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SHIFTING PARADIGMS IN MARKET DEFINITION—FROM STAPLES/OFFICE DEPOT TO AMR/US AIRWAYS

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Recent merger enforcement suggests that the U.S. antitrust authorities have engaged in detailed re-examinations of market definition in a number of industries in which the historical definition of a market was thought to be well understood. One of the most recent examples, of course, is the Department of Justice's challenge of the proposed American Airlines/US Airways merger. This article examines the extent to which recent merger review reflects a "paradigm shift" in market definition, whether in terms of the product market, the geographic market, or relevant market participants. It then reviews historical examples in which these "paradigm shifts" occurred and identifies risk factors that may presage such shifts in the future. These potential "paradigm shifts" may present additional risks, and the occasional opportunity, to antitrust practitioners as they analyze and counsel on potential transactions. The concern with a paradigm shift is that what was previously thought was needed to get a deal through may no longer be enough, and the shift can threaten the deal as a whole. Conversely, certain paradigm shifts may actually enable clearance where historically the deal would have faced scrutiny and required meaningful divestiture or remedies – if not an outright challenge.

To some extent, the agencies' revised *Horizontal Merger Guidelines* reflect the flexibility with which they approach market definition. [2] Among a number of "clarifications and refinements concerning market definition" in the *Guidelines* is the "express acknowledgement that merger analysis need not start

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[2] *See, e.g.*, the current version of the agencies' Horizontal Merger Guidelines issued in 2010. U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines (rev. 2010), *available at* http://www.justice.gov/atr/public/guidelines/hmg-2010.pdf.

with market definition."[3] With that said, the Guidelines still reflect the "continued importance of market definition to the merger review process,"[4] such that changes in how the agencies define the market matter.

I. Certain Recent Merger Enforcement Decisions Reflect A Detailed Re-examination of Established Market Definitions

Three recent mergers – each of which faced considerable scrutiny from U.S. antitrust authorities – suggest that changes in how regulators define the market and the participants in each market can have a dramatic effect on the ability to receive approval for transactions. In particular, what we view as potential "paradigm shifts" in market definition involving markets that were previously well understood may present a real risk to antitrust practitioners as they counsel their clients. We explore each transaction in some depth, and then examine historical instances of shifting paradigms in market definition to try to divine certain risk factors to be aware of when analyzing transactions going forward.

AMR/US Airways

The proposed merger of American Airlines and US Airways is the latest in a series of U.S. airline mergers, including Delta/Northwest in 2008 and United/Continental in 2010.[5] The DOJ's review and approval of the prior mergers indicated that the DOJ would likely include low cost carriers in the

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[3] Christine A. Varney, *The 2010 Horizontal Merger Guidelines: Evolution, Not Revolution*, 77 Antitrust L. J. 651, 655 (2011) (quoting 2010 Guidelines, *supra* note 2, at § 4.0).

[4] *Id.*

[5] The proposed merger would create the world's largest airline. *See* Amended Complaint, United States v. US Airways Group, Docket No. 1:13-cv-01236-CKK (D.D.C. Sept. 5, 2013) hereinafter AMR/US Airways Complaint, ¶ 36. US Airways' answer states that Southwest Airlines is the largest domestic airline by passenger, and would be bigger by that measure than the combined entity. Defendant US Airways Group, Inc.'s Answer to Amended Complaint, United States v. US Airways Group, Docket No. 1:13-cv-01236-CKK (D.D.C. Sept. 10, 2013), ¶ 36.

market for scheduled passenger flights, and would treat city-pair routes with nonstop service in a separate market from routes involving a connection.

