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Massachusetts Institute of Technology

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C. SCOTT HEMPHILL & NANCY L. ROSE

Mergers that Harm Sellers

ABSTRACT. This Feature examines the antitrust treatment of mergers that harm sellers. We separately consider two mechanisms of harm, increased classical monopsony power and increased bargaining leverage. We show that lost upstream competition is an actionable harm to the competitive process. Our central claim is that harm to sellers in an input market is sufficient to support antitrust liability. We defend this conclusion against the contrary view that demonstrated harm to the merging firms' downstream purchasers or final consumers is an essential element of any antitrust claim. Nor is it necessary for plaintiffs to demonstrate a reduction in the input quantity transacted. We further argue that claimed "efficiencies" premised on a reduction in buy-side competition are not efficiencies at all.

AUTHORS. C. Scott Hemphill is Professor of Law at New York University School of Law; Nancy L. Rose is the Charles P. Kindleberger Professor of Applied Economics at the Massachusetts Institute of Technology. Hemphill is an economic expert witness in an antitrust case alleging harm to sellers. We thank Jonathan Baker, David Balan, Peter Carstensen, Joseph Farrell, Debbie Feinstein, Nicholas Hill, Herbert Hovenkamp, Jonathan Jacobs, Jonathan Jacobson, Doug Melamed, Aviv Nevo, Jonathan Sallet, Fiona Scott Morton, Carl Shapiro, William Stallings, Tim Wu, and Matthew Yglesias for helpful comments and discussions.

INTRODUCTION

In the typical merger case considered by antitrust law, the main concern is that the merging parties—two airlines, say—will be able to raise the prices they charge purchasers. Some mergers, however, reduce competition among competing *buyers*, thereby reducing the prices that sellers receive for their products and services. These adverse "buy-side" effects may harm a wide variety of sellers, including workers selling labor, farmers selling agricultural commodities, and video content producers selling sports programming. For example, a merger of Tyson Foods and Hillshire Farms could enable the merged company to reduce the prices paid to pig farmers for animals used to make sausage.[1]

This Feature examines the antitrust treatment of mergers that harm sellers. Our central claim is that harm to sellers in an input market is sufficient to support antitrust liability. We show how economic reasoning and case law support the conclusion that lost upstream competition is an actionable harm to the competitive process, and we defend this conclusion against the contrary view that demonstrated harm to the merging firms' downstream purchasers or final consumers constitutes an essential element of any antitrust claim. Nor is it necessary for plaintiffs to demonstrate a reduction in the input quantity transacted, contrary to the mistaken view that such a reduction must be shown. We further argue that claimed "efficiencies" premised on a reduction in buy-side competition are not efficiencies at all. We focus on mergers, but much of our argument applies to conduct cases as well.

Some mergers of competing buyers harm sellers by increasing the merged firm's incentive to cut back on its purchases of an important input in order to drive down input prices—a classical exercise of *monopsony power*.[2] A buyer that faces small, interchangeable sellers—for example, a hospital in a small city hiring skilled nurses—has monopsony power that is analogous to a seller's monopoly power. A merger of competing buyers can exacerbate the merged firm's incentive to buy less in order to drive down input prices. Increased monopsony power can have adverse economic effects not only in input markets, but output markets as well.

We argue that although an output market impact is sufficient to support liability, it is not necessary. Courts have recognized antitrust liability even where a

1. *See* Complaint at 3, United States v. Tyson Foods, Inc., No. 14-cv-1474, 2014 WL 4249929 (D.D.C. Aug. 27, 2014) (alleging that the acquisition of a competing buyer would harm competition in the market for "purchase of sows from farmers").

2. As explained further in Section I.A, we use this term to denote what economists would recognize as classical monopsony, in which the buyer chooses an input quantity along a supply curve and the exercise of market power reduces input prices by restricting purchases.

competitive output market suffers no adverse effects.[3] This result is consistent with (and reliant upon) the economically symmetric effects of monopoly in output markets and monopsony in input markets. The symmetric treatment of monopoly and monopsony in antitrust law protects the competitive process and the welfare of the merging firms' trading partners, whether purchasers or sellers.[4] Reduced competition between buyers may well harm downstream purchasers, even where that harm is infeasible to prove, but that reduced competition is unlawful even where *in fact* there is no such harm.

To be sure, courts and commentators often refer to the protection of "consumer welfare," rather than trading partner welfare, as the goal of antitrust law. As we explain, such references are consistent with a trading partner welfare approach, the natural result of living in a world where most cases focus on reduced competition between sellers. Whatever the label applied, an approach focused solely on the welfare of downstream purchasers or final consumers is inconsistent with the case law. We therefore disagree with commentators who would confine antitrust enforcement to conduct with demonstrated output market harms.[5]

Mergers of competing buyers harm sellers alternatively, or in addition, by increasing the new firm's *bargaining leverage*. The analysis of buy-side harms has been focused largely on classical monopsony, with relatively little attention given to bargaining leverage.[6] Though sometimes ignored or lumped together with

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3. *See infra* Section I.B (discussing Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., 549 U.S. 312 (2007); and Mandeville Island Farms, Inc. v. Am. Crystal Sugar Co., 334 U.S. 219 (1948)).

4. *See, e.g.*, *The Consumer Welfare Standard in Antitrust: Outdated, or a Harbor in a Sea of Doubt?: Hearing Before the Subcomm. on Antitrust, Consumer Prot. and Consumer Rights of the S. Comm. on the Judiciary,* 115th Cong. 2 (2017) (opening statement of Carl Shapiro, Professor of Business Strategy, University of California, Berkeley), http://www.judiciary.senate.gov/imo/media/doc/12-13-17%20Shapiro%20Testimony.pdf [http://perma.cc/G8B5-4ET6] (stating that the relevant harm arises when the competitive process is disrupted, thereby "harm[ing] trading parties on the other side of the market") [hereinafter Shapiro Testimony]; Gregory J. Werden, *Monopsony and the Sherman Act: Consumer Welfare in a New Light*, 74 ANTITRUST L.J. 707, 735 (2007) (discussing the Sherman Act's role in protecting trading partner welfare); Marius Schwartz, Professor of Economics, Georgetown University, Should Antitrust Assess Buyer Market Power Differently than Seller Market Power?, Comments at the DOJ/FTC Workshop on Merger Enforcement 1, 4 (Feb. 17, 2004), http://www.justice.gov/sites/default/files/atr/legacy/2007/08/30/202607.pdf [http://perma.cc/7ELL-WPTV].

5. *See infra* Section I.B (discussing and criticizing the view that antitrust law protects purchasers or final consumers, but not sellers).

6. *See, e.g.*, ROGER D. BLAIR & JEFFREY L. HARRISON, MONOPSONY IN LAW AND ECONOMICS (rev. ed. 2010); *cf.* PETER C. CARSTENSEN, COMPETITION POLICY AND THE CONTROL OF BUYER POWER: A GLOBAL ISSUE 13 (2017) ("[M]uch of the exploitation resulting from buyer power was and still is ignored."). By bargaining leverage, we mean the exercise of market power

the exercise of classical monopsony power by litigants and courts, bargaining leverage should be analyzed separately, given its distinct economic effects.

