr>
<td>2,000 - 2,399</td>
<td>38.9</td>
</tr>
<tr>
<td>2,400 - 2,999</td>
<td>26.1</td>
</tr>
<tr>
<td>3,000 - 3,999</td>
<td>30.1</td>
</tr>
<tr>
<td>4,000 - 4,999</td>
<td>16.0</td>
</tr>
<tr>
<td>5,000 - 6,999</td>
<td>13.0</td>
</tr>
<tr>
<td>7,000 +</td>
<td>1.3</td>
</tr>
</tbody>
</table>

FTC approved mergers 1996–2007 (%)

As a function of change in HHI

<table>
<thead>
<tr>
<th>Change in HHI</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 - 99</td>
<td>92.3</td>
</tr>
<tr>
<td>100 - 199</td>
<td>56.4</td>
</tr>
<tr>
<td>200 - 299</td>
<td>47.2</td>
</tr>
<tr>
<td>300 - 499</td>
<td>33.3</td>
</tr>
<tr>
<td>500 - 799</td>
<td>27.2</td>
</tr>
<tr>
<td>800 - 1,199</td>
<td>22.5</td>
</tr>
<tr>
<td>1,200 - 2,499</td>
<td>14.5</td>
</tr>
<tr>
<td>2,500 +</td>
<td>2.5</td>
</tr>
</tbody>
</table>

Average: 33.3%

Source: http://www.ftc.gov/os/2008/12/081201hsrmergerdata.pdf
New Horizontal Merger Guidelines (HMG)

- Merger guidelines are not law, but are highly cited
- Old guidelines (1983, 1992) sought precise, step-by-step framework around “relevant market” definition (SSNIP test) and market concentration measurement (HHI index)
- New guidelines (August 2010) envision more flexible approach
  - Greater emphasis on economic effects, lesser emphasis on formulas
  - Direct evidence of price effect
  - Merger simulation models (which may not rely on market definition)
  - Statistical analysis of “natural experiments”
New HMG (cont)

- Thresholds and safe harbors:
  - Higher HHI thresholds (more on this below)
  - 35% market share “safe harbor” deleted

- Greater transparency in agencies’ analytical process
  - Much of what HMG 2010 include was already in use

- Greater scrutiny in differentiated product and R&D intensive industries (new section on innovation)
New HMG (cont)

• But courts will likely continue placing weight on market definition and market shares
  – Will agencies use old HMG in court?
  – Will agencies’ court performance suffer?
  – Will legal uncertainty increase?
HHI thresholds in HMG

- HHI increases by less than 100: no problem
- Post-merger HHI < 1,500: no problem (old threshold 1,000)
- Post-merger HHI between 1,500 and 2,500: if increase in HHI is over 100, significant concerns
- Post-merger HHI over 2,500 (old threshold 1,800): if HHI increases by 100–200, concerns; if HHI increases by more than 200, presumed anticompetitive
EU regulations

• Roughly similar to US regulations
• In addition, separate non-horizontal merger guidelines
  – More likely efficiency effects (e.g., double marginalization)
  – Input foreclosure
  – Customer foreclosure
  – Coordinated effects
Outline

- Merger policy: general principles
- US and EU merger review processes
- Cases
Mini-case: The ill-fated GE-Honeywell merger

- What was the strategic logic for GE to purchase Honeywell?
- Do you find it compelling?
- What was the European Commissions logic in blocking the merger?
- Do you think it made the right decision?
- What should Jack Welch have done?
- Should he have pressed ahead for a deal?
- What are the main learning points from this case?
Staples and Office Depot: the merger

- Staples wants to merger with Office Depot (1996)
- FTC asks for several store divestitures as remedy
- Staples disagrees, case taken to court (1997)
Staples and Office Depot: the case

• Discussion on market definition
  – Stores selling office supplies
  – Office supplies super stores

• Discussion on cost efficiencies
  – FTC claims many efficiencies would have taken place through internal growth
  – FTC claims pass-through rate small

• Discussion effects on prices
  – Prices 11.6% lower in markets with Staples and Office Depot than Staples only

