PROCOMPETITIVE EFFECTS OF MERGERS IN THE 2023 MERGER GUIDELINES: WHAT COUNTS AND WHERE?

BY JOHN ASKER, JULIA GONZALEZ, MATTHEW CALVIN & RACHEL FELDMAN[1]

1 John Asker is the Armen A. Alchian Chair in Economic Theory at the University of California, Los Angeles; Julia Gonzalez is a Manager in Cornerstone Research's Chicago office; Matthew Calvin is a Manager in Cornerstone Research's New York office; Rachel Feldman is an Associate in Cornerstone Research's Chicago office. The authors would like to thank Russell Molter and Kostis Hatzitaskos for assistance, comments, and suggestions. The views expressed herein are those of the authors, who are responsible for the content, and do not necessarily represent the views of Cornerstone Research.

CPI ANTITRUST CHRONICLE May 2024

MERGERS OF COMPLEMENTS
By Herbert Hovenkamp

PERSONALITY TRAITS, PRIVATE EQUITY, AND MERGER ANALYSIS
By Steven C. Salop

THE 2023 MERGER GUIDELINES: LESSONS IN THE IMPORTANCE OF INCIPIENCY, MODERN ECONOMICS, AND MONOPSONY
By Susan Athey & David Lawrence

THE 2023 MERGER GUIDELINES: SHARPENING MERGER ANALYSIS
By Ken Merber, Aviv Nevo & Alison Oldale

POTENTIAL COMPETITION: A FORCE AWAKENED OR A PHANTOM MENACE?
By Darren Bush & Spencer Weber Waller

PROCOMPETITIVE EFFECTS OF MERGERS IN THE 2023 MERGER GUIDELINES: WHAT COUNTS AND WHERE?
By John Asker, Julia Gonzalez, Matthew Calvin & Rachel Feldman

COMMON OWNERSHIP IN THE MERGER GUIDELINES
By John B. Kirkwood

DETERRENCE IN MERGER REVIEW: LIKELY EFFECTS OF RECENT U.S. POLICY CHANGES
By Luke M. Froeb, Steven T. Tschantz & Gregory J. Werden

Visit www.competitionpolicyinternational.com for access to these articles and more!

CPI Antitrust Chronicle May 2024
www.competitionpolicyinternational.com

PROCOMPETITIVE EFFECTS OF MERGERS IN THE 2023 MERGER GUIDELINES: WHAT COUNTS AND WHERE?

By John Asker, Julia Gonzalez, Matthew Calvin & Rachel Feldman

In this article, we provide an overview of the Agencies' recently updated guidance for the assessment of procompetitive effects of mergers and identify pressure points that the Agencies, merging parties, and courts will have to contend with after the release of the 2023 Merger Guidelines. First, we discuss the broad-brush aspects of the 2023 Merger Guidelines that are reflected in the new guidance for procompetitive effects of horizontal mergers. We then discuss the conditions the Agencies now require to credit efficiencies, with particular focus on the procompetitiveness condition, where we see the most substantive changes and open questions. We note the Agencies' new focus on "anticompetitive harm to trading partners" and how it ties to novel theories of harm, and we describe how this update to the procompetitiveness condition makes it more nuanced and poses new challenges for the evaluation of merger efficiencies going forward. We conclude with a discussion of how cost reductions and quality improvements seem to be treated differently in the 2023 Merger Guidelines.

Scan to Stay Connected!
Scan or click here to sign up for CPI's **FREE** daily newsletter.

I. INTRODUCTION

The FTC and the DOJ ("the Agencies") released the 2023 Merger Guidelines last December, and with them they updated the guidance for the assessment of procompetitive effects in merger evaluation.[2] In this article, we provide an overview of those changes, beginning with a general description of the main updates to the merger guidelines that affect the Agencies' guidance on procompetitive effects. We then present the cognizability criteria for merger efficiencies and analyze what has changed with the new guidelines. We dive into the procompetitiveness condition in depth, as this is the condition where we see the most substantive changes. Lastly, we briefly discuss the treatment of different type of efficiencies under the 2023 Merger Guidelines.

We note that the 2023 Merger Guidelines were a substantial rewrite of prior guidance; in this article we focus only on changes that affect guidance for the evaluation of procompetitive effects of horizontal mergers.[3] Our discussion below is based on the new guidelines as written, as we are only beginning to see how the Agencies will apply the guidelines for the evaluation of mergers, and how the courts will reflect the new guidelines in case law.