After all, when the DOJ cleared the Delta/Northwest merger in 2008, it cited low cost carriers as a cognizable source of competition. The agency stated that Delta, then the third largest U.S. airline, and Northwest, the fifth largest, "currently compete with a number of other legacy and low cost airlines in the provision of scheduled air passenger service on the vast majority of nonstop and connecting routes where they compete with each other."[6] When the DOJ cleared Southwest Airlines' acquisition of Airtran in 2011, it noted that "the presence of low cost carriers like Southwest and AirTran has been shown to lower fares on routes previously served only by incumbent legacy carriers."[7]

The same goes for the market involving "city pair" routes (service from an origination city to a destination city), where the agency's traditional approach had been to look at nonstop and connecting service separately. When the DOJ sought to challenge United Airlines' bid to buy US Airways in 2001, it defined the separate relevant markets as, *inter alia*, "hub-to-hub nonstop markets" and "east coast connect markets."[8] Similarly, when the DOJ conditionally cleared the United/Continental merger in 2010, the agency noted "overlap on a limited number of routes where United and Continental offer competing *nonstop* service" (emphasis supplied).[9] And when the DOJ cleared the Southwest

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[6] DOJ, "Statement of the Department of Justice's Antitrust Division on Its Decision to Close Its Investigation of the Merger of Delta Air Lines Inc. and Northwest Airlines Corporation" (Oct. 29, 2008), *available at* http://www.justice.gov/opa/pr/2008/October/08-at-963.html.

[7] DOJ, "Statement of the Department of Justice Antitrust Division on Its Decision to Close Its Investigation of Southwest's Acquisition of Airtran" (Apr. 26, 2011), *available at* http://www.justice.gov/opa/pr/2011/April/11-at-523.html.

[8] DOJ, "Department of Justice and Several States Will Sue to Stop United Airlines From Acquiring US Airways" (July 27, 2001), *available at* http://www.justice.gov/atr/public/press_releases/2001/8701.htm.

[9] DOJ, "United Airlines and Continental Airlines Transfer Assets to Southwest Airlines in Response to Department of Justice's Antitrust Concerns" (August 27, 2010), *available at* http://www.justice.gov/opa/pr/2010/August/10-at-974.html. The DOJ cleared the deal on the

Airlines/AirTran merger in 2011, it pointed out that the two airlines had "overlaps on certain nonstop routes," although it found that such overlaps ultimately did not pose a concern.[10]

In light of its prior definition of the relevant markets, the DOJ's complaint in the American Airlines/US Airways merger represented a shift. That the DOJ ultimately agreed to a more modest settlement, [11] which had more in line with previous approaches, reflects the difficulties DOJ no doubt faced in trying to pivot to an entirely new paradigm.

The DOJ's complaint largely limited the alleged relevant market players to the "network" airlines, ones that have extensive national networks comprising "hub-and-spoke" service, as opposed to non-network carriers, like Southwest Airlines and Jetblue,[12] which offer point-to-point service. The DOJ alleged that the "network" airlines look to each other for price leadership and follow each other on price moves, such as raising ancillary fees on baggage check-in and ticket changes when one of them raised fees or reversing price increases when others did not follow with similar price increases. In contrast, United, American, Delta and US Airways allegedly remain unmoved by the pricing policies of Southwest, which does not charge fees for the first checked bag or ticket changes.[13] The agency also alleged that "cross market initiatives" were common among the "network" airlines. That is, if a network airline undercut a rival on one

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condition that United, then the third largest U.S. airline, and Continental, then the fourth largest, transfer slots and other assets at Newark Liberty Airport to Southwest Airlines. *Id.*

[10] DOJ, "Statement of the Department of Justice Antitrust Division on Its Decision to Close Its Investigation of Southwest's Acquisition of Airtran" (Apr. 26, 2011), *available at* http://www.justice.gov/opa/pr/2011/April/11-at-523.html.

[11] The proposed settlement requires the parties to divest departure gates and 138 takeoff and landing slots at seven airports. See Proposed Final Judgement, United States v. US Airways Group, Docket No. 1:13-cv-01236-CKK (D.D.C. Nov. 12, 2013).

[12] AMR/US Airways Complaint ¶ 32.