• Court sides with FTC
Staples and Office Depot: takeaways

- FTC signals willingness to fight till the end
- Court signals importance of economic analysis
- Unilateral effects important; not just coordination effects (as suggested by 1992 merger guidelines)
Oracle and PeopleSoft (2004)

- SAP, Oracle and PeopleSoft largest firms in ERP
- Oracle makes bid for PeopleSoft. DOJ challenges in Court
- DOJ uses simulation model
- Court rules in favor of defendants (DOJ did not provide sufficient evidence)
HP-Compaq merger (2002)

Given HMG and any other information you think is relevant, do you agree with the FTC’s decision not to oppose merger?

<table>
<thead>
<tr>
<th>Company</th>
<th>Desktop PCs</th>
<th>Servers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dell</td>
<td>13</td>
<td>7</td>
</tr>
<tr>
<td>Compaq</td>
<td>12</td>
<td>16</td>
</tr>
<tr>
<td>HP</td>
<td>8</td>
<td>14</td>
</tr>
<tr>
<td>Gateway</td>
<td>4</td>
<td>–0</td>
</tr>
<tr>
<td>IBM</td>
<td>6</td>
<td>26</td>
</tr>
</tbody>
</table>

Source: Bank of America report, October 2001
Data for 2001Q2
The Nestlé Perrier acquisition

- In February 1992, Nestlé makes a bid for Perrier S.A.
- Market shares prior to merger: Perrier, 35.9%; BSN, 23%; Nestlé, 17.1%; others, 24%
- The Nestlé/Perrier merger ⇒ leading producer with 53% second with 23%
- Nestlé agrees to sell Volvic to rival BSN
- Expected post-merger market shares: Nestlé/Perrier, 38%; BSN (with Volvic), 38%; others, 24%
- Some analysts argued this made things worse: collusion more likely among similar competitors
AT&T and T-Mobile

- March 2011: AT&T announces $39 billion acquisition of T-Mobile USA
- August 2011: DOJ sues to block merger
- Within weeks, Sprint Nextel and C Spire Wireless file private antitrust suits to block merger
- November 2011: FCC announces it is considering order to oppose merger
- December 2011: parties abandon transaction; AT&T pays T-Mobile $4 billion breakup fee (largest in US antitrust history)
AT&T and T-Mobile: what were they thinking?

- AT&T argues it does not compete with T-Mobile while the latter runs adds stating “sometimes you have to pay more to be slower”

- AT&T claims no growth in isolation, although T-Mobile had announced plans to expand unilaterally

- Combining operations would have saved $3 billion per year in duplicative resource costs
AT&T and T-Mobile: takeaways

• Cost efficiencies count for DOJ, but greater weight is placed on competition effects

• Sectoral regulators such as the FCC have broader mandate, frequently tighter standards

• Business strategy
  – Mergers and acquisitions are expensive operations
  – Failed mergers and acquisitions have additional reputational costs
  – Business strategy should be complemented by in-house economic and legal analysis
Live Nation and Ticketmaster

- Ticketmaster and Live Nation announce merger plans in February 2009
- Live Nation had recently entered into ticketing, so merger is both vertical and horizontal
- Strong opposition, including Bruce Springsteen

The one thing that would make the current ticket situation even worse for the fan than it is now would be Ticketmaster and Live Nation coming up with a single system, thereby returning us to a near monopoly situation in music ticketing
Live Nation and Ticketmaster

- UK Competition Commission
  - October 2009: provisionally block
  - December 2009: approve
  - January 2010: rival ticket agency Eventim challenges
  - May 2010: re-approve merger

- In January 2010, DOJ accepts merger conditionally on consent decree
  - Divestiture of Ticketmaster’s Paciolan division
  - Prohibition of certain discriminatory practices (e.g., must use Ticketmaster if hosting Live Nation artists)
Live Nation and Ticketmaster

- Post-mortem
  - Divestitures had little effect
  - Prices have remained high
Live Nation and Ticketmaster: takeaways