When buyers and sellers each have some market power—for example, a health insurer facing a hospital—prices may be set through a negotiation process. As we explain, economists have developed a rich theoretical and empirical literature to describe this bargaining process and the determinants of its outcomes.[7] These models suggest that the agreed upon price is a function, in part, of each side's ability to inflict an unattractive "outside option" on the other if bargaining breaks down. A horizontal merger enables the merging parties to inflict a worse outside option—that is the source of the increased leverage—and thus alter the prices paid. Here, the principal effect of reduced competition may be a wealth transfer, with no necessary immediate effect on quantity transacted.

Courts have found that a merger of sellers that enables such a transfer by reducing competition—for example, a merger of two hospitals that worsens an insurer's outside option—is unlawful.[8] A symmetric injury to the competitive process can arise on the buy side—for example, a merger of two insurers that worsens a hospital's outside option and thereby reduces the price paid. We conclude that such a bargaining-based harm suffered by a hospital or other input provider is equally actionable. We therefore disagree with the position adopted by the Federal Trade Commission (FTC) in several matters, and endorsed by some commentators, that buy-side harms are actionable only if there is a demonstrated reduction in the quantity transacted.[9]

Lower input prices—including lower input prices achieved through increased classical monopsony power or bargaining leverage—can benefit those who purchase from the merged parties if the savings are passed through to purchasers. We therefore consider to what extent lower input prices may offer a cognizable defense to an otherwise anticompetitive merger. For example, an increase in buyer size may result in real resource savings, flowing from lower costs to supply the buyer with certain inputs. The upstream seller may then reduce the price a buyer pays, without any change in buyer leverage or monopsony power. Input price reductions from a merger that reflect real resource savings present a

through price negotiations that may use the *threat* of reduced purchases to lower input prices without necessarily reducing the actual quantity purchased.

7. *See infra* Section II.A (discussing the bargaining literature).

8. *See infra* Section II.A (discussing ProMedica Health System, Inc. v. FTC, 749 F.3d 559 (6th Cir. 2014), and other cases).

9. *See infra* Section II.B. As discussed therein, the FTC's position conflicts with its own enforcement actions against sell-side mergers that increase bargaining leverage, as well as the position taken by the DOJ. Jonathan Sallet has noted this conflict in his recent analysis of the role of buyer power and applicable legal standards in the context of horizontal mergers. Jonathan Sallet, *Buyer Power in Recent Merger Reviews*, ANTITRUST, Fall 2017, at 82.

potential source of efficiencies that counteract the upward pricing pressure in output markets.

By contrast, savings achieved through the exercise of increased classical monopsony power or bargaining leverage are premised on a reduction in competition. Under existing law developed mainly in the analysis of output markets, such "benefits" are not cognizable efficiencies. Such a savings does not count as an antitrust benefit, even if it is passed through to downstream purchasers.

This Feature proceeds in three parts. Part I considers mergers that increase classical monopsony power, concluding that an output market harm is sufficient but not necessary to support antitrust liability. Part II turns to mergers that increase bargaining leverage, arguing that a bargaining-based harm suffered by an upstream seller is actionable, just like a bargaining-based harm suffered by a downstream purchaser. Part III addresses whether and when lower input prices offer a cognizable defense to an otherwise anticompetitive merger. There we explain why lower input prices caused by increased classical monopsony power or bargaining leverage are not a cognizable basis for an efficiency claim.

I. INCREASED CLASSICAL MONOPSONY POWER

A. Input Market Harms

Monopsony is the mirror image of monopoly. The term "monopsony" is sometimes used to refer to a wide range of harms that result from a powerful buyer or a reduction in competition among buyers. We use the term here in its narrower, classical sense—namely, to identify situations in which a firm recognizes that its purchase decisions can change the market price for inputs.[10]

As an initial point of reference, consider a simple monopoly story. The firm has market power in an output market. That is, it recognizes that its decisions affect the selling price. If the firm raises price, its quantity sold falls, but not to zero. Purchasers with high enough willingness to pay still buy the product, while purchasers with lower willingness to pay drop out. By raising the price, the firm

10. The term "monopsony" was coined by Joan Robinson to denote a market with a single buyer. *See* JOAN ROBINSON, THE ECONOMICS OF IMPERFECT COMPETITION 215 (1932). We use monopsony power in that spirit, to include markets with one or a few large buyers, similar to the use of monopoly power in antitrust. This is a narrower construct than often applied in the field of labor economics, for example, where "monopsony" may attach to any deviation from perfectly competitive conditions in labor markets—including search frictions, information asymmetry, and worker immobility—whether related to the number of firms or not. *See, e.g.*, *Labor Market Monopsony: Trends, Consequences, and Policy Responses*, COUNCIL ECON. ADVISERS (Oct. 2016), http://obamawhitehouse.archives.gov/sites/default/files/page/files/20161025_monopsony_labor_mrkt_cea.pdf [http://perma.cc/EF7Z-YEKB] [hereinafter CEA Report].

charges a higher price on all units, which raises overall profits as long as the increased margin on retained sales more than compensates for the profit lost on the sales no longer made. Part of the purchaser loss takes the form of revenue transferred to the firm as extra profit. Additional loss takes the form of "deadweight loss," wherein some purchasers who value the good more than its marginal cost of production are deflected instead to less desirable alternatives.

Now consider monopsony. The firm has market power in an *input* market, such as the labor it hires to make a product. The firm recognizes that its decisions affect the purchase price of the input. If the firm *reduces* the price it pays, the quantity available for *purchase* falls, but not to zero. In the labor context, workers with a low enough reservation wage still accept a job offer; workers with a higher reservation wage drop out. By reducing its wage offer, the firm pays a lower wage for all employees, which can raise its overall profits.

Part of the workers' loss takes the form of wages transferred to the firm as extra profit. Additional deadweight loss arises as workers whose greatest productivity is working for the firm are instead pushed to less productive employment or out of the labor market entirely.[11] The exercise of monopsony power in hiring skilled labor, such as nurses, may lead to further economic losses over time, as some workers choose not to invest in skill acquisition due to the lower wage rate.[12] When the inputs are produced by upstream firms, such as farmers raising beef cattle to be sold to meat processing companies, the further dynamic costs of monopsony may include reductions in investment by upstream firms in capacity, innovation, product quality, or other important input attributes.[13] While dynamic effects such as these will depend on the particular facts and circumstances of a given market, and likely are difficult to quantify empirically, innovation costs of reduced competition among buyers have the potential to dwarf static or short-run costs.[14]

Underlying these effects is the important assumption that a buyer faces atomistic and interchangeable sellers. Under these conditions, there is a competitive supply curve, yielding a single market-clearing price for a given quantity of an input. If that supply curve is upward sloping—higher input prices call forth more of that input, while lower input prices reduce the quantity supplied—buyers with market power recognize that if they purchase more, they pay not only the higher market clearing price for those incremental units, but higher prices

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11. For a detailed treatment of monopsony, see BLAIR & HARRISON, *supra* note 6, at 41-45; B. DOUGLAS BERNHEIM & MICHAEL D. WHINSTON, MICROECONOMICS 610-14 (rev. ed. 2014).

12. *See, e.g.*, Roger G. Noll, *"Buyer Power" and Economic Policy*, 72 ANTITRUST L.J. 589, 601 (2005).

13. *See, e.g.*, ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, MONOPSONY AND BUYER POWER 53-54 (2009) [hereinafter OECD Report] (summarizing economic models in which reduced compensation to sellers can lower the incentive to invest).