[13] *Id.* ¶¶ 42, 46-47, 72-76, 78.

route, that would prompt the rival to respond with a similar discount to undercut the initiating airline on a different route.[14] In sum, the allegations in the DOJ's complaint effectively reduced the relevant market players to the four network carriers, transforming a capstone merger in the recent history of industry consolidation into a proposed 4-to-3 merger. In agreeing to the proposed settlement, however, the DOJ acknowledged, as it had in earlier airline mergers, that "[a]lthough [low cost carriers] serve fewer destinations than the legacy airlines, they generally offer important competition on the routes that they do serve."[15]

That was not the only attempted shift in the agency's approach to evaluating the market. In its amended complaint, the DOJ alleged that the market is scheduled air passenger service between cities. The DOJ did not consider the market for nonstop routes between "city pairs" and the market for connecting service (routes with connection(s)) on such city pairs as separate, but instead looked at how the "network" airlines allegedly compete *across* the two markets.[16] For example, according to DOJ, where an airline initiated a discounted fare for connecting service on a city-pair route that undercut the nonstop fare offered by another airline with the hub for that city pair, then the responding airline would similarly offer a discounted fare for connecting service on a different city-pair route where the initiating airline offers nonstop service. As a result, United, American, or Delta would tend to charge the same price for connecting service on city pair routes as the nonstop airfare charged by any one of them, even though connecting service is inferior to nonstop service.[17]

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[14] *Id.* ¶ 43.

[15] Competitive Impact Statement, , United States v. US Airways Group, Docket No. 1:13-cv-01236-CKK (D.D.C. Nov. 12, 2013).

[16] *Id.* ¶ 48.

[17] *Id.* ¶¶ 48, 50

However, in the complaint, the DOJ alleged that US Airways has been a maverick in this area, because its Advantage Fares frequently price connecting service at a discount to the nonstop airfare offered by a rival. US Airways' network coverage and cost structure allegedly allows the revenue generated from increased sales due to its discounted connecting fares to offset the loss of customers to rival carriers responding with their own discounted connecting fares on US Airway's nonstop routes. Indeed, the DOJ alleged that the other three airlines price their connecting fares on par with one another's nonstop fares, but offer discounted connecting fares on U.S. Airways' nonstop routes. Through this cross-market lens, the DOJ alleged that the potential loss of competition from the merger would directly harm that particular segment of customers for whom the discount of US Airways' connecting service would be worth the inconvenience. The combined entity allegedly would have no incentive to keep the Advantage Fares program because American's network would add too many nonstop routes that could be undercut by rivals in response to Advantage Fares.[18] The DOJ's allegations arguably represent a major change in the agency's approach because in the recent precedents, the agency's various statements did not indicate any major concern with the cross-market competition engaged in by the "network" airlines like United and Delta. Although the Competitive Impact Statement filed with the proposed Final Judgment maintains that at least among certain types of passengers, there are separate markets for non-stop and connecting service, the relatively modest nature of the divestitures compared with the number of allegedly affected markets suggested that the evidence for these separate markets may not have been all that strong.[19]

The two shifts in the agency's definition of the market as alleged in its complaint suggest potential risk factors that may have emboldened the DOJ to attempt a major shift in policy. In addition to public criticism of prior approvals,

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[18] Id. ¶¶ 49-58.

[19] Competitive Impact Statement, , United States v. US Airways Group, Docket No. 1:13-cv-01236-CKK (D.D.C. Nov. 12, 2013).

there may have been a "last mover disadvantage,"[20] in which the effects of previous mergers suggest some harm to competition that threatens further consolidation. More significantly, a risk factor to consider is the presence of "bad" documents in which the parties comment on the market or the rationale for the deal. The DOJ's complaint cites extensively comments made by US Airways executives, particularly the CEO, on how they viewed the market and competition. No matter how the agency had approached the market in years past, those players themselves allegedly appeared to see United, American, and Delta as their chief competition and focus only on those three rivals' pricing and other moves.[21]

In the end, the proposed settlement represents more of an incremental change rather than a whole new paradigm. Perhaps this outcome was inevitable and reflects the inherent difficulty in engineering novel ways of analyzing well studied industries. The DOJ was constrained by its past history and the discipline imposed by having to prove the merits of its new approach in district court.