II. THE 2023 MERGER GUIDELINES: MAIN UPDATES THAT AFFECT THE GUIDANCE ON PROCOMPETITIVE EFFECTS

Our primary focus is on updates contained in the section of the 2023 Merger Guidelines about rebuttal evidence (Section 3) and, in particular, in Section 3.3 on merger efficiencies. But we begin by discussing how the broad-brush aspects of the new guidelines likely color the way procompetitive effects will be evaluated.[4]

All types of mergers are now addressed in the same document. The Agencies previously had separate guidelines for horizontal and vertical mergers. Within each, the Agencies outlined criteria for evaluating anticompetitive effects and efficiencies based on the particularities of each type of merger. The 2023 Merger Guidelines replaced both the 2010 Horizontal Merger Guidelines ("2010 HMG") and the 2020 Vertical Merger Guidelines.[5] In Section 2, the 2023 Merger Guidelines provide detailed guidance as to potential anticompetitive effects for different types of mergers. In Section 3, the new guidelines describe the potential procompetitive effects of mergers with no distinction between types of mergers.[6]

In seeking to cover all types of mergers in the same document, the 2023 Merger Guidelines require flexible language to refer to all third-party market participants that might be affected by the mergers (e.g. buyers of the merging parties' products or services, suppliers of inputs to the merging parties, entities that might compete with an upstream merging party and also be a supplier to a downstream merging party, etc.). The Agencies use the term "trading partner[s]" extensively throughout the guidelines in places where the old guidelines would have more concretely said "consumers," "suppliers," etc. Nonetheless, nothing about the use of this term indicates that it is intended to include a firm's competitors in a relevant market: consistent with long-standing economic and legal analytical approaches, the new guidelines are clearly written to protect competition rather than competitors.[7]

Guidance on novel theories of harm. The Agencies now provide specific guidance about several novel theories of harm. The 2023 Merger Guidelines cover a variety of topics that have attracted interest in recent years, including serial acquisitions, risks of harm in labor mar-

2 "Justice Department and Federal Trade Commission Release 2023 Merger Guidelines," *U.S. Department of Justice*, December 18, 2023, available at https://www.justice.gov/opa/pr/justice-department-and-federal-trade-commission-release-2023-merger-guidelines, accessed on March 25, 2024. The 2023 Merger Guidelines are available at https://www.justice.gov/d9/2023-12/2023%20Merger%20Guidelines.pdf.

3 The treatment of efficiencies in vertical mergers, and the changes introduced by the 2023 Merger Guidelines, are beyond the scope of this article.

4 For a comprehensive review of the changes in the 2023 Merger Guidelines we direct the interested reader to the other articles in this issue of Competition Policy International.

5 The FTC withdrew their endorsement of the 2020 Vertical Merger Guidelines on September 15, 2021; the 2023 Merger Guidelines replaced the 2020 Vertical Merger Guidelines for the DOJ. See "Justice Department Issues Statement on the Vertical Merger Guidelines," *Department of Justice*, September 15, 2021, available at https://www.justice.gov/opa/pr/justice-department-issues-statement-vertical-merger-guidelines, accessed March 28, 2024.

6 The Agencies also provide some specific insight on the assessment of efficiencies at the end of some Guidelines in Section 2, referring to the framework in Section 3. This type of language was not present in the Draft Merger Guidelines; its inclusion in the final version is a welcome addition.

7 This language was first introduced in *Brown Shoe v. US*, 370 US 294 (1962): "Taken as a whole, the legislative history illuminates congressional concern with the protection of competition, not competitors, and its desire to restrain mergers only to the extent that such combinations may tend to lessen competition."

kets, entrenchment, and multi-sided platforms. Although we use the label "novel," in many instances, these novel theories of harm could have been gleaned from the old guidelines; in these cases, the new guidelines function as a restatement of prosecutorial intent.[8] As the Agencies bring cases under these novel theories of harm, the case law on these theories will develop as well.[9]

In the following sections, we describe how the assessment of merger efficiencies has changed in the new guidelines and how these new aspects of the 2023 Merger Guidelines are reflected on these changes.

