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FTC and DOJ Release Proposed Revisions to Horizontal Merger Guidelines: Implications for Bank Mergers

MICHAEL MIERZEWSKI, BETH DESIMONE, HOWARD HYDE, WASIM QUADIR

A proposed revision to the horizontal merger guidelines does not change the current Herfindahl-Hirschman Index thresholds set forth in the Bank Merger Screening Guidelines.

The Federal Trade Commission ("FTC") and the U.S. Department of Justice ("DOJ") released for public comment a proposed revision of the Horizontal Merger Guidelines. First issued in 1992, the Horizontal Merger Guidelines outline the principal analytical techniques applied by the FTC and DOJ in reviewing a proposed merger for its effects on competition.[1] The recent revisions reflect a shift away from a single structured methodology towards a more flexible approach that incorporates a range of analytical tools. Notably, the proposed guidelines create more permissive "safe harbors," as measured by the Herfindahl-Hirschman Index ("HHI"), used in determining whether a proposed transaction should be subject to further review.

Bank and financial holding companies that engage in bank mergers or acquisitions may have been encouraged by this proposed revision. Unfortu-

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nately, however, it appears that the DOJ and FTC do not propose to change the current HHI thresholds set forth in the Bank Merger Screening Guidelines[2] despite the proposed revisions to the Horizontal Merger Guidelines.

LEGAL FRAMEWORK UNDER EXISTING GUIDELINES

The basic legal framework for antitrust review of bank mergers is set forth in the seminal 1963 case of *United States* v. *Philadelphia National Bank* in which the United States sought to enjoin a bank merger under the Sherman Act and the Clayton Act.[3] *Philadelphia National Bank* sets forth an analysis that first requires a determination by the acquirer of the relevant product market and the relevant geographic market for financial institutions in the area affected by a proposed merger. In the case of the bank merger at issue, the court concluded that the product market was the cluster of banking products and services known as "commercial banking." The court also established that the geographic market was essentially local in nature, limited to the area to which banking customers can practically turn for alternatives. The case also established the precedent of using deposit market shares as a proxy to determine each market participant's share of a market.

Although significant financial and technological innovations over the past several decades have expanded the variety of products offered by banks and the geographic areas within their reach, *Philadelphia National Bank* remains the law in bank mergers and acquisitions. Today, regulators supplement court guidance in part with the Horizontal Merger Guidelines in their review of proposed bank mergers and acquisitions. The guidelines set forth a series of criteria that rely upon consumer sensitivity to price changes in determining whether two products are within the same market or geographic area. In addition, the DOJ and the Federal Reserve apply the Bank Merger Screening Guidelines, issued in 1995 jointly by the DOJ, the Federal Reserve, and the Office of the Comptroller of the Currency.

The federal bank regulators also apply certain additional criteria in their analysis of a specific transaction. For example, the Federal Reserve Banks offer preliminary geographic market definitions, subject to modification, based on Ranally Statistical Areas or other predefined geographic regions. Some of these defined markets can be quite large, especially if they encompass large metropolitan areas.

Once regulators have determined the relevant product and geographic markets, they analyze the transaction's likely competitive effects on those markets. To quantify the effect of a merger on market concentration, regulators rely on the Herfindahl-Hirschman Index. The HHI for a given market is calculated as the sum of the squares of each competitor's market share. The maximum HHI of 10,000 (100^2) reflects a market dominated by a single monopolist. A lower HHI, by contrast, reflects a more competitive market.

According to the existing Horizontal Merger Guidelines, mergers that result in an HHI that is beneath a certain threshold and an increase in the HHI that is beneath a certain threshold are unlikely to have adverse competitive effects. In most industries, mergers that result in an HHI of no greater than 1,800 and involve an HHI increase of less than 100 ordinarily do not require further analysis. Mergers that result in an HHI of more than 1,800 but an HHI increase less than 50 are also unlikely to trigger further review.

The Bank Merger Screening Guidelines, in recognition of the increased competition faced by banks from non-local banks and from non-bank institutions such as credit unions, finance companies, mortgage companies and other non-bank lenders, establish broader HHI "safe-harbors" for banks than those established for other industries in the Horizontal Merger Guidelines. Specifically, if a proposed merger or acquisition results in a post-merger HHI that is no greater than 1,800 and an HHI increase that is no greater than 200 (based on deposit data), then the federal banking agencies are unlikely to further review the competitive effects of the proposed transaction (provided the combined parties' post-merger market share is less than 35 percent).

Bank mergers or acquisitions that result in an HHI greater than 1,800 and an HHI increase greater than 200 will likely trigger further scrutiny. A merger that exceeds the HHI thresholds will not automatically fail: regulators may examine mitigating factors that lessen the adverse competitive effects of the transaction, such as the lack of competition between the merging parties or the likelihood of new entry by competing banks, based on the economic characteristics of the market.

HHI THRESHOLDS UNDER THE PROPOSED HORIZONTAL MERGER GUIDELINES

The recently proposed Horizontal Merger Guidelines set forth more permissive HHI thresholds than those established by either the existing Horizontal Merger Guidelines or the Bank Merger Screening Guidelines. Under the proposed Horizontal Merger Guidelines, if a merger results in an HHI greater than 2,500 and an HHI increase greater than 200, then the merger will be presumed to enhance market power. Mergers that result in an HHI increase of no greater than 100 are unlikely to require further scrutiny, even in highly concentrated markets with an HHI above 2,500. The proposed guidelines also note that these thresholds are not rigid screens but are merely one way of identifying those mergers which are important to examine further. In order to assess the anticompetitive effects of a merger, regulators may employ a wide range of analytical tools, ranging from an examination of the actual effects of other mergers in the relevant market to customer survey data on the relative attractiveness of different products or suppliers.

Despite the language indicating that the proposed revisions would apply to all mergers, we have been informally advised by staff at the Antitrust Division of the Department of Justice that the thresholds established by the Bank Merger Screening Guidelines are proposed to continue to apply to bank mergers. If that proposal stands, parties involved in bank mergers or acquisitions would not be able to take advantage of the more liberal screening thresholds in the Horizontal Merger Guidelines in their currently proposed form.

NOTES

[1] US Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines, issued 1992, revised 1997, *available at*: http://www.justice.gov/atr/public/guidelines/hmg.htm.

[2] US Department of Justice, Bank Merger Competitive Review — Introduction and Overview (1995), *available at*: http://www.justice.gov/atr/public/guidelines/6472.htm.

[3] *United States v. Philadelphia National Bank*, 374 U.S. 321 (1963).