14. *See* Noll, *supra* note 12.

on all the previously purchased units. The marginal cost of hiring additional labor is not only the compensation paid to the additional workers, but also additional payments to all the other workers at the resulting higher market wage.[15] Thus, even as a labor market monopsonist pushes the market wage down, it perceives a marginal cost of labor that is higher than that wage.

Monopsony is a frequent concern in labor and agricultural markets. A typical example is a company town located next to an isolated coal mine.[16] The mine sets a low wage without worrying, at least in the short run, about losing too many employees. Another classic example is the only grain elevator or chicken processor for many miles around. Of course, in practice, degrees of market power exist, just as with market power in output markets. We use the term "monopsony" to encompass the full range, including settings with multiple buyers (so-called oligopsony).

As with lawfully acquired monopoly power, antitrust law does not prohibit the exercise of lawfully acquired monopsony power, despite its economic costs. Yet antitrust problems do arise when buyers *increase* their monopsony power by combining forces. Agreements by competing buyers, especially of labor, have attracted enforcement attention. For example, the Department of Justice (DOJ) has challenged a hospital association's coordinated purchase of so-called "per diem" nursing services,[17] as well as agreements between leading technology firms not to "poach" each other's employees, resulting in orders prohibiting both practices.[18] In 2016, the DOJ and the FTC announced an intention to criminally investigate employer agreements not to hire each other's employees or to fix

15. *See* BERNHEIM & WHINSTON, *supra* note 11, at 611. In other input markets, sellers are not "anonymous," and prices for their inputs are instead set through a process that recognizes their particular value of transacting with the buyer. If sellers are small or atomistic, this may take the form of price discrimination in which buyers implicitly or explicitly group sellers into categories. Group-specific prices may each be set through a monopsony process, like that described above. These often are described as posted price processes, and the analysis is similar.

16. *See, e.g.*, Orley C. Ashenfelter et al., *Labor Market Monopsony*, 28 J. LABOR ECON. 203, 204 (2010); CEA Report, *supra* note 10, at 3.

17. Final Judgment, United States v. Arizona Hospital and Healthcare Ass'n, 2007-2 Trade Cas. (CCH) ¶ 75,869, 2007 WL 9431423 (D. Ariz. 2007) (describing DOJ's allegation that collusive conduct reduced competition in the market for "hospitals' purchases of per diem nursing services").

18. Final Judgment, United States v. Adobe Systems, Inc., No. 10-cv-01629 (D.D.C. Mar. 18, 2011); United States v. Lucasfilm, Inc., No. 10-02220, 2011 WL 2636850 (D.D.C. June 3, 2011) (order approving proposed final judgment). *See also* Competitive Impact Statement at 3-8, United States v. Knorr-Bremse AG, No. 18-cv-00747 (D.D.C. Apr. 3, 2018) (describing alleged no-poaching agreements between leading suppliers of specialized rail equipment).

wages or terms of employment.[19] Outside the realm of government enforcement, private cases have challenged no-poach deals and other horizontal agreements to suppress upstream wages.[20] A notable example is the series of cases challenging NCAA rules that place a ceiling on the wages of coaches[21] and student-athletes.[22] The DOJ, FTC, and private plaintiffs also have challenged buy-side cartels in agricultural markets.[23]

The DOJ also has challenged mergers that threatened to increase monopsony power, frequently among competing buyers of agricultural products including

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19. *See Antitrust Guidance for Human Resources Professionals*, U.S. DEP'T OF JUSTICE & FTC (Oct. 2016), http://www.justice.gov/atr/file/903511/download [http://perma.cc/UH2J-KXXY]. This guidance was reaffirmed in 2017. *Acting Assistant Attorney General Andrew Finch Delivers Remarks at Global Antitrust Enforcement Symposium*, U.S. DEP'T OF JUSTICE (Sept. 12, 2017), http://www.justice.gov/opa/speech/acting-assistant-attorney-general-andrew-finch-delivers-remarks-global-antitrust [http://perma.cc/9V33-YZD8].

20. *See* Amended Complaint, *In re* High-Tech Emp. Antitrust Litig., No. 11-cv-2509 (N.D. Cal. Sept. 13, 2011).

21. *See* Law v. NCAA, 134 F.3d 1010, 1024 (10th Cir. 1998) (condemning an NCAA rule that placed a limit on basketball coach earnings).

22. The rules capped scholarships at a level several thousand dollars below the full cost of attendance and prohibited additional cash compensation. O'Bannon v. NCAA, 802 F.3d 1049, 1054 (9th Cir. 2015). Reflecting the unusual facts of the case, a swap of the university's services for the student's labor, the district court understood the case alternatively as a conspiracy to sell educational services at a high price (an ordinary monopoly story) and as a conspiracy to purchase student labor at a low price (a monopsony story). *Id.* at 1057-58.

23. *See, e.g.*, Mandeville Island Farms, Inc. v. Am. Crystal Sugar Co., 334 U.S. 219 (1948) (challenging a cartel of sugar beet buyers); Knevelbaard Dairies v. Kraft Foods, Inc., 232 F.3d 979 (9th Cir. 2000) (challenging a cartel of milk buyers under state law in accordance with Sherman Act principles); Nat'l Macaroni Mfrs. Ass'n v. FTC, 345 F.2d 421, 427 (7th Cir. 1965) (challenging a cartel of durum wheat buyers); Indictment, United States v. Wilmot, No. 97CR213 (D. Neb. Dec. 17, 1997) (challenging bid-rigging in the procurement of cattle). Agency enforcement against buy-side cartels extends to bid-rigging that is not well described as an exercise of classical monopsony power. *See, e.g.*, OECD Report, *supra* note 13, at 247 (submission of United States) (describing extensive criminal prosecutions against buyer cartels, particularly as to real estate foreclosure auctions); John Asker, *A Study of the Internal Organization of a Bidding Cartel*, 100 AM. ECON. REV. 724 (2010) (describing a bidding ring of stamp dealers).

beef buyers,[24] pig buyers,[25] organic milk buyers,[26] chicken processors,[27] grain traders,[28] and rice millers.[29] Beyond agricultural markets, the DOJ has challenged health insurer mergers on the ground that they would, among other effects, suppress the amount paid to physicians and other health care providers.[30]

In merger analysis of downstream impact, agencies rarely are concerned with either monopoly or perfectly competitive downstream markets. Similarly, monopsony concerns are most likely to arise when a merger combines rival purchasers in a concentrated input market. The reduction in competition from a merger between two product market competitors can create upward pricing pressure in the product market, by enabling each firm to recapture profits from the sales lost to its merger partner when it raises its own product price.[31] In a mirror image, a merger between two *input* market competitors can manifest its competitive harm through downward pricing pressure on input prices.[32]

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24. Amended Complaint at 4, United States v. JBS S.A., No. 08-CV-5992 (N.D. Ill. Nov. 7, 2008) (alleging that the acquisition of a competing beef packer would harm competition in the market for "purchase [of] fed cattle").

25. Complaint at 3, United States v. Tyson Foods, Inc., No. 14-cv-1474, 2014 WL 4249929 (D.D.C. Aug. 27, 2014) (alleging that the acquisition of a competing buyer would harm competition in the market for "purchase of sows from farmers"; case was later settled).