III. COGNIZABILITY CRITERIA FOR EFFICIENCIES: WHAT HAS CHANGED

The stated conditions that efficiencies must satisfy to be deemed cognizable remain substantially unchanged and are now helpfully presented as a checklist: efficiencies must be merger-specific, verifiable, be passed through so they benefit others in the relevant market, and be procompetitive.[10] For the first three criteria, the Agencies provide more explicit and detailed guidance without substantial changes. As we will discuss in Section 4, the updated language on procompetitiveness has made the criteria more subject to interpretation.[11]

Merger specificity. The 2023 Merger Guidelines indicate that the Agencies must be convinced that the presented efficiencies could not be achieved in the absence of the merger through reasonable means. The merger parties would have an incentive to pursue any efficiencies they can in the absence of the merger. Therefore these (non-merger-specific) efficiencies are likely to exist both in the world where the parties merge as well as in the one where they do not merge. The 2023 Merger Guidelines now spell out concrete types of alternative arrangements that could generate the same efficiencies without the potential anticompetitive effects of the merger at issue, such as "organic growth of one of the merging firms, contracts between them, mergers with others, or a partial merger involving only those assets that give rise to the procompetitive efficiencies."[12]

Verifiability. The Agencies will have to be convinced that those efficiencies can and have been verified. The Guidelines note that "efficiencies are often speculative and difficult to verify and quantify, and efficiencies projected by the merging firms often are not realized."[13] Therefore, the Agencies require that firms demonstrate ("using a reliable methodology and evidence not dependent on the subjective predictions of the merging parties or their agents") that their purported efficiencies are likely to be achieved.[14]

Pass-through. The Agencies now explicitly require that the efficiencies "prevent a reduction in competition" to be cognizable, in the sense that the purported efficiencies must benefit others in the relevant market rather than just increasing profits for the merging parties. In the 2010 HMG, pass-through was implicitly required as part of the condition for an efficiencies defense to be successful;[15] its explicit addition is a notable change by the Agencies.

8 For example, horizontal merger guidelines have explicitly discussed monopsony risk since 1992. Therefore, a theory based on labor market harms would not have been precluded by the former guidelines. Nonetheless, the 2023 Merger Guidelines provide a clear statement of the Agencies' intent to challenge mergers they see as resulting in labor market harms. 1992 Merger Guidelines ("The exercise of market power by buyers ('monopsony power') has adverse effects comparable to those associated with the exercise of market power by sellers. In order to assess potential monopsony concerns, the Agency will apply an analytical framework analogous to the framework of these Guidelines."). 2023 Merger Guidelines ("Guideline 10 'When a Merger Involves Competing Buyers, the Agencies Examine Whether It May Substantially Lessen Competition for Workers, Creators, Suppliers, or Other Providers'").

9 For example, the FTC recently included claims of labor market harms in their challenge of the proposed *Kroger/Albertson*'s merger. "FTC Challenges Kroger's Acquisition of Albertsons," *Federal Trade Commission*, February 26, 2024, available at https://www.ftc.gov/news-events/news/press-releases/2024/02/ftc-challenges-krogers-acquisition-albertsons, accessed on March 25, 2024 ("For thousands of grocery store workers, Kroger's proposed acquisition of Albertsons would immediately erase aggressive competition for workers, threatening the ability of employees to secure higher wages, better benefits, and improved working conditions.").

10 In what follows, for ease of exposition we name these conditions with terms that may differ slightly from the names given by the Agencies in the 2023 Merger Guidelines.

11 In addition to changes in the cognizability criteria, the Agencies also updated the language of their guidance about crediting efficiencies outside of the relevant market. The 2010 HMG stated that "the Agencies in their prosecutorial discretion will consider efficiencies not strictly in the relevant market." (2010 HMG, p. 31). The 2023 Merger Guidelines now state that the Agencies will not credit efficiencies outside of the relevant market (2023 Merger Guidelines, pp. 27, 32). The Agencies continue to emphasize that "the Agencies' enforcement decisions will necessarily continue to require prosecutorial discretion and judgment" elsewhere in the Guidelines (2023 Merger Guidelines, p. 4).

12 2023 Merger Guidelines, p. 32.

13 2023 Merger Guidelines, p. 33.

14 2023 Merger Guidelines, p. 33.

15 2010 HMG, p. 31 ("The greater the potential adverse competitive effect of a merger, the greater must be the cognizable efficiencies, and the more they must be *passed through* to customers, for the Agencies to conclude that the merger will not have an anticompetitive effect in the relevant market." Emphasis added).

Procompetitiveness. The Agencies have changed the language of the procompetitiveness condition for cognizability. The new language in the 2023 Merger Guidelines requires that efficiencies are "Not Anticompetitive," or "do not result from the anticompetitive worsening of terms for the merged firm's trading partners." In contrast, the 2010 HMG required that efficiencies "do not arise from anticompetitive reductions in output or service."[16] In Section 4 we discuss this requirement in the context of the broader changes in the 2023 Merger Guidelines and potential room for interpretation in more depth.

