

RELEVANT MARKET DEFINITION AND SSNIP TEST UNDER THE 2010 US HORIZONTAL MERGER GUIDELINES

The article reviews some of the provisions of the 2010 US Horizontal Merger Guidelines concerning the relevant market definition and the hypothetical monopolist test (SSNIP test). The new Guidelines replace the 1992 Guidelines and adopt the new approach to merger review that the Department of Justice and the Federal Trade Commission ('Agencies') apply. They mainly focus on the direct evidence of potential impact of a horizontal merger on competition and thus deemphasize the role of relevant market analysis.

The 2010 Guidelines also change the hypothetical monopolist test, although it remains an important tool used to define relevant market. The hypothetical monopolist test still asks would a hypothetical profit-maximizing firm would impose at least small, but significant and non-transitory increase in price, but it is no longer implemented using the iterative procedure and the "smallest market principle" is softened.

The author analyses whether the courts will accept this new Guidelines' approach instead of a traditional analysis of market definition, market shares and market concentration. It is noticed that market definition plays a smaller, though still significant role in the merger analysis and that the Agencies and courts will continue to determine a relevant market in the merger review process.

Keywords: *hypothetical monopolist test, SSNIP test, relevant market, competition law, US law*

1. INTRODUCTION

In August 2010, the United States Department of Justice (through its Antitrust Division) and the Federal Trade Commission ('the Agencies') adopted new Horizontal Merger Guidelines, which purpose is to outline the principal analytical techniques, practices and the enforcement policy of the

Agencies with respect to horizontal mergers under federal antitrust laws. These Guidelines are the result of a revision process of the Horizontal Merger Guidelines that had been issued almost 20 years ago, in 1992, and partially amended in 1997 ('the 1992 Guidelines'). Replaced Guidelines had the same purpose – to provide the specific standards and analytical framework for the assessment of horizontal mergers and to improve the predictability of the Agencies' merger enforcement policy.

Both Guidelines were designed to describe the assessment techniques and the main evidence types used to predict whether horizontal mergers may substantially lessen competition or tend to create monopoly in any line of commerce or in any activity affecting commerce in any section of the country. The 2010 Guidelines, however, better reflect current Agencies' thinking and actual practice, since the Agencies have not followed the replaced Guidelines for years.

The new Guidelines focus on competitive effects of horizontal mergers more than the 1992 Guidelines and go further in accepting modern economic learning and techniques in legal assessment of horizontal mergers. As a consequence, the new Guidelines make an important innovation concerning the relevant market definition and its role in merger analysis. They deemphasize market definition analysis in favor of more direct evidence of competitive effects and change the hypothetical monopolist test (SSNIP test) which has remained the most important tool in determining the relevant market.

2. RELEVANT MARKET DEFINITION

The 2010 Guidelines abandon the analytical framework set forth in the prior Guidelines which was structured as a five-step analytical process followed by the Agencies for assessing the competitive effects of horizontal mergers and determining whether mergers may substantially harm competition. These parts are: 1) market definition and concentration; 2) potential adverse competitive effects; 3) entry analysis; 4) efficiencies; and 5) failure and exiting assets.

However, the 1992 Guidelines were not applied mechanically, because it might provide misleading answers to the economic questions raised under the antitrust laws. Application of standards set forth in the 1992 Guidelines is an integrated process because each of the Guidelines section represents distinct analytical element of an integrated approach to merger review that the Agencies apply. As the Commentary on the 1992 Guidelines

states,¹ the ordering of these sections “is not itself analytically significant, because the Agencies do not apply the Guidelines as a linear step-by-step progression that invariably starts with market definition and ends with efficiencies or failing assets.” Thus, the relevant market definition process was not isolated from the other analytic parts of the Guidelines, but it was integrated component of an overall analysis of the merger’s likely effect on competition. This analysis is a tool that allows the Agencies to answer the ultimate inquiry in merger analysis: whether the merger is likely to create or enhance market power or to facilitate its exercise in relevant market.²

The new Guidelines eliminate this five-step structured approach and adopt a new, more flexible approach to merger analysis which does not consist of uniform application of a single methodology. They make clear that the Agencies should not approach merger assessment in the linear fashion described in the prior guidelines, because it is “fact-specific process through which the Agencies, guided by their experience, apply a range of analytical tools to the reasonably available and reliable evidence to evaluate competitive concerns in a limited period of time.”³ This means that the Agencies may use any reliable tools, techniques, evidence and whatever approaches they consider as appropriate for assessment of merger effect on competition and consumers. The 2010 Guidelines thus only illustrate and do not exhaust the range of means of merger analysis and the applications of the relevant principle.

