

COST-BENEFIT ANALYSIS WITHOUT THE BENEFITS OR THE ANALYSIS:  
HOW NOT TO DRAFT MERGER GUIDELINES

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*ABSTRACT:* Previous iterations of the DOJ/FTC Merger Guidelines have articulated a clear, rigorous, and transparent methodology for balancing the pro-competitive benefits of mergers against their anticompetitive costs. By describing agency practice, guidelines facilitate compliance, ensure consistent and reasonable enforcement, increase public understanding and confidence, and promote international cooperation.

But the 2023 Draft Merger Guidelines do not. They go to great lengths to articulate the potential anticompetitive costs of mergers but with no way to gauge “substantiality.” Most significantly, they ignore potential benefits, which eliminates the need for balancing. In other words, the Draft Guidelines provide very little guidance about current practice which adds risk, which deters mergers, which seems to be the point. We offer specific recommendations for Horizontal, Vertical, and Tech Mergers that do a better job differentiating procompetitive mergers from anticompetitive ones.

**KEYWORDS:** Antitrust, Merger Enforcement, Horizontal Mergers, Vertical Mergers, Technology Mergers.

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## Introduction

The wealth-creating engine of capitalism is the movement of assets to higher-valued uses.<sup>1</sup> Our biggest and most valuable assets, and those with the greatest wealth-creating potential are corporations. Antitrust law and practice work to facilitate this movement, while deterring the types of mergers which substantially lessen competition.

In the past, the Federal Trade Commission (FTC) and the Department of Justice (DOJ) have jointly issued guidelines for evaluating mergers that guide agency practice.<sup>2</sup> The guidelines have evolved over time to reflect changes in economic theory, legal doctrine, and the agencies' enforcement experiences. Guidelines tell us what matters, why it matters, and most importantly how much it matters.

By articulating a clear, rigorous, and transparent methodology for distinguishing pro- from anti-competitive mergers, guidelines have encouraged good mergers and deterred bad ones, measured mostly by their effect on consumers, as the different iterations of guidelines provided antitrust enforcers, and potential merging parties, a common framework to evaluate evidence and argue cases.<sup>3</sup> As such, each iteration of the guidelines encouraged a dialog between potential plaintiffs and defendants and between attorneys and economists that moved antitrust law and policy forward to promote competition and innovation.

But the 2023 Draft Merger Guidelines move law and policy backwards. They begin with the premise that the bipartisan consensus of the past forty years has led to a gross under-enforcement of the law, resulting in undue concentration and bad outcomes, measured not by whether consumers were harmed, but rather by whether competitors or others were.

The Draft Guidelines support this premise by citing cherry-picked, older decisions, while ignoring a long body of case law contrary to this view. As such, the Draft Guidelines seem atavistic, yearning for a return to a golden past that does not reflect the modern evolution of the law or economics.<sup>4</sup> Worse, in the new guidelines, economic analysis is relegated to one of four appendices rather than serving as the basis for the legal analysis. By sequestering the economics, legal burden shifting becomes untethered from economics, and incoherent.

We believe that merger enforcement should aggressively target only anticompetitive behavior. The Draft Guidelines have identified a number of scenarios where, under the right facts, a merger may be anticompetitive. However, a set of scenarios is not a substitute for an analytical framework. Without one, we are left wondering how the analysis should be conducted and what the standard is. In sum, the Draft Guidelines do not provide much guidance.

Furthermore, by jettisoning the traditional analytic framework, adopted largely by the courts, the Draft Guidelines also create uncertainty, which deters mergers, regardless of whether they are

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<sup>1</sup> LUKE M. FROEB, BRIAN T. MCCANN, MICHAEL R. WARD, AND MIKE SHOR, *MANAGERIAL ECONOMICS: A PROBLEM-SOLVING APPROACH*, (Sixth Ed. 2023).