ABI/Grupo Modelo

The review of the ABI/Grupo Modelo merger represents less a paradigm shift in market definition and more an emphasis on a definition of the market that had been used previously but not to the same effect. On June 28, 2012 Anheuser-Busch InBev SA/NV ("ABI") agreed to acquire Grupo Modelo S.A.B. de C.V. ("Modelo") for $20.1 billion.[22] At the time, ABI was the largest seller of beer in the United States, with a nationwide market share of approximately 39%. Modelo, based in Mexico, accounted for 7% of beer sales in the U.S.[23] Crown

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[20] Steven Pearlstein, "Why the Justice Department blocked the American-US Airways merger," Washington Post, Aug. 15, 2013 (quoting DOJ antitrust division chief Bill Baer).

[21] AMR/US Airways Complaint ¶¶ 47, 64, 73-76.

[22] ABI already owned non-controlling direct interests in Modelo and Modelo's operating subsidiary. In the transaction, ABI agreed to buy the remaining equity interest.

[23] Complaint at 2, United States v. Anheuser-Busch InBev SA/NV, No. 1:113-cv-00127 (D.D.C. Jan. 31, 2013).

Imports LLC ("Crown"), a joint venture between Modelo and Constellation Brands, Inc. ("Constellation"), was the exclusive importer of Modelo beers into the United States. ABI and Modelo also agreed to sell Modelo's 50% interest in Crown to Constellation along with the exclusive right to import Modelo beer into the U.S. for ten years. The DOJ filed suit to enjoin the merger on January 31, 2013, alleging the merger would restrain trade in national and local markets for beer in the U.S.

The DOJ defined the market to include all beer. Significantly, the DOJ did not define submarkets based on groups of beer brands with different prices and perceived quality. ABI, however, classified brands into four segments: sub-premium, premium, premium plus, and high-end. Premium beers are priced higher than sub-premium and lower than premium-plus and high-end beers. Regardless, the DOJ alleged that "beers compete with one another across segments."[24]

This market definition decision was critical to the DOJ's case for challenging the merger. Corona was Modelo's flagship brand in the U.S., and was also the best-selling high-end beer. Although ABI owned some high-end brands, it allegedly faced significantly more competition in that market segment from small-scale breweries and has a relatively low market share.[25] By defining the market broadly, the DOJ was able to allege that Modelo and ABI were in direct competition for sales across a larger portion of the market, including the premium segment where ABI allegedly had some power to set prices.

The DOJ's market definition theory was, according to the DOJ, supported by internal documents from ABI and Modelo. The Complaint alludes to documents describing the Modelo and Crown's "momentum plan" to compete with domestic premium beers. Pursuant to the plan, Crown deliberately held the

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[24] Complaint, *supra* note 20, at 10.

[25] *See* http://www.brewersassociation.org/pages/business-tools/craft-brewing-statistics/number-of-breweries.

price of Corona steady while ABI increased the price of its premium beers on an annual basis. As a result, Modelo's Corona allegedly gained market share at the expense of ABI's premium Bud Light. The DOJ also alleged that ABI saw Corona as a serious competitor and that ABI was taking steps to develop new products to win back the market share it lost due to the momentum plan.[26]

The DOJ ultimately settled the challenge after the parties agreed to a significant divestiture of assets. Modelo agreed to sell, not only the right to import Corona and other Modelo beers into the U.S. but also its largest production facility to Constellation.[27] The settlement agreement also includes a commitment by Constellation to increase production capacity to meet future demand in the U.S. and an agreement by ABI to supply beer to Constellation on favorable terms to ensure it can meet short-term demand.

To some extent, the DOJ's broad view of the beer market was consistent with its review and approval of the merger between Anheuser-Busch and InBev in 2008. There, as here, the DOJ employed a similarly broad product market definition and ultimately employed a similar remedy. However, the antitrust issues were limited to three geographic markets in the U.S. (Buffalo, Rochester, and Syracuse) and involved beer brands that competed within the premium sub-market. In those markets, Labatt, an imported beer owned by InBev, had similar market share to Anheuser-Busch and MillerCoors. The merger would have eliminated competition between Anheuser-Bush brands and Labatt and resulted in a significantly consolidated market.

