Coordinated effects analysis in mergers

Are mergers reviewed differently when the industry has a history of collusive behaviour? By Joseph G Krauss and Kirk Morgan II Hogan & Hartson, LLP.

US antitrust enforcement agencies appear to be giving greater consideration to the possibility of coordinated effects in merger cases. A series of complaints recently filed by the Antitrust Division of the US Department of Justice (DoJ) alleging coordinated effects seem to suggest that the agencies may be over-relying on one factor in their analysis—past collusion—as the principal reason for challenging those mergers. A closer analysis of these complaints, however, reveals there is no single reliance on past collusion. Rather, past collusion is being used to demonstrate that the propensity for coordinated interaction may be more than merely theoretical in some markets. Consequently, merging parties should realise the practical effect of being in an industry with prior collusion: mergers in such industries are likely to be given far greater scrutiny in the US, Europe and elsewhere.

Both the former Clinton Administration and the current Bush Administration have been very active in prosecuting cartels in diverse fields of commerce, such as the computer chip, marine construction and graphite electrode industries. And as companies have begun to compete in a global marketplace, cartels have become international—the DoJ has prosecuted more than 50 companies since 1996 for participating in international cartels. Some of the more notable international cartels that the DoJ has successfully prosecuted for global price-fixing are the Citric Acid cartel, which was comprised of US, German, Swiss and Dutch firms; the Lysine cartel, which was comprised of US, Japanese and Korean firms that manufactured lysine as a livestock feed additive; and the Vitamins cartel, which was comprised US, Swiss, Canadian, German and Japanese vitamin manufacturers.

Industries that exhibit cartel behaviour often exhibit some of the same market characteristics that are prevalent in industries that are ripe for mergers. For example, parties in industries characterised by declining margins often are prone to find ways to reverse this trend. Sometimes companies may resort to cartel behaviour as a way to stabilise or increase margins—an ‘if you can’t beat them, join them’ philosophy. More often companies look to mergers and acquisitions as a way to increase margins, through lower costs or increased efficiencies—an ‘if you can’t beat them, buy them’ philosophy. But implementing the first philosophy can often hamper the second. Evidence of past industry collusion has long been a factor that US antitrust enforcement agencies have considered when examining proposed mergers and is increasingly being used by other antitrust enforcement regimes around the world.

Traditional role of past collusion in coordinated effects analysis

The 1984 DoJ Merger Guidelines (‘the 1984 Guidelines’) set forth the general principles that the agency used in deciding whether or not to challenge a merger. Although considerable attention was given to market concentration data, the 1984 Guidelines stressed that such data was “only the starting point for analysing the competitive impact of a merger”. In the context of coordinated effects analysis, the DoJ identified several market conditions that might facilitate or reduce the ability of firms to coordinate, including whether firms in the market “previously have been found to have engaged in horizontal collusion regarding price, territories, or customers, ...”

The 1992 DoJ/FTC Guidelines furthered the movement towards a less rigid and more flexible totality of the circumstances analysis of mergers. Under the 1992 DoJ/FTC Guidelines, market shares and concentration levels are still starting points for analysing a proposed merger and can still create a presumption as to whether a proposed merger will have an anti-competitive impact, but factors other than market concentration data also are relevant. Some of the additional factors—sometimes referred to as the ‘plus factors’—described as relevant to a coordinated effects analysis are whether a market is “characterised by product homogeneity, standardisation of pricing and other competitive terms” and whether competitors in a given market have access to competitive information. As with the 1984 Guidelines, the 1992 DoJ/FTC Guidelines also recognise that past collusion in an industry can be one of the factors that give rise to concerns that remaining firms may coordinate their activities following a merger.

Some critics of the Clinton Administration’s merger enforcement programme have argued that following the adoption of the 1992 DoJ/FTC Guidelines, US antitrust merger enforcement became more focused on unilateral effects rather than collusion. One vocal critic has been the Federal Trade Commission’s (FTC’s) former chief economist, David Scheffman, who has attributed the rise of unilateral effects analysis to the fact that unilateral effects cases often do not require the rigorous investigation that is required in many coordinated effects cases. Whether or not this was true in the past, the FTC and the DoJ now seem to have a rejuvenated interest in coordinated effects analysis. This is perhaps best seen in the FTC’s recent decision to approve the proposed cruise line mergers (the competing bids of Carnival Corporation and Royal Caribbean Cruises for P&O Princess Cruises).

In approving both of these much-contested and highly publicised proposals, the FTC “devoted considerable effort to probing unilateral issues”, but primarily focused on the “risk of coordinated interaction among firms remaining post-merger”. Despite evidence that the proposed mergers would increase concentration in the postulated ‘cruise line’ market, the FTC nonetheless relied on the additional factors outlined in the 1992 DoJ/FTC Guidelines to conclude that the merger did not raise the risk of collusion among the remaining firms.