<sup>2</sup> DOJ/FTC Draft Merger Guidelines (2023), available at [https://www.justice.gov/d9/2023-07/2023-draft-merger-guidelines\\_0.pdf](https://www.justice.gov/d9/2023-07/2023-draft-merger-guidelines_0.pdf).

<sup>3</sup> Daniel A. Crane, *Rethinking Merger Efficiencies*, 110 MICH L. REV. 347, 352 (2011).

<sup>4</sup> William E. Kovacic & Carl Shapiro, *Antitrust Policy: A Century of Economic and Legal Thinking*, 14 J. ECON. PERSP. 43 (2000).

anti-competitive.<sup>5</sup> Judges will eventually realize that the agencies are both bringing cases against procompetitive mergers, and potentially missing anticompetitive ones, and ignore them. As a result, these Draft Guidelines could, ironically, entrench case law that at times has been too lenient.

There is a better way. Guidelines should continue to recognize that most mergers have no anticompetitive effects and may have efficiency benefits, use economics to determine whether a merger's anticompetitive costs are substantial, and cost-benefit analysis to weigh a merger's costs against its benefits. That the Draft Guidelines do not reflect this rudimentary principle seems like a fatal flaw.

In the subsequent sections, we propose a cost-benefit approach grounded in economic, and more in alignment with current case law and presumptions. As such, it is more likely to succeed in court. We focus on the three areas of merger control: horizontal, vertical, and tech mergers.

## Horizontal Mergers

The overwhelming majority of mergers are benign or pro-competitive, reducing costs or generating some kind of synergy.<sup>6</sup> Only a small number “substantially lessen competition.” Identifying those that do can be done with empirical comparisons, like previous mergers in the same industry, or with economic models that characterize observed competition (calibration) and measure the loss of competition (simulation).

Market delineation combined with concentration thresholds are useful starting points to the analysis. Although different concentration measures are more appropriate in some settings like auctions,<sup>7</sup> the change in the Herfindahl Hirshman Index (HHI) —much more than the level— seems to capture the loss in competition for common models. However, the competitive effects of changes in the HHI depend on the size of the efficiencies, and the aggregate elasticity of consumer demand.<sup>8</sup> Though Nocke and Whinston, wrote their paper as a critique of the high thresholds in the 2010 Guidelines, their results can also be read as criticism of the thresholds in the 2023 Draft Guidelines:

In terms of stringency, our results indicate that if a 3% efficiency gain is a reasonable presumption, then mergers involving a Herfindahl increase over 200 may often lead to consumer harm. ... The [2010] Guidelines may be sufficiently

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<sup>5</sup> D. Daniel Sokol et al., *Antitrust Mergers and Regulatory Uncertainty*, [ ] BUS. LAWYER [ ] (2023 forthcoming); Alice Bonaime et al., *Does Policy Uncertainty Affect Mergers and Acquisitions?*, 129 J. FIN. ECON. 531 (2018).

<sup>6</sup> See, e.g., David L. Meyer, *Merger Enforcement is Alive and Well at the Department of Justice*, U.S. DEP'T OF JUST. (Nov. 15, 2007), <https://www.justice.gov/atr/speech/mergerenforcement-alive-and-well-department-justice> (“We recognize that most mergers are procompetitive, or at least competitively neutral, and we will not interfere with those transactions.”).

<sup>7</sup> Lance Brannman, Luke M. Froeb, *Mergers, Cartels, Set-Asides and Bidding Preferences in Asymmetric Second-price Auctions*, 82 Rev. Econ. & Stats. 283 (2000).