By introducing a more integrated approach, with a wide choice of methodologies, the new Guidelines make a significant change in merger enforcement policy and depart from the traditional relevant market determination. According to the new Guidelines, market definition plays two roles. First, market definition specifies the line of commerce and section of the country in which the competitive concern arises. Second, market definition allows the Agencies to identify market participants and measure market shares and market concentration.⁴ Therefore, the Guidelines recognize the importance of market definition for merger analysis and state that the ultimate goal of market definition is to help determine whether the merger may substantially lessen competition.

¹ US Department of Justice and the Federal Trade Commission, Commentary on the horizontal Merger Guidelines (2006), (‘the Commentary’), <http://www.justice.gov/atr/public/guidelines/215247.pdf>.

² See US 1992 Horizontal Merger Guidelines, sec. 0.2.

³ US 2010 Horizontal Merger Guidelines, sec. 1.

⁴ See US 2010 Horizontal Merger Guidelines, sec. 4.

However, the Guidelines do not treat market definition as a foundational or necessary part of a merger analysis and are explicit that the Agencies' analysis "need not start with market definition".⁵ Market definition is no longer a prerequisite starting point to merger analysis, because the measurement of market shares and market concentration is not an end in itself, but it is useful to the extent it illuminates the merger's likely competitive effects. It is just one of a number of factors and analytical tools used by the Agencies to assess competitive effects. The Guidelines state that "evidence of competitive effects inform market definition, just as market definition can be informative regarding competitive effects...Such evidence also may more directly predict the competitive effects of a merger, reducing the role of inferences from market definition and market shares".⁶

Because the Guidelines place much greater emphasis on more direct evidence of competitive effects, it is provided that where analysis suggests alternative and reasonably plausible candidate markets, and where the resulting market shares lead to very different inferences regarding competitive effects, it is particularly valuable to examine more direct forms of evidence concerning those effects. In addition, it is provided that relevant markets need not have precise metes and bounds.⁷

However, despite of this de-emphasis of the relevant market role in merger analysis, the Guidelines still consider relevant market to be very important and lay down that "evaluation of competitive alternatives available to customers (*i.e. relevant market determination*) is always necessary at some point in the analysis". This means that delineation of relevant market is sometimes central in analyses of horizontal mergers and it should not be seen as separate from competitive effects analysis, although some of the analytical tools used by the Agencies to assess competitive effects do not rely on market definition.

3. HYPOTHETICAL MONOPOLIST TEST

The hypothetical monopolist test is well established analytical tool for market determination, which was introduced in US competition law in 1982 by the US Department of Justice Merger Guidelines (1982). The test was considered as a significant methodological advance when it was introduced and it was one of the organizing principles of the 1992 Guidelines. Because of the marginalization of market definition in the new Guidelines, the

⁵ US 2010 Horizontal Merger Guidelines, sec. 4.

⁶ *Loc. cit.*

⁷ *Loc. cit.*

hypothetical monopolist test is modified, although it is still important and helpful method for defining relevant market.

The hypothetical monopolist test is increasingly being adopted in many jurisdictions through out the world representing a means for market definition and not an end in itself. It is used to help the Agencies to define relevant market in which the merging parties compete, i.e. to delineate the market in product and geographical terms in order to identify the competitive constraints that the parties involved face. It is thus a tool to identify the competing firms and to calculate market shares of those firms which is necessary to determine the degree of market power. The Agencies use this method to evaluate a potential competitive concerns with a horizontal merger, because the traditional indirect approach to the economic concerns with market power is based on market shares of firms and begins with relevant market determination.