In both transactions, the settlement required divestiture of significant assets necessary to manufacture as well as sell beer in order to ensure the third party would be a viable independent competitor to the merging entity. But the

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[26] *See* Complaint, *supra* note 20, at 19.

[27] *See* Department of Justice, "Justice Department Reaches Settlement with Anheuser-Busch InBev and Grupo Modelo in Beer Case" 1-2 *available at* http://www.justice.gov/opa/pr/2013/April/13-at-452.html.

treatment of these mergers stands in contrast to the DOJ and FTC's frequent practice of defining narrower submarkets for certain products, which would likely have resulted in a less significant remedy in Modelo.[28]

AT&T/T-Mobile

The DOJ's challenge to the proposed merger of AT&T, Inc. ("AT&T") and T-Mobile USA, Inc. ("T-Mobile") reflected elements that would later appear in both AMR/US Airways in focusing on a subset of large providers that competed on a nationwide basis, and ABI/Modelo in applying a market definition that had been alluded to in earlier transactions but not with the same resultant effects.[29]

In prior mergers involving mobile wireless communications services, regulators had come to define the geographic market as local, rather than national,[30] finding that consumers chose providers of mobile wireless services where they live, work, and travel frequently. They did not believe that customer preferences for nationwide plans or similarity in nationwide pricing indicated that the market was national. Nor did they find distinct product markets for products offering nationwide service versus those offering local/regional service.[31] At the same time, they at least acknowledged that "firms that can only provide local/regional plans may not play the same competitive role as firms offering

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[28] *See, e.g.*, Nestle-Dreyer's (FTC 2003) (involving the merger of two rivals in the sale of superpremium ice cream).

[29] *See* Second Amended Complaint, United States v. AT&T Inc., Docket No. 1:11-cv-01560-ESH (D.D.C. Sept. 30, 2011) [hereinafter AT&T/TMO Complaint], ¶¶ [xx].

[30] *See, e.g.*, Complaint, United States v. AT&T Inc., Civ. No. 1:09-cv-01932-JDB, at ¶ 15 (D.D.C. filed Oct. 13, 2009) (DOJ concluded that mobile services are offered in "numerous local geographic markets," given that, among other considerations, customers generally choose among providers that market services "where they live, work, and travel on a regular basis" and "[t]he number and identity of . . . providers varies among geographic areas"). *See also* Verizon/ALLTEL Order, 23 FCC Rcd at 17471 ¶ 49; Memorandum Opinion and Order, Applications Nextel Communc'ns, Inc. and Sprint Corporation for Consent to Transfer Control of Licenses and Authorizations, 20 FCC Rcd 13991-95 ¶¶ 57, 63-67 (2005) ("Sprint/Nextel Order"); Cingular/AT&T Wireless Order at 21567-69 ¶¶ 104-112.

[31] *See, e.g.*, Cingular/AT&T Wireless Order at ¶ 80.

nationwide service plans,"[32] and that pricing may be substantially similar nationwide, suggesting that nationwide providers looked to one another in pricing.

In AT&T/T-Mobile, the DOJ shifted its identification of market participants and geography to nationwide. In its complaint, the DOJ alleged that "AT&T and T-Mobile are two of only four mobile wireless providers with nationwide networks and a variety of competitive attributes associated with that national scale and presence."[33] In defining the geographic market, the DOJ identified this shift, alleging that "[m]obile wireless telecommunications services are sold to consumers in local markets that *are affected by nationwide competition among the dominant service providers*."[34] Thus, while the DOJ examined competitive conditions in local Cellular Market Areas ("CMAs"), the focus was clearly on the Big Four (AT&T, T-Mobile, Sprint, and Verizon Wireless), which "utilize networks that cover the vast majority of the U.S. population, advertise nationally, have nationally recognized brands, and offering pricing, plans, and devices that are available nationwide."[35] In so doing, the DOJ was able to limit the market participants to the "Big Four" and point to a more significant concentration in the national market.[36] As with AMR/US Airways and ABI/Modelo, the DOJ was also able to use party documents to support the position that AT&T and T-Mobile were most focused on competition from the other national providers, and T-Mobile played an important disruptive role in the marketplace.