26. Competitive Impact Statement, United States v. Danone S.A., 2017-2 Trade Cas. (CCH) ¶ 80,053, 2017 WL 3172888, at 6-7 (D.D.C. Apr. 3, 2017) (describing a DOJ allegation that the acquisition of a raw organic milk processor would reduce competition in, *inter alia*, "the purchase of raw organic milk from farmers" in the northeast United States).

27. Complaint at 7, United States v. George's Foods, LLC, No. 11CV00043 (W.D. Va. May 10, 2011), 2011 WL 2445076 (alleging that the acquisition of a competing chicken processor would harm competition in the market for "purchase of broiler grower services"; the case settled).

28. United States v. Cargill, Inc., No. 99CV01875, 2000 WL 1475752, at *1 (D.D.C. June 30, 2000) (granting final judgment in the settlement of a DOJ suit alleging that the acquisition of a competing grain trader would harm competition in "grain purchasing services").

29. United States v. Rice Growers Ass'n of Cal., No. S-84-1066, 1986 WL 12562, at *4 (E.D. Cal. 1986) (agreeing with DOJ's allegation that acquisition of a competing rice miller would harm competition in the market for "purchase or other acquisition for milling of paddy rice grown in California").

30. Revised Competitive Impact Statement, United States v. Aetna Inc., No. 3-99CV1398-H, 1999 WL 1419046, at *15 (N.D. Tex. Dec. 7, 1999) (describing DOJ's allegation that "Aetna's acquisition of Prudential will also consolidate its purchasing power over physicians' services in Houston and Dallas, enabling the merged entity to unduly reduce the rates paid for those services").

31. *See, e.g.*, Joseph Farrell & Carl Shapiro, *Antitrust Evaluation of Horizontal Mergers: An Economic Alternative to Market Definition*, B.E. J. OF THEORETICAL ECON., Article 9 (2010) (defining and discussing upward pricing pressure).

32. In addition to these unilateral effects between close substitute buyers, in principle there may be coordinated effects as well. *See, e.g.*, Antitrust Div., *Statement of the Department of Justice's*

The parties to a merger or agreement that increases monopsony power are often also competitors in output markets. This is not a necessary condition; a merger between a mine and a sawmill—or a wage suppressive agreement between Pixar and Apple[33]—can harm competition in the hiring of employees without affecting output market competition. But where the merging firms also compete in product markets, lost competition downstream poses a second competitive threat.[34] In such cases, an antitrust challenge usually focuses on the loss of competition in output markets, and the claim of lost buy-side competition may never be raised or adjudicated.[35] These litigation decisions by parties and courts have resulted in a dearth of buy-side case law, despite the frequent presence of upstream harm.

B. Output Market Harms: Sufficient, But Not Necessary

Output markets are relevant to increased monopsony power in a second, entirely distinct way. The effects of increased monopsony power may be felt in output markets. When a monopsonist reduces input purchases, it generally makes further adjustments, such as increasing its purchase of other inputs (e.g., substituting machinery for labor) and reducing the quantity or quality of its output (e.g., less coal from the mine, or lower patient staffing ratios at hospitals). If the firm also has market power in the output market, the reduced output has an additional adverse effect. The cutback in output raises product prices and produces additional deadweight loss.[36]

As long as there is an adverse effect in an output market, condemnation as a violation of antitrust law is straightforward. The harder question arises if the adverse effects of increased monopsony power appear to be observed *entirely in input markets*. Some cases turn on this point. For example, if the firm sells in a

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Antitrust Division on Its Decision To Close Its Investigation of Perdue's Acquisition of Coleman Natural Foods, U.S. DEP'T OF JUSTICE (May 2, 2011), http://www.justice.gov/opa/pr/statement-department-justice-s-antitrust-division-its-decision-close-its-investigation-perdue [http://perma.cc/25FV-GN4A] [hereinafter DOJ Perdue Closing Statement] (noting the potential threat of increased coordination in the purchase of inputs, but concluding that the transaction at issue did not pose this harm).

33. *See* Complaint at 4, United States v. Adobe Sys., Inc., No. 10-cv-01629 (D.D.C. Sept. 24, 2010) (alleging an agreement between Apple and Pixar not to recruit each other's employees through cold calls).

34. In buy-side agreement cases, the agreeing firms may well be competitors in output markets, but the agreement typically does not regulate outputs (though, as discussed below, there might be an effect on output markets).

35. *See* CARSTENSEN, *supra* note 6, at 141 (noting the relative lack of attention to buy-side issues).

36. There is a seldom discussed symmetric effect with monopoly. When a monopolist reduces output, it cuts back on inputs, which may have a harmful effect in input markets.

highly competitive product market, its cutback in output may not appear to raise downstream prices, and the economic harm may seem isolated to sellers and to allocative efficiency losses in the upstream market.[37] However, numerous cases are premised on input market effects alone,[38] particularly when output market harms may be comparatively difficult to measure or demonstrate. Nor is the question limited to monopsony. In the bargaining leverage context discussed in Part II, immediate harm to the output market may be attenuated or absent. A further reason to care about identifying input-side harms is that if they are actionable harms, then, as discussed below, they are removed from consideration as sources of efficiency.[39]

If antitrust serves only the welfare of downstream purchasers or final consumers, as some commentators suggest,[40] then a case challenging increased monopsony power with effects observed only in input markets would not be sustained. However, the Supreme Court has taken a different view. Several cases recognize that anticompetitive conduct that affects only input markets violates antitrust law. For example, in *Mandeville Island Farms, Inc. v. American Crystal Sugar Co.*, the Court considered a buyer cartel, stating that "[i]t is clear that the agreement is the sort of combination condemned by the Act, even though the price-fixing was by purchasers, and the persons specially injured under the treble

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37. Another example arises where the monopsonized input is a component of the firm's fixed costs, and therefore does not affect its output decision. For an argument that effects are unlikely to be confined to the monopsonized input market, however, see Noll, *supra* note 12, at 599-600 & nn.24-25 ("When lower-productivity suppliers displace higher-productivity suppliers [due to monopsony restriction of input purchases], more resources are used to produce the final good than would have been used in the absence of monopsony. If these additional resources have productive use anywhere else in the economy, the net result of the monopsony is to raise the real price of the final product and to reduce the value of total output to consumers."). Monopsony also may reduce welfare by worsening input quality. *See id.* at 601 (discussing a health care monopsony: "[I]f physicians must make continuing investments in human capital to keep their skills current, monopsony will reduce their incentive to do so and, as a result, quality-adjusted supply will decline.").

38. See, for example, the *Cargill* and *George's Foods* cases cited *supra*, and the *Weyerhaeuser* case discussed *infra*. *See also* DOJ Perdue Closing Statement, *supra* note 32 (discussing DOJ investigation of combination of chicken processors, limited to effect on input markets); Marius Schwartz, Econ. Dir. of Enf't, Antitrust Div., U.S. Dep't of Justice, Buyer Power Concerns and the Aetna-Prudential Merger, Address at Fifth Annual Health Care Antitrust Forum, 7-8 (Oct. 20, 1999), http://www.justice.gov/atr/speech/buyer-power-concerns-and-aetna-prudential-merger [http://perma.cc/5NFG-9TEY] (discussing the absence of an output harm allegation in *Cargill*, given that output price for grain is "determined in world markets"). However, as discussed *supra* note 37 and accompanying text, even in such cases the general equilibrium effect involves some output market harm, albeit one that may be difficult to measure.

39. *See infra* Part III.