<sup>8</sup> Joseph Farrell & Carl Shapiro, *Antitrust Evaluation of Horizontal Mergers: An Economic Alternative to Market Definition*, B.E. J. THEORETICAL ECON, Jan. 2010, art. 9, 1 (2010). Luke M. Froeb & Gregory J. Werden, *A Robust Test for Consumer Welfare Enhancing Mergers Among Sellers of a Homogeneous Product*, 58 ECON. LETTERS 367 (1998).

protective of consumers, however, if most mergers result in at least a 5% efficiency gain.<sup>9</sup>

The main message of their paper is that concentration thresholds are merely starting points to merger analysis, which is already a globally-recognized standard.<sup>10</sup> To the extent that presumptions are developed, we suggest using the Hypothetical Monopolist paradigm to delineate markets and recognize that the change in HHI matters much more than the level. Simply put, the magnitude of change in HHI that would prevent consumer harm depends on the aggregate elasticity of demand and on the size of the merger synergies. This is a shortcoming that should have been easy to address in any new guidelines. As a screen, we would recommend safe harbor for a change in HHI that is below 200, with the recognition that the economically correct threshold depends on the size of the efficiencies, the elasticity of demand, and the mode of competition (bargaining, bidding, pricing, or quantity).

But this analysis is based on unilateral effects competition. Without a separate section on coordinated effects, which has existed since the 1990s,<sup>11</sup> cases will continue to be framed as “unilateral.” As a result, antitrust merger law will generally ignore the oligopoly problem, which impacts a number of industries.<sup>12</sup>

### **Vertical Mergers:**

In cases where mergers combine substitutes, harm to competition may arise from the internalization of horizontal pricing externalities, which may push prices up. When mergers internalize vertical pricing externalities, the opposite is true. This is satisfied under linear pricing, whether pricing is sequential (in vertical situations) or simultaneous (as in the Cournot's complements case). Consequently, the benefits of the Elimination of Double Marginalization and Cournot complements are mathematically opposite to horizontal effects.<sup>13</sup> It would, therefore, be misguided to treat vertical and horizontal mergers similarly.<sup>14</sup>

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<sup>9</sup> Volker Nocke & Michael D. Whinston, *Concentration Screens for Horizontal Mergers*, 112 AMER. ECON. REV. 1915 (2022).

<sup>10</sup> OECD, Market Concentration, DAF/COMP/WD(2018)46 (2018) at 4-5 (“To form a preliminary assessment of the strength of competition in a given market, competition agencies often rely on market concentration as an imperfect indicator. However, this is done with caution since there is an ambiguous relationship between the structure of a market and the intensity of competition within that market.”).

<sup>11</sup> D. Daniel Sokol & Sean Sullivan, *The Decline of Coordinated Effects and How to Reverse It*, [ ] Fla. L. Rev. [ ] (forthcoming).

<sup>12</sup> D. Daniel Sokol & Sean Sullivan, *Coordinated Effects and the Half-Truth of the Law Enforcement Narrative*, CPI Antitrust Chronicle July 2023, 1, 13 (“As we develop in recent scholarship, the frequency of coordinated effects enforcement has declined — since the early 1990s — by every metric we have used to track it. This decline is evident in the paltry number of coordinated effects cases in recent decades of reported opinions. It is evident in a review of recent survey data on practitioner experiences with merger investigations. And, most impressively, it is evident in what limited transparency data are available on internal agency enforcement practices.”).

<sup>13</sup> Daniel O’Brien, *The Antitrust Treatment of Vertical Restraint: Beyond the Possibility Theorems*, in THE PROS AND CONS OF VERTICAL RESTRAINTS 40, 76 (2008).

<sup>14</sup> Carl Shapiro & Herbert Hovenkamp, *How Will the FTC Evaluate Vertical Mergers?*, ProMarket, Sept. 23, 2021, available at <https://www.promarket.org/2021/09/23/ftc-vertical-mergers-antitrust-shapiro-hovenkamp/> (“we find it very helpful to think of EDM as just one example of a far more general concept: some supply chains are handled more efficiently within a single firm than through contract. An extensive economic literature about vertical integration and “make or buy” decisions teaches us that vertical integration can spur innovation and greatly benefit

There is a similar argument regarding investments in cases of complementary versus substitute investments, although demand shifts may behave differently, potentially causing an over- or under-supply of variety or quality. Once again, it would be highly unwise to make the same assumptions for these two cases.