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[32] *Id.*

[33] AT&T/TMO Complaint ¶ 2.

[34] *Id.* ¶ 14 (emphasis supplied).

[35] *Id.* ¶¶ 17-18.

[36] *Compare id.* ¶ 23 *with id.* ¶ 24.

II. Historical Examples of a “Paradigm Shift”

There have been several examples historically of a shifting paradigm in market definition. Below we analyze two notable cases in an effort to identify risk factors that may presage paradigm shifts going forward.

Staples/Office Depot

In what has become one of the classic cases of the importance of market definition in antitrust analysis, the FTC engineered a major shift in defining the market for office supplies to challenge Staples’ bid to buy Office Depot in 1997. The defendants had argued that the relevant market was the sale of consumable office supplies, of which the combined entity would have a percentage market share in the single digits.[37] Indeed, many observers at the time probably would have approached the market in this way. In a nod to this traditional approach, the D.C. district judge, from whom the FTC sought an injunction against the merger, “acknowledged that there is, in fact, a broad market encompassing the sale of consumable office supplies by all sellers of such supplies.”[38] But deploying powerful documentary evidence from the parties themselves showing that the parties mainly set prices in local geographic areas against one another, regardless of the presence of a nearby retailer like Wal-Mart, the FTC proceeded to limit the relevant market to sales of certain office supplies through office superstores. The district court observed the momentous shift represented by the agency’s approach, recognizing that “it is difficult to overcome the first blush or initial gut reaction of many people to the definition of the relevant product market as the sale of consumable office supplies through office supply superstores.”[39] But the court agreed with the FTC, which proffered advertisements showing that customers living in cities with only one office supply superstore paid significantly higher

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[37] FTC v. Staples, 970 F. Supp. 1066, 1075 (D.D.C. 1997).

[38] *Id.*

[39] *Id.*

prices than customers in cities with two or more superstores offering identical products. Facing this new market definition, the parties' proposed transaction transformed into a 3-to-2 merger: Staples, the largest office supply superstore, was trying to acquire its biggest competitor in the submarket of office supply superstores. The FTC successfully obtained a preliminary injunction and the parties subsequently abandoned the deal.

Of course, we now know that the story did not end there. Sixteen years later, in light of changed circumstances, it appears the agency has expanded the relevant market, this time in favor of the parties. On Nov. 1, 2013, the FTC ended a seven-month investigation and allowed Office Depot and Office Max to merge without conditions. The parties and commentators argued that the Internet had disrupted the market. The FTC agreed, explicitly stating that the market had changed and that customers now looked beyond office supply superstores to big box retailers such as Wal-Mart and, more importantly, to Internet retailers such as Amazon when deciding where to buy office supplies. Based on the old market definition, the parties' market shares would have been prohibitive; but those shares would not have reflected their current competitive positions, which have been trending downward on underperforming bricks-and-mortar stores. This stark contrast to the 1997 outcome illustrates the importance of shifts in market definition—whether brought about by technological change or other changes in competitive dynamics, or—in determining whether is challenged or gets through without conditions. Often, the parties' documents will reflect these changed circumstances.

Factual shifts can occur in even shorter amounts of time. In 2011, European and U.S. stock exchange giants Deutsche Börse and NYSE agreed to merge. The DOJ investigated the merger and ultimately approved it subject to conditions. In its complaint, the DOJ defined the market for "displayed equities trading services" that included only public displayed stock exchanges (NYSE, NASDAQ, and recent entrants BATS and Direct Edge) but specifically excluded off-exchange trading such as dark pools, which made up 30-35% of equities trading volume. This definition was somewhat surprising given the rapid rise of dark pools and other off-exchange trading venues that had proliferated dramatically over the past decade. The DOJ's concern was that traders would be forced to pay more to trade and would be stuck with only four options. Two years later, the third and fourth largest stock exchanges BATS and Direct Edge agreed to merge. Had the DOJ applied the earlier market definition in NYSE, the parties would have been confronted with resistance to a 4-3 merger. Instead, the DOJ did not issue a second request and granted early termination for the merger. Although the DOJ did not provide insight into its decision, it appears to have accepted that the nature of the equities trading market had changed due to recent technological advances. Accordingly, the DOJ was able to adapt its prior analysis and appears to have agreed that the market included many more players besides NYSE and NASDAQ, and as a result, a merged BATS-Direct Edge could not raise prices on traders without losing significant market share to off-exchange platforms.