40. *See, e.g.*, Steven C. Salop, *Question: What Is the Real and Proper Antitrust Welfare Standard? Answer: The True Consumer Welfare Standard*, 22 LOY. CONSUMER L. REV. 336 (2010).

damage claim are sellers, not customers or consumers."[41] As the Tenth Circuit has recognized, "[t]he Supreme Court's treatment of monopsony cases strongly suggests that suppliers . . . are protected by antitrust laws even when the anti-competitive activity does not harm end-users."[42]

The point is made even more clearly in *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, in which the Court considered predatory purchasing by an alleged monopsonist.[43] The Court heavily emphasized the parallel nature of monopoly and monopsony conduct as an economic and—the Court concluded—legal matter. The Court recognized that conduct directed to input markets might—but not always—also affect competition in output markets, and the Court was at pains *not* to rely on such an effect.[44] It expressly presumed that there was no output market effect in the case at hand, and repeatedly noted that the adverse effects here would be felt only in input markets.[45] While *Weyerhaeuser* was a case about predation, not merger or horizontal agreement, the locus of harm is the same. This result echoes the legislative history of the Sherman Act, which reveals an abiding concern with the welfare of workers and sellers of agricultural products, not only purchasers.[46]

Turning to mergers, the Horizontal Merger Guidelines issued jointly by the DOJ and FTC come to the same conclusion. Section 12 explicitly indicates that

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41. 334 U.S. 219, 235 (1948) (footnotes omitted). The Court is not perfectly clear on this point since it also saw an effect in output markets. *Id.* at 241.

42. Telecor Commc'ns, Inc. v. Sw. Bell Tel. Co., 305 F.3d 1124, 1133-34 (10th Cir. 2002).

43. 549 U.S. 312 (2007).

44. *Id.* at 321-24.

45. *Id.* at 324-25 ("Even if output prices remain constant, a predatory bidder can use its power as the predominant buyer of inputs to force down input prices and capture monopsony profits."); *see also id.* at 321 (noting that the case did not "present a risk of significantly increased concentration" in output markets); *id.* at 321 n.2 (noting and distinguishing an alternative setting, not present in *Weyerhaeuser*, in which a "monopsonist could . . . also recoup its losses by raising output prices").

46. *See* Werden, *supra* note 4, at 713-16 (describing this history); Renata Hesse, Acting Assistant Att'y General, And Never the Twain Shall Meet? Connecting Popular and Professional Visions for Antitrust Enforcement, Remarks at 2016 Global Enforcement Symposium (Sep. 20, 2016), http://www.justice.gov/opa/speech/acting-assistant-attorney-general-renata-hesse-antitrust-division-delivers-opening [http://perma.cc/F7RN-KSJN] (relying in part on the Sherman Act's legislative history for the conclusion that "a merger that gives a company the power to depress wages or salaries or to reduce the prices it pays for inputs is illegal whether or not it also gives that company the power to increase prices downstream").

in a merger of buyers, enforcement agencies focus on the harm to sellers.[47] Effects on downstream markets are merely a secondary consideration.[48] To illustrate these points, the Guidelines offer an example in which two buyers merge, and the relevant harm is a wealth transfer from farmers to the merged buyer, without any output effect.[49] This evidence contradicts the erroneous suggestion made by the FTC that section 12 focuses upon or is limited to output-side harm. For example, in a statement closing its investigation of a merger of two pharmacy benefit managers (PBMs), the FTC summarized its analysis as follows:

> The Commission also considered whether the proposed acquisition would confer monopsony power on the merged company when it negotiates dispensing fees with retail pharmacies. As a general matter, transactions that allow firms to reduce the costs of input products have a high likelihood of benefitting consumers, since lower costs create incentives to lower prices. Only in special circumstances does an increase in power in negotiating input prices adversely impact consumers. See Merger Guidelines § 12. The Commission examined this concern closely but found that the proposed transaction was unlikely to create or enhance monopsony power.[50]

The closing statement gives the erroneous impression that section 12 is focused on harm to downstream purchasers or final consumers. Commentators have been similarly led astray.[51] In fact, the Guidelines support the opposite conclusion that the proper focus is harm to sellers.

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47. U.S. DEP'T OF JUST. & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES § 12, at 32-33 (2010), http://www.ftc.gov/sites/default/files/attachments/merger-review/100819hmg.pdf [http://perma.cc/G8AZ-EX9K] [hereinafter HORIZONTAL MERGER GUIDELINES] (stating that when suppliers have few alternatives to merging buyers, "the Agencies may conclude that the merger of competing buyers is likely to lessen competition in a manner harmful to sellers").

48. *Id.* at 33 ("Nor do the Agencies evaluate the competitive effects of mergers between competing buyers strictly, or even primarily, on the basis of effects in the downstream markets in which the merging firms sell.").

49. *Id.* (Example 24); *see also* Peter Carstensen, *Buyer Power and the Horizontal Merger Guidelines: Minor Progress on an Important Issue*, 14 U. PA. J. BUS. L. 775, 780 (2012) (emphasizing this aspect of the Guidelines).

50. Statement of the Federal Trade Commission Concerning the Proposed Acquisition of Medco Health Solutions by Express Scripts, Inc., FTC File No. 111-0210, at 7 (Apr. 2, 2012), http://www.ftc.gov/sites/default/files/documents/closing_letters/proposed-acquisition-medco-health-solutions-inc.express-scripts-inc./120402expressmedcostatement.pdf [http://perma.cc/2Q7P-S5Z3] [hereinafter FTC *Express Scripts* Closing Statement]. We discuss this closing statement in greater detail in Section II.B.

51. *See, e.g.*, Rani Habash & John Scalf, *An Inside Look at Monopsony Issues in the FTC's Express Scripts-Medco Merger Investigation*, ANTITRUST HEALTH CARE CHRONICLE, Sept. 2012, at 24, 25

Overall, this evidence challenges the view that antitrust law is solely concerned with the welfare of downstream purchasers or final consumers.[52] The evidence is more consistent with the view that antitrust law protects the competitive process,[53] in service of preserving the welfare of the merging parties' trading partners, whether buyers or sellers. Indeed, when courts and commentators refer to "consumer welfare," often they really mean the welfare of trading partners.[54] Such invocations of "consumer welfare" are the natural result of living in a world where the issue in most cases is reduced competition between sellers, and the harmed trading partners are their downstream purchasers. The imprecision of the phrase "consumer welfare" is hardly surprising, as can be seen in the fact that a merger of competing intermediate good providers is actionable, even though the effect is felt in the first instance by purchasing firms, not final consumers.[55]

& n.9 (erroneously citing section 12 for the proposition that "[i]mportantly, however, the agencies stress that mergers resulting in decreased prices paid by the merged firm are not necessarily anticompetitive, but often create procompetitive efficiencies that lower prices for consumers").