Empirical studies, more often than not, confirm these effects: integrated firms internalize competition from complements in their decision-making.<sup>15</sup> The resulting benefits occur when market power exists at both levels, and it is a broadly applicable point. While firms may occasionally contract around the issues, and integrated firms may impose harm on competitors, it is the net effect that is important. The evidence does not endorse treating vertical mergers in the same way as horizontal ones.

The European Non-Horizontal Guidelines have pushed the impact of pricing and investment externalities in non-horizontal mergers into the realm of "efficiencies" where they are treated as afterthoughts.<sup>16</sup> The DOJ and FTC followed suit in the since abandoned 2020 Vertical Merger Guidelines.<sup>17</sup> We are now in a situation where benefits from the internalization of pricing and complementary investment externalities are being sidelined as add-on efficiencies, rather than being recognized as integral effects on price or investment. As such, "efficiencies" are often overlooked by the agencies. These efficiencies matter.

We offer an alternative approach. The agencies should embrace "benefits and harms" instead of "efficiencies and harms." This is more than a change in nomenclature: benefits stemming from the internalization of externalities that cause price or investment effects in vertical mergers should not be overlooked—they should be viewed as direct effects, just like price effects in horizontal mergers. Thus, the agencies should incorporate a balance of harm against the benefits of vertical mergers by computing their net effect on consumers.<sup>18</sup>

## Technology Mergers

Nothing is more important than technological innovation. In the late 1950s, Nobel Laureate Robert Solow attributed about seven-eighths of the growth in U.S. GDP to technical progress,<sup>19</sup> and stressed the importance of policies to encourage growth—“Adding a couple of tenths of a percentage point to the growth rate is an achievement that eventually dwarfs in welfare significance any of the standard goals of economic policy,”<sup>20</sup> which includes antitrust.

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consumers, especially when new methods require risky investments and coordination throughout the supply chain.”).

<sup>15</sup> See Laurent Frésard, Gerard Hoberg, & Gordon M Phillips, *Innovation activities and integration through vertical acquisitions*, 33 REV. FIN. STUD. 2937 (2020); Enghin Atalay, Ali Hortaçsu & Chad Syverson, *Vertical Integration and Input Flows*, 104 AM. ECON. REV. 1120, (2014); Jaideep Shenoy, *An Examination of the Efficiency, Foreclosure, and Collusion Rationales for Vertical Takeovers*, 58 MGMT. SCI. 1482 (2012). But see Fernando Luco & Guillermo Marshall, *The Competitive Impact of Vertical Integration by Multiproduct Firms*, 110 AM. ECON. REV. 2041 (2020).

<sup>16</sup> Guidelines on the Assessment of Non-Horizontal Mergers Under the Council Regulation on the Control of Concentrations Between Undertakings § 5, 2008 O.J. (C 265) 6 (2008).

<sup>17</sup> U.S. DEPT OF JUSTICE & FED. TRADE COMM'N, VERTICAL MERGER GUIDELINES (2020).

<sup>18</sup> Fed. Trade Comm'n v. Microsoft Corp., No. 23-CV-02880-JSC, 2023 WL 4443412 (N.D. Cal. July 10, 2023); United States v. UnitedHealth Grp. Inc., 630 F. Supp. 3d 118, 153 (D.D.C. 2022).