This makes it clear that the U.S. antitrust authorities remain receptive to examining the full facts and if the industry evolution shows that in fact the market has expanded in terms of the number of competitors, they are willing to acknowledge that conclusion even if it means taking a position that is different from a prior recent precedent.

Rite Aid/Revco

The second historical example of a shift in market definition involved a different approach to the locus of competition. When the two biggest drug retailers in the U.S., Rite Aid Corp. and Revco D.S., Inc., sought to merge and faced FTC review in 1996, practitioners, based on the established approach, may have looked upon the relevant market as that of consumers walking into pharmacies in their local areas and paying out of pocket for prescription drugs. In the geographic areas where the combined market share of the merging parties would be high, the parties might have been counseled to prepare to divest some stores in discrete locations.

Instead, the FTC defined another relevant market that would be the locus of anticompetitive concern and ultimately jeopardize the deal. In addition to the pharmacy chains' market for retail sales to cash-paying customers, the FTC described the chains' competition in the increasingly important market for participation in benefit provider networks covered by group health insurance plans offered by third-party payors, such as employers. Recognizing the trend in how customers increasingly bought and paid for prescription drugs, the FTC perceived that a significant chunk of pharmacies' sales to retail customers were paid for by pharmacy benefits covered by such group plans.[40] As the country's two top drugstore chains with extensive coverage across local areas, Rite Aid and Revco competed closely to be included in employer health plans' pharmacy benefit networks. Because plan enrollees would generally need access to one of the two chains, the combined entity would have significant bargaining power vis-à-vis the group plans, which paid dispensing fees to chains to obtain participation in provider networks.[41] In seeking to block the deal, the FTC alleged that the proposed merger is "the first drug store merger where the focus has been on anticompetitive price increases to the growing numbers of employees covered by these pharmacy benefit plans, rather than exclusively focusing on the cash paying customer."[42]

For the first time, the agency's concern was not only with the local geographic markets—15 metropolitan areas in which the combined market share from the merger would be over 35% of retail pharmacies[43] —in which the two pharmacy chains competed for walk-in customers, but with the combined entity's

[40] FTC, "FTC Will Seek to Block Rite Aid/Revco Merger" (Apr. 17, 1996), *available at* http://www.ftc.gov/opa/1996/04/riterevc.shtm.

[41] DOJ & FTC, "Commentary on the Horizontal Merger Guidelines" (Mar. 2006), *available at* http://www.justice.gov/atr/public/guidelines/215247.htm.

[42] FTC, "FTC Will Seek to Block Rite Aid/Revco Merger" (Apr. 17, 1996), *available at* http://www.ftc.gov/opa/1996/04/riterevc.shtm.

[43] DOJ & FTC, "Commentary on the Horizontal Merger Guidelines" (Mar. 2006), *available at* http://www.justice.gov/atr/public/guidelines/215247.htm [hereinafter Merger Guidelines Commentary].

purchasing power vis-à-vis large employer group plans on account of such entity's extensive network. Rite Aid proposed to divest 340 stores to decrease its market share in certain geographic markets and the FTC reportedly requested Rite Aid to divest about twice that number. Not reaching a settlement, the FTC issued a statement saying it would seek a preliminary injunction of the merger, and one week later, the parties abandoned the $1.8 billion deal.[44]

In their commentary on the Horizontal Merger Guidelines of 2006, the DOJ and FTC noted that two years before the Rite Aid/Revco challenge, the FTC had applied a similar market definition framework—(1) out-of-pocket customers and (2) third-party payors like health insurance plans and pharmacy benefit managers—to the Thrifty/PayLess proposed merger. The agency found anticompetitive effects in the retail customer market required divestitures in some geographic areas, but did not find anything of concern with the impact of the proposed combination of the two drugstores in the third-party payor market. In hindsight, that deal was the harbinger for the Rite Aid/Revco challenge. The growing trend in how consumers actually paid for the relevant product, and the shift in the locus of retail transactions, had emerged, the FTC had begun to recognize such, and both presaged the agency's novel challenge in Rite Aid/Revco in 1996.