52. *See, e.g.*, Werden, *supra* note 4, at 717-19 (concluding that monopsony case outcomes are inconsistent with a sole focus on the welfare of downstream purchasers or final consumers); *see also* Maurice E. Stucke, *Looking at the Monopsony in the Mirror*, 62 EMORY L.J. 1509, 1543-48 (2013) (similar). By contrast, Steve Salop argues that monopsony case outcomes are consistent with an approach that only counts the welfare of final consumers. *See* Salop, *supra* note 40, at 342-43. Salop does not analyze cases such as *Mandeville Island Farms* and *Weyerhaueser*, instead pointing to *Kartell v. Blue Shield of Mass., Inc.*, 749 F.2d 922 (1st Cir. 1984) (Breyer, J.). *Kartell* denied liability for an insurer's agreements to prevent "balance billing." Although sometimes invoked as a buy-side cartel case, read in context, the *Kartell* court appeared to view the arrangement—an insurer purchasing care on behalf of its customers—as a mere exercise of market power, rather than a buy-side horizontal restraint. *Id.*

53. *See, e.g.*, United States v. Microsoft Corp., 253 F.3d 34, 58-59 (D.C. Cir. 2001) (en banc) (per curiam) (defining anticompetitive effect in terms of "harm [to] the competitive process"); Town of Concord v. Bos. Edison Co., 915 F.2d 17, 21 (1st Cir. 1990) (Breyer, J.) ("[A] practice is 'anticompetitive' only if it harms the competitive process."); Clamp-All Corp. v. Cast Iron Soil Pipe Inst., 851 F.2d 478, 486 (1st Cir. 1988) (Breyer, J.) (similar); Morrison v. Murray Biscuit Co., 797 F.2d 1430, 1437 (7th Cir. 1986) (Posner, J.) ("The purpose of antitrust law, at least as articulated in the modern cases, is to protect the competitive process as a means of promoting economic efficiency.").

54. *See* Schwartz, *supra* note 4, at 2 (interpreting the oft-cited principle that "antitrust protects consumers not competitors" as a "metaphor" for recognizing harm to "trading partners," not only final consumers, and concluding that "[a] merger that increases market power and enables the merged firm to impose worse terms on its trading partners is equally objectionable if the trading partners in question are suppliers to, or buyers from, that firm"); Shapiro Testimony, *supra* note 4 (stating that "consumer welfare," properly understood, includes sellers harmed by lost competition between buyers).

55. *See, e.g.*, FTC v. Staples, Inc., 190 F. Supp. 3d 100 (D.D.C. 2016) (blocking a merger of office supply companies due to reduced competition in the market for the sale and distribution of consumable office supplies to large businesses buying for their own use); FTC v. Sysco Corp.,

Nor does the embrace of trading partner welfare imply embrace of a total welfare standard, even though both of them credit the effect on firms to some degree.[56] The weakness of a total welfare test is not the inclusion of a firm in the welfare maximand, but rather the inclusion of the welfare of the firm or firms causing the reduction in competition. Attention to trading partner welfare does not have this problem.

The normative basis for a trading partner welfare approach may be briefly stated. When a merger suppresses competition between rivals for a seller's business, ordinarily we may expect, in addition to the harm to workers or other sellers, inefficiency and consumer harm. For example, the exercise of increased classical monopsony power usually has an adverse effect on downstream purchasers, even where that effect is not directly measured. To be sure, in a particular case it may be possible to argue that the merger is actually harmless or even beneficial. The trading partner welfare perspective reflects an implicit judgment that a fine-grained search for case-specific exceptions carries an unacceptable risk of false negatives.

Such shortcuts are common. Antitrust law does not give cartel defendants license to show that their particular cartel is actually beneficial. In a merger of sellers, courts do not require the plaintiff to trace the merger's price effects through multiple levels of production to measure the impact on final consumers; nor is case law sympathetic to a defense that the merger would improve welfare by raising downstream prices that have been inefficiently suppressed by monopsony. Instead, courts appropriately accept harm to downstream purchasers as evidence of impairment to competition. The same is true when the harm is upstream. In this way, a trading partner welfare approach dismisses, as hubris, the attempt to trace out and weigh every effect of the merger.

Overall, then, a trading partner welfare approach accords well with the case law and economic reasoning, and under this approach, a merger that results in increased classical monopsony power may be condemned on account of harm to the input market.

2015-1 Trade Cas. (CCH) ¶79,221, 2015 WL 8856221 (D.D.C. 2015) (blocking a merger of competing distributors of food to restaurants and other businesses).

56. The same can be said of a "consumer welfare" standard that, in intermediate goods cases, counts the welfare of the purchasing firms. The fact that such a standard takes account of the welfare of (some) firms does not imply embrace of a total welfare approach.

II. INCREASED BARGAINING LEVERAGE

A. *Increased Leverage by Sellers*

Some exercises of buyer power do not fit the classical monopsony model in which large buyers face atomistic sellers with no market power. Instead, transactions are mediated through bilateral bargaining between differentiated buyers and sellers. Here, the key monopsony distortion—withholding purchases of the input to move along an input supply curve—may be absent. But anticompetitive effects may nonetheless arise.

It is common in such settings for the upstream and downstream firms to negotiate over whether the upstream firm's products are included in a bundle of inputs offered for sale by the downstream firm, and the economic terms—such as prices, quantities, transfer payments, and contractual restraints—that are associated with making those upstream products available to customers of the downstream firm. Economic models of these negotiations,[57] generally based on the concept of *Nash bargaining*, suppose that parties bargain over the division of surplus, or value, from reaching an agreement. The bargaining outcome is influenced by two factors. First is relative *bargaining power*, which determines the fraction of the surplus from agreement that each party captures. It is common to assume that surplus is split in half, but the actual division will depend on, *inter alia*, relative bargaining proficiency and patience, and any split between 0% and 100% is possible. This is independent of the second factor, *bargaining leverage*, which affects the magnitude of the surplus, and derives from each party's outside option, or walk-away value.[58] The potential anticompetitive effect of a merger

57. The seminal paper is John F. Nash, Jr., *The Bargaining Problem*, 18 ECONOMETRICA 155 (1950); important later work includes Henrick Horn & Asher Wolinsky, *Bilateral Monopolies and Incentives for Mergers*, 19 RAND J. ECON. 408 (1988). For applications to health care, see Gautam Gowrisankaran et al., *Mergers When Prices Are Negotiated: Evidence from the Hospital Mergers*, 105 AM. ECON. REV. 172 (2015); Matthew Grennan, *Price Discrimination and Price Bargaining, Empirical Evidence from Medical Devices*, 103 AM. ECON. REV. 145 (2013); and Kate Ho & Robin S. Lee, *Insurer Competition in Health Care Markets*, 85 ECONOMETRICA 379 (2017). Hospitals provided an early application of bargaining models to empirical merger analysis by the FTC and DOJ. *See, e.g.*, Cory S. Capps et al., *Antitrust Policy and Hospital Mergers: Recommendations for a New Approach*, 47 ANTITRUST BULL. 677 (2002); Gregory Vistnes, *Hospitals, Mergers, and Two-Stage Competition*, 67 ANTITRUST L.J. 671 (2000).

58. Some commentators and courts use the term "bargaining power" to include what we mean by bargaining leverage. We maintain the distinction to focus attention on the competitive impact of a merger, which is exercised through increased leverage. *See* Aviv Nevo, Deputy Assistant Att'y General, Antitrust Div., U.S. Dep't of Justice, Mergers that Increase Bargaining Leverage, Remarks as Prepared for the Stanford Institute for Economic Policy Research and Cornerstone Research Conference on Antitrust in Highly Innovative Industries (Jan. 22, 2014).

derives from the latter: by depressing the walk-away value to firms opposite the merging parties, a merger can enable the parties to increase their profits at the expense of those against whom they negotiate.