<sup>19</sup> <https://faculty.georgetown.edu/mh5/class/econ489/Solow-Growth-Accounting.pdf>

<sup>20</sup> [https://www.nobelprize.org/nobel\\_prizes/economic-sciences/laureates/1987/solow-lecture.%E2%80%8C.html](https://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/1987/solow-lecture.%E2%80%8C.html)

The antitrust agencies can have a big effect on innovation by reducing the rewards from innovating.<sup>21</sup> In particular, acquisitions of tech firms often create incentives that induce firms to innovate. However, these acquisitions can also eliminate future rivalry. Of course, there will be particular mergers that may threaten innovation, and there may be new antitrust learnings about specific markets that should be incorporated into the guidelines, but the critical issue is to create a system that weighs the pros and cons of mergers. The larger empirical literature suggests that merger and acquisition activities can promote innovation.<sup>22</sup>

However, the Draft Guidelines single out tech acquisitions as a particular problem. The basis for this is a 2021 study, conducted by the FTC that collected data on acquisitions by Google (Alphabet), Apple, Facebook (Meta), Amazon, and Microsoft (collectively, “GAFAM”)<sup>23</sup> for the stated purpose of analyzing the effects of these acquisitions on competition.<sup>24</sup> However, the FTC did not include these data in their report, or an analysis of the potential competitive effects of GAFAM’s acquisitions, ex-ante or retrospectively.

Fortunately, academic research has stepped in to address questions that the FTC did not, including the competitive impact of GAFAM acquisitions in the areas in which these acquisitions occurred. Based on these works, two sets of conclusions were reached. First, acquisitions of technology companies are critical in creating the incentives to innovate—for technology ventures, exits via acquisitions are about five times more likely than IPOs.<sup>25</sup> These exits create an ex-ante incentive to innovate. In addition, investors evaluate regulatory risks as part of their due diligence when considering an investment; excessive regulatory risks, like those posed by uncertain antitrust enforcement, can deter investors from investing, particularly in the early and growth stages of ventures.<sup>26</sup>

Second, evidence suggests that GAFAM’s acquisitions do not necessarily pose anticompetitive risks; rather, they seem to encourage competition. GAFAM acquisitions account for less than 1.5% of tech acquisitions; on a per-firm basis, other firms have matched or exceeded GAFAM in

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<sup>21</sup> <https://www.wsj.com/articles/warren-and-graham-emulate-historys-failed-regulators-innovation-big-tech-firms-1ca2002d>

<sup>22</sup> Jan Bena & Kai Li, *Corporate Innovations and Mergers and Acquisitions*, 69 J. FIN. 1923 (2014); Marianna Makri, Michael A. Hitt & Peter J. Lane, *Complementary Technologies, Knowledge Relatedness, and Invention Outcomes in High Technology Mergers and Acquisitions*, 31 STRATEGIC MGMT. J. 602 (2010).

<sup>23</sup> “Non-HSR Reported Acquisitions by Select Technology Platforms, 2010-2019,” <https://www.ftc.gov/system/files/documents/reports/non-hsr-reported-acquisitions-select-technology-platforms-2010-2019-ftc-study/p201201technologyplatformstudy2021.pdf>. For the 2010-2019 period, the FTC’s study reports the number of GAFAM acquisitions above \$1 million, the frequency of acquisitions, the distribution of the acquisition amounts in dollars, the types of acquisitions, whether they were domestic in nature, some features of their corresponding merger agreements, the target companies’ business areas, and the age distribution of the acquired companies. According to the FTC study, there were 616 acquisitions by GAFAM above \$1 million during 2010-2019, but about two thirds of them were below \$25 million and about 80% were below \$50 million.

<sup>24</sup> At the outset, the FTC had suggested that the study would assess whether the transactions had any impact – positive or negative – on competition. See Federal Trade Commission (Feb 11, 2020), <https://www.ftc.gov/news-events/news/press-releases/2020/02/ftc-examine-past-acquisitions-large-technology-companies> (“The Commission plans to use the information obtained in this study to examine trends in acquisitions and the structure of deals, including whether acquisitions not subject to HSR notification might have raised competitive concerns,” in “FTC to Examine Past Acquisitions by Large Technology Companies.”).

<sup>25</sup> Dan Wang, Emily Cox Pahnke, & Rory M. McDonald, *The Past Is Prologue? Venture-Capital Syndicates’ Collaborative Experience and Start-Up Exits*, 65 ACAD. MGMT. J. [ ] (2022 forthcoming).