Under the hypothetical monopolist test provided in the 1992 Guidelines, product market was defined as a product or group of products such that a hypothetical profit-maximizing firm that was the only present and future seller of those product ('monopolist') would impose at least small, but significant (5%) and non-transitory increase in price ('SSNIP').⁸ Beginning with each product produced or sold by each merging firm (*candidate market*), the test asks whether a hypothetical monopolist that is supplier of those products would impose a SSNIP, i.e. what would happen if a hypothetical monopolist imposed a SSNIP. If the SSNIP causes that the reduction in sale of the product would be large enough that a hypothetical monopolist would not find it profitable to impose such increase in price, the candidate market is expanded and the process is repeated. The Agencies will add to the product group the product that is the next-best substitute for the merging firm's product,⁹ and the process will continue until a group of products is identified such that a hypothetical monopolist over that group of products could profitable impose SSNIP.¹⁰ It means that this iterative process is repeated until the Agencies reach the smallest group of products

⁸ US 1992 Horizontal Merger Guidelines, sec. 1.11. The principles of market definition described in the article are applied to define a relevant geographic market as well as a relevant product market.

⁹ The term "next best substitute" refers to the alternative which, if available in unlimited quantities at constant prices, would account for the greatest value of diversion of demand in response to a "small but significant and non-transitory" price increase (US 1992 Horizontal Merger Guidelines, sec. 1.11, f.9).

¹⁰ In performing successive iterations of the price increase test, the hypothetical monopolist will be assumed to pursue maximum profits in deciding whether to raise the prices of any or all of the additional products under its control.

that satisfies the test, i.e. that the hypothetical monopolist would impose at least SSNIP.

Under the 2010 Guidelines, the hypothetical monopolist test is modified, although the basic hypothetical monopolist test is still the same. The core of the hypothetical monopolist test is maintained, but the Agencies will continue to use this test with a more flexibility. The Guidelines prescribe that the Agencies use the hypothetical monopolist test to evaluate whether groups of products in candidate markets are sufficiently broad to constitute relevant antitrust markets and to identify a set of products sold by one of the merging firms.

The Guidelines explicitly accept the logic of demand-side substitution to define market. They focus on customer's ability and willingness to substitute away from one product to another in response to a price increase or a corresponding non-price change such as a reduction in product quality or service. The main question is thus how customers might react to a SSNIP.

Similarly to the prior guidelines, the hypothetical monopolist test requires that a hypothetical profit-maximizing firm, not subject to price regulation, likely would impose at least small, but significant and non-transitory increase in price on at least one product in the market, including at least one product sold by one of the merging parties. But, the hypothetical monopolist test is no longer iterative procedure, so the products are not added to the candidate market in order of "next-best substitutes". As a consequence, the "smallest market principle" is softened, because in combination with the algorithm for expanding the candidate market it suffers from a two problems. The first one, theoretical problem, is that this principle can fail to detect a merger as horizontal in some cases where the merging firms sell substitute product and their merger would likely harm competition. The second is practical problem that one may not be able to identify the "next-best substitute" at each stage of the algorithm.¹¹

The new explanation of the "smallest market principle" is based on the Agencies' practice that it is hard to identify one and only one relevant market, because the hypothetical monopolist test frequently may lead to more than one market affected by a merger. Therefore, the Guidelines make

¹¹ See Carl Shapiro, „The 2010 Horizontal Merger Guidelines: From Hedgehog to Fox in Forty Years”, <http://ssrn.com/abstract=1675210>, p. 38. For a similar view, see Steven C. Salop, Serge Moresi, “Updating the Merger Guidelines: Comments”, <http://www.ftc.gov/os/comments/horizontalmergerguides/545095-00032.pdf>, p. 9; Varney E. Christine, „The 2010 Horizontal Merger Guidelines: Evolution, not Revolution”, *Antitrust Law Journal*, vol. 77, br. 2/2011, p. 656. “The identification of the next-best substitute can make a huge difference to the outcome of the market definition algorithm.” (Steven C. Salop, Serge Moresi, *op. cit.*, p.9).

clear that the hypothetical monopolist test ensures that markets are not defined too narrowly, but it does not lead to a single relevant market. The test is now designed to allow the Agencies to evaluate a merger in any relevant market satisfying the test, guided by the overarching principle that the purpose of defining the market and measuring market shares is to illuminate the evaluation of competitive effects.¹²

As a result, the Guidelines state that when the Agencies rely on market shares and concentration, they usually do so in the smallest relevant market satisfying the hypothetical monopolist test. It means that the smallest market satisfying the test is *usually* (not always) a relevant market, although the test often reveals separate markets that are relevant for the assessment of competitive effects of merger. This caveat confirms that the purpose of the new Guidelines is to help Agencies to prevent anticompetitive merger in *any* relevant market.