For a concrete example, consider the health insurance market. Each insurer negotiates with a set of upstream hospitals over inclusion in the insurer's network and the prices of hospital services provided to the insurer's customers, among other terms. If insurers' customers value broad provider networks, and hospitals value access to large groups of potential patients, each insurer may have an interest in reaching agreements to include every hospital in the insurer's network, and vice versa.

To understand this dynamic, we begin with a merger of sellers—here, hospitals—before turning to a merger of buyers (insurers). For example, in 2010, the FTC considered a merger of two of the four hospital providers in Lucas County, Ohio.[59] From an insurer's perspective, each hospital in Lucas County represents an alternative way to provide health care access to its customers.[60] Its *surplus* from a particular hospital contract is the difference between the insurer's plan value without that hospital in its network (the insurer's walk away value) and its value with the agreement to provide access to that hospital to its insured population at the agreed upon service prices.

There is a direct connection between the shape of an insurer's value function and the competition between hospitals for inclusion in its network.[61] Suppose each additional in-network hospital bed provides exactly the same incremental value to an insurer—a linear value function. Negotiations would split the surplus, say in half, and we would expect no better *per bed* terms for larger hospitals than for smaller ones. In this case, hospitals are not competitive substitutes for the insurer—the insurer's value of each hospital with (say) 500 beds is the same whether or not other hospitals are in the insurer's network. A merger of two hospitals proportionally scales total surplus and would not change the negotiated per bed split. If, instead, the incremental value to the insurer of access to hospital beds is diminishing—each additional bed added to the network has slightly less value than the one before—we would describe the value function as *concave*. And empirical evidence suggests that the insurer's value function is typically concave.[62] The consequence of concavity is that we expect larger hospitals

59. ProMedica Health Sys., Inc. v. FTC, 749 F.3d 559 (6th Cir. 2014).

60. We use "customers" loosely to include those who directly purchase insurance through individual policies, and those who are insured through employer-sponsored insurance plans.

61. For discussion, see Nevo, *supra* note 58.

62. Concavity extends even to cross-market hospital systems. *See, e.g.*, Cory Capps et al., *Competition and Market Power in Option Demand Markets*, 34 RAND J. ECON. 737 (2003); Gowrisankaran et al., *supra* note 57; Matthew S. Lewis & Kevin E. Pflum, *Hospital Systems and Bargaining Power: Evidence from Out-of-Market Acquisitions,* 48 RAND J. ECON. 579 (2017); Leemore

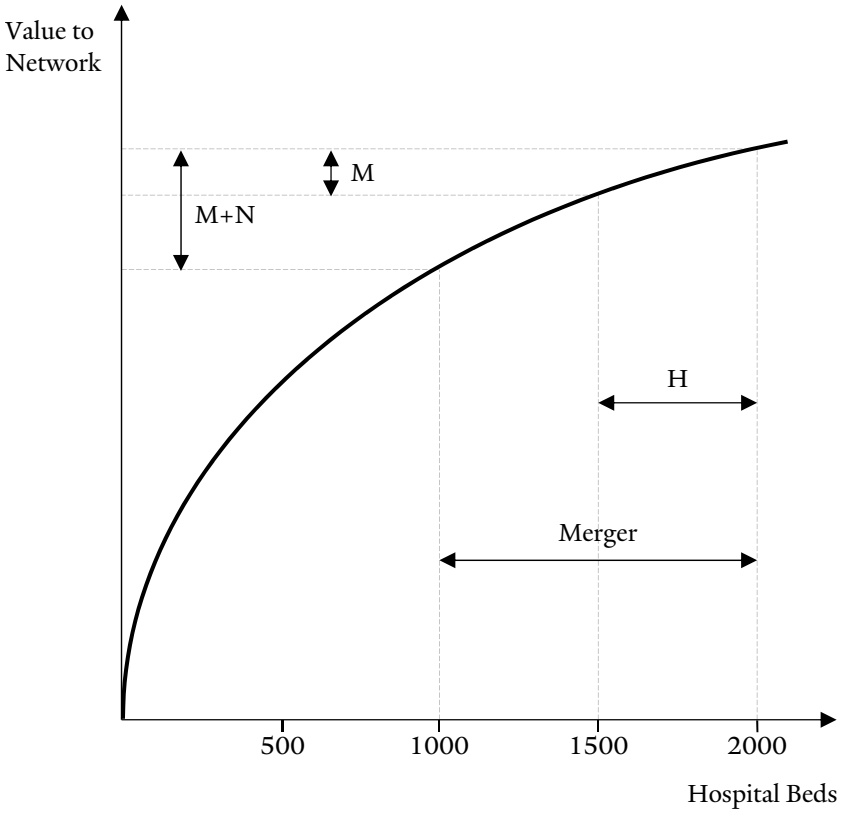
to strike better deals on a per-customer basis, all else equal, reflecting their ability to impose a worse walk-away value on the insurer.[63]

A hypothetical may help illustrate the connection of concavity with competition. Suppose there are four equal-sized hospitals, and an insurer's network is most valuable if it offers access to all four. But an employer's willingness to pay for a plan with more in-network hospitals increases less than proportionately with the number of hospitals—access to the first hospital in network is worth a lot, but the value increments decrease as the number of in-network hospitals expands. The employer is willing to pay almost as much for a plan that includes three of the four hospitals as for one with all four—say, just a few percent less. This concavity is illustrated in Figure 1.

Dafny et al., *The Price Effects of Cross-Market Hospital Mergers* (Nat'l Bureau of Econ. Research Working Paper No. 22106, 2017).

63. Value functions need not be concave, or even linear, and in those markets larger buyers would not exercise greater leverage. *See* Hans-Theo Normann et al., *Do Buyer-Size Discounts Depend on the Curvature of the Surplus Function? Experimental Tests of Bargaining Models*, 38 RAND J. ECON. 747 (2007).

FIGURE 1.
CONCAVE INSURER VALUE FUNCTION



Each hospital, if included, adds 500 beds to the network. Competition is reflected in the high walk-away value for adding the fourth hospital (designated by H) — if the insurer fails to reach an agreement with one hospital, other hospitals provide substitute ways to deliver in-network hospital access to the insurer's customers. So, if the insurer negotiates independently with these four hospitals — as it would under competition — each negotiation is over the difference in the insurer's value between access to three-fourths of hospitals (1,500 beds) and access to all hospitals (2,000 beds) — the surplus at risk in each of those independent negotiations, represented by M in Figure 1.

Now consider a merger between two hospitals, now controlling 1,000 beds. No longer are their negotiations independent. When the insurer negotiates with this hospital, its walk-away value becomes the insurer's value with access to only half of the hospitals (1,000 beds). By eliminating competition between themselves, the merging hospitals force a disagreement outcome on the insurer (the

amount M+N in Figure 1) that is worse than twice the cost of losing a single hospital (the total of 2M in Figure 1), increasing the merged hospital's bargaining leverage and the value it can extract from insurers. In this scenario, the merger harms insurers.