IV. THE PROCOMPETITIVENESS CONDITION FOR EFFICIENCIES IN THE 2023 MERGER GUIDELINES

As discussed above, the procompetitiveness condition in the 2023 Merger Guidelines is one of the more significant updates to the guidance about efficiencies. The 2023 Merger Guidelines replace the 2010 HMG's focus on output with a focus on anticompetitive harms to "trading partners."[17] While the 2023 Merger Guidelines may now more directly address risk posed by certain mergers, a necessary trade-off is that the guidance on efficiencies is vaguer and leaves more room for interpretation in how it applies to different types of mergers.

The 2010 HMG's focus on efficiencies that do not lead to anticompetitive reductions in output is generally equivalent to efficiencies that do not lead to *any* reductions in output in the relevant market. The inclusion of the word "anticompetitive" does not generally alter the Agencies' meaning. For example, in a horizontal merger between sellers (i.e. firms that primarily compete in selling to end-users in "downstream" markets), if the merger results in better market outcomes (either lower prices or higher quality), consumers will buy more, and market output will increase. Likewise, if output falls after a merger, this suggests consumers in the relevant market overall are likely worse off than before in a horizontal merger between sellers.[18]

Because the 2023 Merger Guidelines seek to give guidance on a broader set of mergers and novel theories of harm, a simple focus on output is no longer sufficient to assess the impact specific to every potential market the agencies might seek to define. For instance, if merging firms also compete in "upstream" markets for inputs (e.g. book publishers competing with each other for the rights to manuscripts), then the combined firm may be able to exert increased monopsony power to drive down the price and reduce the market quantity of its input, which may create efficiencies in the downstream relevant market. It could be possible, hypothetically, for the number of books bought by end consumers to increase but the number of book manuscripts penned by writers to decrease. This type of scenario, which can analogously be applied to labor markets, is possibly one of the Agencies' concerns when focusing on "the anticompetitive worsening of terms for the merged firm's trading partners."[19]

The Agencies express the updated requirement more explicitly in the footnote to the procompetitiveness condition, where they state that they "will not credit efficiencies if they reflect or require a decrease in competition in a separate market."[20] This condition, in practice, likely raises the bar for an efficiencies defense. The evaluation of whether efficiencies are cognizable, even for horizontal mergers, may now more often require the definition of multiple relevant product markets (e.g. downstream *and* upstream).

The Agencies and merging parties assessing the merger's efficiencies will now have to analyze whether any worsening of terms for trading partners is anticompetitive. In doing so, they will have to recognize that not all reductions in output are an *anticompetitive* worsening of terms. For instance, if a merger allows the combined firm to operate more efficiently (e.g. through improved productivity or elimination of duplicated resources), it may require fewer inputs from its suppliers. As we describe below with an example, this reduction in output from the input suppliers may make them worse off without being an anticompetitive outcome.

16 2010 HMG, p. 30.

17 2023 Merger Guidelines, p. 33.

18 We understand that this guidance is still reflected in the 2023 Merger Guidelines, though it might be less explicit. For a merger between two firms selling in a downstream market with no significant concerns about upstream competition, the only relevant trading partners are customers who buy their products. Thus, evaluating the terms for trading partners (consumers) amounts to evaluating changes in output in the downstream market.

19 See, e.g. 2023 Merger Guidelines, fn 71("For example, if input costs are expected to decrease, the cost savings will not be treated as an efficiency if they reflect an increase in monopsony power."). Given the focus on labor markets elsewhere in the 2023 Merger Guidelines (as discussed above in Section 2) it seems likely that labor markets were the main type of market the Agencies had in mind when updating the language of the procompetitiveness condition.

20 2023 Merger Guidelines, fn 71.

As an example of how it may be difficult to parse out which worsening of terms are anticompetitive, consider a merger between two trucking companies, both of which frequently operate half-filled trucks on the same route.[21] The merger would generate a procompetitive efficiency in the downstream market because the firms could combine these half-full shipments and reduce the number of trips — and, therefore, truckers — needed post-merger to ship the same number of goods. This would reduce the merged firm's labor cost both because fewer truckers would be needed, but also because the reduction in the demand for truckers could lower their competitive wage.