One more important Guidelines' clarification concerns to the modification of the "reasonable interchangeability" standard, which is explicitly mentioned in the Guidelines, but only in the context of the hypothetical monopolist test. The "reasonable interchangeability" standard is changed through the application of a Upward Pricing Pressure (UPP) in way that distances Agencies' approach from traditional use of this standard by the courts.¹³ Such modification is a big change in the new Guidelines, but it does not reflect any change in Agencies' practice in defining relevant market, because this new approach is already described in the Commentary on the Horizontal Merger Guidelines.¹⁴

The 2010 Guidelines state that properly defined antitrust markets often exclude some substitutes to which some customers might turn in the face of a price increase even if such substitutes provide alternatives for those customers.¹⁵ Group of products may satisfy the hypothetical monopolist test without including the full range of substitutes from which customers choose.¹⁶ This means that group of products can satisfy the hypothetical monopolist test using SSNIP and form relevant market, even the majority of diverted sales lost because of a SSNIP would go to products outside the

¹² US 2010 Horizontal Merger Guidelines, sec. 4.1.1.

¹³ UPP is new economic tool used to measure how the elimination of the competitive constraint operating between two merging parties may affect their pricing incentives through the potential recapture of sales that may otherwise have been diverted to the merger partner. See James A. Keyte, Kenneth B. Schwartz, "Tally-Ho!: UPP and the 2010 Horizontal Merger Guidelines", *Antitrust Law Journal*, vol. 77, br. 2/2011, p. 587, f. 4.

¹⁴ See The Commentary, p. 6, 12, 15.

¹⁵ US 2010 Horizontal Merger Guidelines, sec. 4.

¹⁶ US 2010 Horizontal Merger Guidelines, sec. 4.1.1.

relevant market. The test now allows the Agencies to determine relevant product market as a group of products even if there is significant substitution between that group of products and other products.¹⁷ In order to ensure that close substitutes are included in relevant product market and that markets are not defined too narrowly, the Guidelines state that “when applying the hypothetical monopolist test to define a market around a product offered by one of the merging firms, if the market includes a second product, the Agencies will normally also include a third product if that third product is a closer substitute for the first product than is the second product”.¹⁸

4. APPLICATION OF THE GUIDELINES BY THE COURTS

Market definition has its roots in US Supreme Court’s precedent law and has a central place in the US courts’ analyses of horizontal mergers under Section 7 of the Clayton Act. The courts have long treated market definition as the first step in analysing and used the resulting market shares and market concentration as the main evidence of competitive effects of a merger. Although the Agencies accept this new, highly-economic and direct evidence approach, it is questionable how the courts will react to such approach and how they will interpret the new Guidelines.

Despite some initial courts’ reluctance, the Agencies expect that the courts will increasingly accept the Guidelines’ approach, although the courts still pay considerable attention to market definition. US courts historically have first defined the relevant market because determination of the market was a “necessary predicate to a finding of a violation of the Clayton Act”.¹⁹ Because of that, the courts are not ready to focus on competitive effects only and they will not stop to define relevant market in their analyses. US courts will continue to pay direct attention to market definition in merger review process, which means that market definition still plays significant (but smaller) and very specific role in merger analysis. Therefore, the Agencies must consider such practice of the courts and should follow it, despite the new Guidelines, especially if they challenged the transaction in the courts. But, the prior guidelines have had a significant influence on US courts and its practice, so it could be expected that US courts accept the new Guidelines also.