III. Risk Factors That May Presage a Paradigm Shift

In light of the historical examples of a paradigm shift in market definition noted above, along with the recent trends in merger enforcement, we can perhaps begin to divine some risk factors that may presage a shift in market definition (product, geographic, or participants) in future cases.

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[44] Alec Matthew Klein, "Rite Aid ends lengthy battle to buy Revco FTC is accused of playing politics to thwart the deal" (Apr. 25, 1996), *available at* http://articles.baltimoresun.com/1996-04-25/business/1996116060_1_rite-aid-merger-drugstore-chains.

a. *Significant consolidation in the industry*

Many of the industries involved above had seen significant consolidation prior to the deal at issue. On the one hand, this may provide substantial precedent in favor of defining the market in a predictable way. On the other hand, where such consolidation was beginning to have an effect on competition in the market, such as in the airline industry, it may present greater risk that antitrust authorities may shift the market definition to challenge the deal.

b. *Market with indicia of coordinated pricing*

Similarly, evidence of coordinated pricing among a subset of competitors can permit antitrust authorities to limit the relevant market participants to that subset. Antitrust authorities have focused recently on the disruptive effects that a target may have had on such price coordination. For example, Modelo only had 7% of the national beer market, but it was alleged to have a much larger influence because it disrupted ABI's ability to coordinate pricing with MillerCoors. Similarly, US Airways' Advantage Fares allegedly threatened coordinated pricing on non-stop versus connecting routes. And in AT&T/T-Mobile, the DOJ argued that T-Mobile was a "challenger brand."[45]

c. *Recent examples of market definition that may be more pronounced in the proposed deal*

Further, prior reviews by the agencies may offer clues of an emerging market definition, particularly as competitive dynamics change in the industry. There are several examples in which the agencies' prior review of deals alluded to an alternate, secondary approach to the market, even if the deal at issue did not raise enough anticompetitive concerns under that novel approach for it to be brought to the foreground or to jeopardize the deal. Predecessor transactions to Rite Aid/Revco, ABI/Modelo, and AT&T/T-Mobile offer relevant examples of

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[45] AT&T/TMO Complaint ¶ 3.

how these nascent definitions of the market proved particularly relevant in later deals.

d. *Technological shift in the marketplace*

While a shift in competitive dynamics may elicit an unfavorable shift in market definition, the reverse can happen as well, increasingly with the advent of disruptive technology. A technological shift, such as the rise of the Internet, resulted in the recent approval of Office Depot/Office Max, and technological advances expanded the market antitrust authorities considered in BATS/Direct Edge. Accordingly, static market shares of the parties based on an old market definition may not adequately reflect the declining competitive position of the parties.

e. *How the parties view competition and relevant competitors*

Critically, in our view, the antitrust authorities are relying more and more on internal documents and statements to support their definition of the relevant market(s) and the possibility of anticompetitive harm. Thus, if the parties' internal documents imply a view of the market that contrasts with agencies' previously established approaches to, or the traditional views of, the relevant market, this may raise a red flag. *See* ABI/Modelo and AMR/US Airways.

In all, a couple of lessons for practitioners emerge. In approaching a proposed transaction, counsel should not necessarily start by telling the parties how the agency generally views the market or how the agency has viewed the market in the past and is likely to view the market this time around. The initial question should be to ask the parties how they themselves view the market and who their competitors are. While antitrust authorities approach market definition in their own way, often it will correspond – at least in part – with how the parties think about the market and the relevant market participants.