<sup>26</sup> Jian Jia, Ginger Zhe Jin, & Liad Wagman, *The Short-Run Effects of the General Data Protection Regulation on Technology Venture Investment*, 40 MKTG. Sci. 661 (2021).

the volume of majority-control acquisitions each year since 2018.<sup>27</sup> In areas where GAFAM acquisitions have occurred, there tends to be an increase in acquisitions by other firms, undermining claims that GAFAM acquisitions deter future competition.<sup>28</sup> GAFAM primarily acquire tech companies in areas beyond their core businesses, and competition both within GAFAM and between GAFAM and other leading technology incumbents has been steadily rising.<sup>29</sup> Finally, investment in an industry increases in the short-term following a GAFAM acquisition in that industry.<sup>30</sup>

Relatedly, the only peer-reviewed case study of a specific high-profile tech acquisition merger finds that Facebook's (Meta's) integration of Instagram led to increased demand by consumers in the photo sharing industry following the merger. The study finds that Facebook's increased role in the photo sharing ecosystem through the acquisition of Instagram ultimately benefited the complementary market by increasing overall foot traffic in the space.<sup>31</sup>

These peer-reviewed empirical findings do not support the suggestion in the Draft Guidelines that these tech acquisitions are likely to harm competition and consumers. Instead, allowing acquisitions of smaller tech companies and ventures by firms with "sufficient size and resources to enter," including potentially minority acquisitions, can better promote investment, innovation and competition than requiring would-be acquirers to develop the technologies in-house.<sup>32</sup> Acquirers with "sufficient size and resources" create the incentives to innovate in the first place – the prospect of acquisition attracts entry and investment.<sup>33</sup> The FTC/DOJ Draft Guidelines seek eliminate this incentive, which may chill new innovation, and harm competition and consumers.

## Conclusion

The new Draft Merger Guidelines are a missed opportunity to effectively guide agency enforcement. Without a coherent merger analysis that embraces both costs and benefits that does not relegate economics to secondary status in an appendix, the Draft Guidelines will likely deter mergers, regardless of whether they are anticompetitive. And if the Draft Guidelines are rejected by the Courts, they may end up entrenching the 2010 Guidelines, which the current agency heads see as too lenient. In close cases where the 2010 Guidelines do need to be updated to reflect new learnings, paradoxically, the lack of integration of new economic knowledge with a set of presumptions divorced from both economics and its application to law will make it harder to win cases that should be deterred.

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<sup>27</sup> Ginger Zhe Jin, Mario Leccese & Liad Wagman, *How Do Top Acquirers Compare in Technology Mergers? New Evidence from an S&P Taxonomy*, [ ] INT'L J. INDUST. ORG. [ ] (2022 forthcoming).

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

<sup>30</sup> See Tiago S. Prado & Johannes M. Bauer, *Big Tech platform acquisitions of start-ups and venture capital funding for innovation*, 59 INFO. ECON. & POL. (2022) (examining approximately 32,000 venture capital investments and 400 tech venture acquisitions by GAFAM firms from 2010 to 2020).

<sup>31</sup> Zhuoxin Li & Ashish Agarwal, *Platform Integration and Demand Spillovers in Complementary Markets: Evidence from Facebook's Integration of Instagram*, 63 MGMT. SCI. 3138 (2016).

<sup>32</sup> See Guideline 4 and its accompanying text in the draft FTC/DOJ merger guidelines, [https://www.justice.gov/d9/2023-07/2023-draft-merger-guidelines\\_0.pdf](https://www.justice.gov/d9/2023-07/2023-draft-merger-guidelines_0.pdf).

<sup>33</sup> Gary Dushnitsky & D. Daniel Sokol, *Mergers, Antitrust, and the Interplay of Entrepreneurial Activity and the Investments That Fund It*, 24 VAND. J. ENT. & TECH. L. 255 (2022).