DoJ’s recent use of prior collusion

Recently, within a 10-day span this past April, the DoJ filed three complaints showing that it too is also starting to look beyond unilateral effects. These complaints allege that proposed mergers would increase the likelihood of coordinated interaction in each of three markets—graphite electrodes,
pressure-sensitive labelstock and the supply of milk. Markedly, all three complaints cite evidence of prior industry collusion as one of the bases for alleging that coordinated effects are likely. Undoubtedly the complaints raise questions about the future role that past collusion evidence will have in coordinated effects cases. An examination of the complaints, however, reveals that although the DoJ will treat evidence of past collusion seriously, there is no clear indication that past collusion alone will trump other market factors or automatically doom any future proposed mergers.

In US v SGL Carbon Aktiengesellschaft (‘SGL Carbon’), the DoJ challenged the efforts of SGL Carbon LLC (‘SGL’) to acquire the assets of the Carbide/Graphite Group (‘C/G’), with whom SGL had competed to produce graphite electrodes. (The DoJ has since discussed the complaint after another bidder stepped forward.) The DoJ alleged that the merger would violate Section 7 of the Clayton Act by leading to coordinated effects between competitors in the graphite production industry. In addition to arguing that a merger of SGL and C/G would result in a highly concentrated market, the complaint also made reference to a DoJ investigation in the late 1990s into worldwide price fixing and market allocation in the graphite industry. That investigation led to a guilty plea by SGL and its former CEO, who currently serves as chairman of SGL’s executive committee. Based on the level of market concentration and the history of past collusion in the graphite industry, the complaint concluded that “[t]he conditions in the graphite electrode market are conducive to tacit and explicit coordinated interaction because the salient characteristics of the market have not changed appreciably since the 1990s price fixing and market allocation conspiracy.” Thus, the DoJ seemed to rely heavily, but not exclusively, on past collusion to form the basis for its coordinated effects allegations.

In US v UPM-Kymmene (‘UPM-Kymmene’), the DoJ challenged the efforts of UPM-Kymmene, Oyj (‘UPM’) to acquire Morgan Adhesives Company (‘MA Ctac’), with which UPM has competed to produce pressure-sensitive labelstock in North America. The complaint cited to UPM memos dating from 2001 that allegedly showed that UPM and another leading producer (referred to as “Leading Producer”) in the complaint but identified in later proceedings as Avery) had already “attempted to limit competition between themselves, as reflected in written and oral communications to each other through high level executives regarding explicit anticompetitive understandings.” But despite this detailed description of possible past collusion, the complaint went further, and also cited to additional evidence for support that coordinated effects were likely following the merger. The complaint stated that post-merger “UPM would... have diminished incentives to compete for sales to the Leading Producer’s customers, because it would stand to lose proportionately more business than otherwise if the Leading Producer retaliated by competing for UPM customers, and it would instead have enhanced incentives to cooperate with the Leading Producer.” As further evidence of potential coordinated effects, the complaint also cited to forward looking statements by MACtac’s CEO stating that the transaction would bring pricing “discipline” to UPM and the decision of UPM to inform at least two customers that price hikes will follow after the merger is completed.

During the subsequent trial on the DoJ’s request for an injunction blocking the deal, little attention was given to the complaint’s alleged prior collusion. Instead, the DoJ, and ultimately the District Court judge, relied more on evidence that the merged firm would have an incentive to maintain price stability and have little incentive to ‘go after’ the leading firm (Avery) for market share. The District Court judge concluded that the merged firm would likely be content to go along with price increases by Avery and simply fight for business that Avery left for it and other smaller producers. Thus, although allegations of past collusion had a prominent role in the DoJ’s complaint, the DoJ relied on other, more traditional evidence that anti-competitive effects were likely.

Finally, in US v Dairy Farmers of America Inc (‘Dairy Farmers of America’), the DoJ challenged the plans of Dairy Farmers of America Inc (‘Dairy Farmers’) to purchase the Southern Belle Dairy Co Inc (‘Southern Belle’), with which one of Dairy Farmers’ subsidiaries, Flav-O-Rich, has competed to supply school milk to school districts located in Kentucky and Tennessee. As in SGL Carbon and UPM-Kymmene, the DoJ alleged that the markets in which the proposed mergers would take place are highly concentrated. The DoJ complaint also pointed out that “[m]any school districts in (Kentucky and Tennessee) previously had to pay higher prices as victims of a criminal bid-rigging conspiracy involving school milk.” The complaint notes that, in 1992, the former owners of a Flav-O-Rich and Southern Belle pleaded guilty to participating in the conspiracy over a 10-year period. However, in addition to this evidence of past collusion, the complaint also alleged that coordinated effects were probable because “[i]n many markets, Southern Belle and Fav-O-Rich are clearly the two dairies able to supply school milk most economically, and would benefit (at the expense of consumers) by acting together at DFA’s direction to raise one or both of their bids.”