- Increasingly, the distinction between vertical and horizontal mergers becomes blurred
- Broadly speaking, two types of concessions:
  - divestitures
  - behavioral
- Regulators incur Type I and Type II errors; this one looked like a Type II error
XM and Sirius satellite radio

- FCC awards two satellite radio licenses
- Sirius and XM begin broadcasting in 2001
- Subscription based ($10/m), commercial free service
- Mostly used by drivers
- Music, talk, sports, etc; some premium content
- By the end of 2006, 17 million subscribers
- No profit. February 2007, Sirius and XM propose to merge
XM and Sirius satellite radio

- Merger is approved by DoJ in March 2008; and by FCC in July 2008 (longest investigation in history)
  - alternative audio services
  - no competition in key input markets (nearly inelastic supply)
  - beneficial merger specific efficiencies (penetration pricing externality)

- Subject to FCC-imposed behavioral conditions
  - price freeze (for three years)
  - à la carte pricing
  - noncommercial and diversity programming
XM and Sirius satellite radio

- Post-mortem as of 2012 (vd 2009)
  - nearly bankrupt in 2009, currently profitable
  - monthly fee $14.99 (up by 11.5%)
  - 21.9 million subscribers (up 26.5%)
XM and Sirius satellite radio: takeaways

• Failing firm can be a valid argument for merger
• Countervailing power can be a valid argument too
• Efficiencies can be more than saving fixed costs
Comcast and NBC

- In December 2009, Comcast announces purchase of controlling stake in NBC
- Primarily a vertical merger
- Concerns: upstream foreclosure and downstream foreclosure
  - U: other content suppliers
  - D1: competing multi-channel video programming distributors (MVPDs), e.g., TimeWarner and Verizon
  - D2: online video programming distributors (OVDs), e.g., Hulu and Netflix
- Benefits: greater coordination in content creation and distribution (in a rapidly changing industry)
Comcast and NBC

- Potential threats greater than benefits
- Approval subject to conduct-oriented conditions
  - Allow MVPDs and OVDs the option of binding arbitration over rates
  - Commit as ISP not to discriminate against OVDs
- Almost no complaints since then (exception: Bloomberg successfully requests that its channel be placed in a news neighborhood)
- DoJ investigation on ISP discrimination
Comcast and NBC

- In Fall 2009, Comcast planned to launch an Internet service for the poor that was sure to impress federal regulators.

- David Cohen, Comcast’s chief of lobbying, told the staff to wait: Comcast was planning a controversial $30 billion bid to take over NBC Universal, and Cohen needed a bargaining chip for government negotiations.

- The strategy was quintessential Cohen. The hard-charging 56-year-old veteran of Philadelphia politics and Democratic campaign bundler: the “wonk rock star.”
Comcast and NBC

- Al Franken opposes merger, Alec Baldwin makes fun of it
- 97 Congressmen signed a letter urging FCC to approve the merger without conditions; 84 of these received donations from Comcast (460 out of 535 Members of Congress received donations from Comcast)
- FCC approves merger on January 18, 2011
- Four months later, Meredith Attwell Baker, one of the commissioners who voted for the deal, joined Comcast’s Washington lobbying office
Comcast and NBC: takeaways

• Creative use of concessions
  – binding arbitration over rates (increasingly common)
  – use merger as quid pro quo (e.g., no discrimination as ISP, diversity in hiring)

• It’s the politics, stupid!
Comcast and TimeWarner

- February 2014: Comcast and TimeWarner announce plans to merge
- Non-overlapping cable providers
- Together, 40% as Internet Service Providers (ISP)
  - Netflix and others oppose merger
- Greater monopsony power w.r.t. content providers
  - lower prices (partly passed on to consumers)
  - lower investment incentives (upstream)
Comcast and TimeWarner: things to look for

- Behavioral remedies to ease OVDs’ concerns (e.g., Netflix); will arbitration do?
- Monopsony power: lower prices but also lower incentives for content creation (cf Sirius XM)
- Expect a lot of politics
- Update: meeting scheduled for April 22, 2015 (first meeting since merger was announced)