The US courts are not bound to follow the new Guidelines, because the Guidelines are not law, so there is no major change in merger

¹⁷ See Carl Shapiro, *op. cit.*, p. 36-37; Varney E. Christine, *op. cit.*, p. 656; James A. Keyte, Kenneth B. Schwartz, *op. cit.*, p. 590.

¹⁸ US 2010 Horizontal Merger Guidelines, sec. 4.1.1.

¹⁹ *Brown Shoes Co. v. United States*, 370 U.S. 294 (1962), at 324.

enforcement decision making as yet. The Guidelines serve to educate the courts about the analytical tools that Agencies use in merger analysis and thus it seems that the courts need some time to accept new approach and highly economic framework within which merger analysis takes place.

In the meantime, the new Guidelines can reduce certainty about the result of relevant market determination because the Agencies have the discretion to define relevant market and because the courts do not reject the use of market definition to predict competitive effects. The Guidelines should help business community to assess how the Agencies are likely to evaluate horizontal mergers, because it must consider how the Agencies will react to potential mergers. Therefore, it is so important that the Agencies and courts harmonise their practice in order to increase the certainty and transparency of the analytical process underlying the enforcement decisions.

5. CONCLUSION

The 2010 Guidelines introduce a more integrated, flexible, detailed and less mechanistic approach to horizontal merger analysis, reflecting the accumulated Agencies' experience and new economic learning in modern competition law. The significant developments in economic theories and tools to predict competitive harms are included in the new Guidelines, although the Guidelines retain the basic approach to the merger analysis. As a consequence, the Guidelines depart from market definition, rather focusing on competitive effects of horizontal mergers.

Introduced direct evidence approach represents the evolution of the Agencies' practice and merger enforcement policy since the last revision in 1992 and is an important contribution of the new Guidelines because it should help the Agencies and courts to avoid the negative outcomes of process of the relevant market determination. It is sometimes very hard to define relevant market because in most cases market boundaries are unclear and it can't always be defined with precision. Defining the relevant market requires careful consideration of the available facts and the Agencies often lack sufficient data to determine precisely when products are close enough substitutes to be included in the same market.

For these reasons, the Guidelines adopt new approach to merger analysis and abandon prior practice, focusing on assessment of potential impact of merger on competition. Therefore, the courts will probably accept Agencies' approach according to which the market definition is not the first step in merger review process, but it does not mean they reject the use of market definition and market concentration to predict competitive effects.

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RELEVANTNO TRŽIŠTE I TEST PRETPOSTAVLJENOG MONOPOLISTE U AMERIČKIM SMERNICAMA O HORIZONTALNIM KONCENTRACIJAMA

U radu se analiziraju pojedine odredbe američkih Smernica o horizontalnim koncentracijama iz 2010. godine kojima se regulišu relevantno tržište i test pretpostavljenog monopoliste (SSNIP test). Nove smernice su zamenile Smernice iz 1992. godine i usvajaju novi pristup koji Ministarstvo pravde i Federalna trgovinska komisija ('Agencije') primenjuju u analizi koncentracija. Smernice su usmerene na metode direktne procene efekata koje koncentracije imaju na konkurenciju i zato više ne naglašavaju ulogu koju utvrđivanje relevantnog tržišta ima u ovoj analizi. Takođe je izmenjen test pretpostavljenog monopoliste, iako je test ostao važan metod za utvrđivanje relevantnog tržišta. Testom se i dalje utvrđuje da li bi pretpostavljeni monopolista izvršio malo, ali značajno i trajno povećanje cena, ali se on više ne primenjuje kao iterativan postupak, a princip utvrđivanja "najužeg tržišta" je ublažen. Autor analizira da li će sudovi prihvatiti ovaj novi pristup koji usvajaju Smernice umesto da utvrđuju relevantno tržište, tržišne udele i tržišnu koncentraciju. Ukazuje se na to da relevantno tržište ima manju, ali još uvek značajnu ulogu u analizi koncentracije, i da će Agencije nastaviti da utvrđuju relevantno tržište u postupcima ocene horizontalnih koncentracija.

Ključne reči: *test pretpostavljenog monopoliste, SSNIP test, relevantno tržište, pravo konkurencije, američko pravo*