Consequently, although all three of these recent complaints rely in part on evidence of past collusion to establish that the proposed mergers and acquisitions at issue create a threat of coordinated effects, each complaint addressed a transaction in an industry that was already highly concentrated.

Furthermore, in each complaint the acquiring parties had been involved directly in the alleged acts of past collusion. It should also be noted that at least two of the three complaints also make some reference to other market factors that raise the threat of coordinated effects. In fact, in the District Court decision granting the DoJ’s motion to enjoin UPM from acquiring MACtac, the court made no reference to the evidence of past collusion that the DoJ cited in its complaint. The court instead relied entirely on a series of market factors that led it to believe that UPM’s proposed acquisition would have anti-competitive effects.

Therefore, while it is somewhat remarkable that in a 10-day span the DoJ would issue three coordinated effects complaints emphasizing evidence of past collusion, these cases should not be seen as a signal that evidence of past collusion alone is sufficient to establish a coordinated effects case. The DoJ’s complaints are perhaps more indicative of the number of cartel cases the DoJ has brought in recent years which demonstrate that coordinated effects can be more than merely theoretical in some industries.

Role of past collusion in European Commission coordinated effects analysis

The European Merger Guidelines that were first issued in the early 1990s made no reference to coordinated effects, or ‘collective dominance’ as it is known in Europe. Without guidelines, the European Commission (EC) examined collective dominance issues on a case-by-case basis rather than applying a more formal systematic analysis to all cases. As an example, in 1996, the EC prohibited the Gencor/Lonrho merger, finding a number of
factors present that made coordination likely, including a history of past collusion.

Nevertheless, as the EC has given increased attention to cases raising collective dominance concerns, this case-by-case approach has faced some criticism. In July 2002, the Court of First Instance (CFI) overturned the European Commission’s decision to reject the bid of a travel company, Airtours, to acquire its competitor First Choice. In prohibiting the acquisition, the European Commission stated that the general rule for when a proposed merger or acquisition will lead to collective dominance is whether the concentration “makes it rational for the oligopolists, in adapting themselves to market conditions, to act—individually—in ways which will substantially reduce competition between them”. On the basis of a high degree of market concentration and the possibility that the merger could increase the existing degrees of transparency and interdependence in the industry, the European Commission rejected Airtours’ proposed acquisition on collective dominance grounds. The CFI, however, rejected this conclusion and strongly criticised it as not taking into account several factors that indicated that anti-competitive effects were unlikely.

On the heels of this decision, the EC recently issued a Draft European Commission Notice on the Appraisal of Horizontal Mergers, (‘the EC Draft Guidelines’), which allotted a third of its text to a discussion of collective dominance. As such, the EC Draft Guidelines testify both to the new importance of collective dominance in Europe and the need for a more systematic approach to the topic. These guidelines list a variety of factors in addition to market concentration that are relevant to an analysis of collective dominance issues. Like the 1992 DoJ/FTC Merger Guidelines, the EC Draft Guidelines recognise that past collusion can support a finding of collective dominance. Paragraph 48 states that “[e]vidence of past co-ordination in similar product or geographic markets may…be useful information indicating” that a proposed merger will allow competing firms to coordinate their activities.

Despite the debate about the precise meaning of Paragraph 48, recent EC decisions and the EC Draft Guidelines indicate that like the DoJ, the EC is moving towards a totality of the circumstances review of proposed mergers. Evidence of past collusion surely will factor prominently in future merger reviews by the EC. As with their US counterparts, European regulators may find that past collusion may be an indicator of a propensity for collusion in a given market that makes the likelihood of great coordination in the future more than a mere theoretical possibility.

Future for industries characterised by past collusion

Firms that propose a merger or acquisition in an industry with a history of past collusion should expect increased scrutiny in the US and Europe. The recent flurry of DoJ complaints emphasising evidence of past collusion demonstrates its importance in coordinated effects analysis. Evidence of past collusion can, however, be overcome. Firms in industries with a history of past collusion should be prepared to show that market conditions have changed since the past collusion has occurred and that other factors outlined in the 1992 DoJ/FTC Guidelines and the EC Draft Guidelines, such as the ease of market entry, indicate that collusion is unlikely. But whether such a showing will outweigh evidence of past collusion in the enforcer’s (and ultimately the judge’s) mind remains to be seen.

Joseph Krauss represented Carnival Corporation in obtaining US antitrust clearance in one matter on the first page of this article.