However, if the two firms also account for a large proportion of trucker employment, the combined firm may also have increased monopsony power. The merged firm could use its monopsony power to hire even fewer truckers — and pay them even lower wages — than it would have otherwise without increased monopsony power. This further reduction in both labor demand and wages would constitute an anticompetitive worsening of terms for truckers. But, regardless of the monopsony power of the merged firm, the direction of the change in market outcomes would be the same: the combined firm will be hiring fewer truckers at lower wages. The 2023 Merger Guidelines do not provide further details on what the Agencies would do in a case like this, where a productive efficiency and a claimed competitive harm both push prices and output in the same direction.

Analyzing the tradeoffs between the effects of horizontal mergers in downstream and upstream markets, as well as the distinction between procompetitive and anticompetitive worsening of terms for trading partners, is likely going to be one of the new challenges in the evaluation of merger efficiencies going forward.[22]

V. DIFFERENTIAL TREATMENT OF DIFFERENT TYPES OF EFFICIENCIES?

As a last observation, the 2023 Merger Guidelines are now more explicit about how the Agencies may differentially treat the procompetitive effects of cost-reducing and quality-improving efficiencies. The new guidelines describe rebuttal evidence on repositioning (including improvements in product quality) and rebuttal evidence on entry separately from the efficiencies discussion in Section 3.3. While the 2010 HMG already stated that "Repositioning is a supply-side response that is evaluated *much* like entry," the new guidelines seem to take a stronger stance with their rebuttal Section 3.2 on "Entry and Repositioning." In addition, as mentioned above, one of the cognizability criteria requires that efficiencies do not "merely benefit the merging firms," which would arguably apply more straightforwardly to cost-reducing efficiencies.[23]

From the point of view of economics, both types of procompetitive effects should be incorporated into the analysis of the competitive effects of a merger. They both have the potential to make the overall effect of the merger positive for "trading partners" in the relevant market. Efficiencies that reduce marginal costs allow the merged firm to produce its product or service more cheaply (e.g. by producing in greater volume and achieving economies of scale), which can be passed through and cause price reductions. Quality improvements allow the combined firm to produce a better product (e.g. when the combination of networks by merging mobile phone companies increases speed and connectivity) which makes end-users of the product better-off.[24] In other words, there are no conceptual reasons to treat these types of procompetitive effects differently in an economic analysis of competitive effects.

Despite the placement of the repositioning discussion in the 2023 Merger Guidelines and our interpretation of the cognizability criteria for efficiencies, nothing in the current language of Section 3.3 explicitly limits the criteria to be applied only to cost-reducing efficiencies. As the Agencies apply the updated guidance, their intent will become more apparent.

21 We are indebted to Taylor Owings and other panelists (David Berger, Beatriz Marques, Noah Phillips, and Craig Malam) who first discussed this hypothetical example on the ABA webinar "Mergers that Create a Better Workplace? Some Practical Considerations Raised by Guideline 10 of the 2023 Merger Guidelines Addressing Potential Impacts on Workers" held on March 8, 2024.

22 Similar tradeoffs will have to be assessed between the procompetitive effect of merger-induced innovation and any worsening of terms it may have on labor markets (e.g. if the innovation facilitates cost-saving substitution of labor for capital).

23 2023 Merger Guidelines, p. 33. For cost-reducing efficiencies to benefit others than the merging firm, the combined firm has to pass through the reduction in cost into lower prices. Quality improvements after a merger typically occur organically; the question of pass-through is much less relevant than for cost-reducing efficiencies.

24 Note that improvements in product quality or selection might be driven by marginal cost reductions, in that the lower marginal cost of the combined firm makes this repositioning profitable.

VI. CONCLUSIONS

The 2023 Merger Guidelines are a substantial rewrite of previous guidance that combines criteria for all types of mergers in the same document and contains novel theories of harm, including an increased focus on labor markets. In this article, we discuss how these broad-brush aspects of the new guidelines are reflected in the updates to the guidance for procompetitive effects of horizontal mergers. In particular, we highlight the Agencies' new focus on anticompetitive harm to trading partners in the procompetitiveness condition for cognizability. We think that the changes in language for that condition and its interpretation will create new challenges and opportunities in merger review in the future. Lastly, we discuss how cost reductions and quality improvements seem to be treated differently in the 2023 Merger Guidelines.

Our overview is based on the new guidelines as written. The open questions we point out in this article will start to be resolved as the Agencies challenge and evaluate mergers under the 2023 Merger Guidelines.

CPI COMPETITION POLICY® INTERNATIONAL

CPI Subscriptions

CPI reaches more than 35,000 readers in over 150 countries every day. Our online library houses over 23,000 papers, articles and interviews.

Visit competitionpolicyinternational.com today to see our available plans and join CPI's global community of antitrust experts.