One difference from the classical monopsony setting considered in Part I bears note. The principal immediate effect of increased bargaining leverage may be a transfer between the insurer and the hospital. If the bargaining is "efficient" in an economic sense, there may not be a reduction in quantity or accompanying deadweight loss from the transfer, although that outcome is not inevitable or guaranteed.[64] Thus, a bargaining theory of harm raises the following question: does a transfer suffice, even without any reduction in output? An economist focused on total welfare might naively respond that a "mere" transfer does not affect total welfare. But one cannot assume that an apparently efficient bargain from the standpoint of the two parties necessarily results only in a wealth transfer between the parties. Contracts are likely to be inherently incomplete, providing room for parties to adapt ex post away from the efficient outcome toward their unilateral best response, leading to deadweight loss.[65] For example, firms may reduce investments in maintaining or improving product quality or quantities, as their returns are reduced by their trading partners' bargaining leverage.[66] Or firms may use their leverage to extract contractual terms that further reduce competition by raising rivals' costs or impeding rivals' access to markets.[67]

Moreover, courts do not generally insist that a purchaser, harmed due to reduced competition among the sellers, show not only its own loss in the form of a higher price paid but also a deadweight loss. Recognizing a harm from transfer is also consistent with the ordinary calculation of damages to purchasers, which provides a recovery measured by the overcharge, not deadweight loss.[68]

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64. Efficient bargaining *assumes* that the two sides maximize the total surplus, then negotiate a division, avoiding output reductions and deadweight loss, at least in a static sense.

65. *See, e.g.*, Jonathan B. Baker et al., *Merger To Monopoly to Serve a Single Buyer: Comment*, 75 ANTITRUST L.J. 637, 638-41 (2008); Oliver Hart, *Incomplete Contracts and Control*, 107 AM. ECON. REV. 1731 (2017).

66. *See* Noll, *supra* note 12, at 608-09.

67. In the hospital-insurer context, see, for example, Complaint, United States v. Charlotte-Mecklenburg Hospital Authority, No. 3:16-cv-00311-RJC-DCK (W.D.N.C. June 9, 2016). The complaint alleges that the Carolinas Healthcare System uses its market power to negotiate not only high prices for its services (allowable under the antitrust laws), but also contractual terms, such as prohibitions on insurers steering patients to low-cost providers or providing patients with information on relative costs across providers, to further reduce competition with other health care providers in the market. *Id.* While this case addresses unilateral conduct by the defendant, this mechanism also could generate competitive harm in a merger context.

68. *See* Noll, *supra* note 12, at 612-13.

Increased bargaining leverage is a source of competitive harm. The leading case on this point, *ProMedica Health System, Inc. v. FTC*,[69] arose from the FTC's challenge to the Lucas County hospital merger between ProMedica, the dominant provider in the county, and St. Luke's, a smaller rival.[70] In an opinion affirming an administrative law judge's order of divestiture, the Sixth Circuit offered an unusually clear statement of the bargaining leverage theory. The court explained that larger hospitals have more bargaining leverage over managed care organizations (MCOs), a type of insurer:

> It is harder for an MCO to exclude the county's most dominant hospital system than it is for the MCO to exclude a single hospital that services just one corner of the county—a corner, moreover, that the dominant system also services. And that means the MCOs' walk-away point for the dominant system is higher—perhaps much higher—than it is for the single hospital. Here, the record bears out that conclusion: ProMedica's rates before the merger were among the highest in the State, while St. Luke's rates did not even cover its cost of patient care. That was true even though St. Luke's quality ratings on the whole were better than ProMedica's.[71]

The court observed that while MCOs in the county generally had offered networks that included all four hospital providers, they at times successfully offered networks with only three, including networks that omitted ProMedica,[72] suggesting that no single provider was a "must have." The court concluded that the merger would raise prices by increasing ProMedica's bargaining leverage.[73]

Beyond *ProMedica*, courts have accepted increased bargaining leverage as a theory of harm in other FTC challenges to mergers of health care providers.[74]

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69. 749 F.3d 559 (6th Cir. 2014).

70. *Id.* at 561.

71. *Id.* at 563.

72. *Id.* at 562.

73. *Id.* at 569-70.

74. *See, e.g.*, Saint Alphonsus Med. Ctr.–Nampa, Inc. v. St. Luke's Health Sys., Nos. 1:12-CV-00560-BLW, 1:13-CV-00116-BLW, 2014 WL 407446, at *9 (D. Idaho Jan. 24, 2014), *aff'd*, 778 F.3d 775 (9th Cir. 2015) (finding a significant increase in "bargaining leverage with health plans" post-acquisition); *id.* at *10-11 (discussing leverage and "best alternative to a negotiated agreement" at length); FTC v. Penn State Hershey Med. Ctr., 838 F.3d 327, 346 (3d Cir. 2016) ("The Government's evidence shows that the increase in the Hospitals' bargaining leverage as a result of the merger will allow the post-merger combined Hershey/Pinnacle to profitably impose a SSNIP on payors."); FTC v. Advocate Health Care, No. 15 C 11473, 2017 WL 1022015, at *2 (N.D. Ill. 2017) ("A hospital has more bargaining leverage if there are fewer substitutes for it that can be included in the insurer's network; the insurer has more leverage if there are more substitutes for the hospital.").

The FTC and DOJ have also identified increased bargaining leverage of sellers as a basis for challenging mergers in a variety of industries. For example, the FTC voted to challenge a 1996 merger of drug store chains on concerns that the merger would worsen the outside option for PBMs that, much like insurers, build networks of providers.[75] The DOJ insisted on divestitures as a condition for approving a 2000 merger of competing providers of "aggregation, promotion, and distribution of residential broadband content," on the ground that the merger would confer increased leverage in selling these services to broadband content providers.[76] In 2016, the DOJ settled a merger of broadcasters whose combination, the agency argued, would yield, *inter alia*, increased leverage in the sale of retransmission rights to multichannel video programmer distributors (MVPDs) such as traditional cable companies and satellite distributors.[77]

B. Increased Leverage by Buyers

Those cases all involved increased bargaining leverage by merging sellers. We are now ready to consider the symmetric upstream case, in which buyers combine and thereby increase their bargaining leverage against a seller. For example, suppose two insurers merge. Whether there is increased leverage now

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75. *Commentary on the Horizontal Merger Guidelines*, U.S. DEP'T JUSTICE & FED. TRADE COMM'N 13 (2006), http://www.justice.gov/atr/file/801216/download [http://perma.cc/YQ9N-95F6] ("Rite Aid and Revco constrained one another's pricing leverage with PBMs in bargaining for inclusion in PBM networks . . . . A high proportion of PBM plan enrollees would have considered the merged entity to be their preferred pharmacy chain, leaving PBMs with less attractive options for assembling networks that did not include the merged firm. This would have empowered the merged firm successfully to charge higher dispensing fees as a condition of participating in a network."). The proposed merger was abandoned in 1996 after the FTC voted to block it. *Rite Aid Abandons Proposed Acquisition of Revco after FTC Sought to Bl[o]ck Transaction*, FED. TRADE COMM'N (Apr. 24, 1996), http://www.ftc.gov/news-events/press-releases/1996/04/rite-aid-abandons-proposed-acquisition-revco-after-ftc-sought [http://perma.cc/4BVN-HDTJ].

76. Competitive Impact Statement at 12, United States v. AT&T Corp., No. 1:00-cv-01176 (D.D.C. May 25, 2000) ("If the proposed merger [between AT&T and MediaOne] were consummated, concentration in the market for aggregation, promotion, and distribution of residential broadband content and services would be substantially increased . . . . AT&T would have substantially increased leverage in dealing with broadband content providers, which it could use to extract more favorable terms for such services.").

77. Complaint at 11, United States v. Nexstar Broad. Grp., Inc., No. 1:16-cv-01772 (D.D.C. Sept. 2, 2016) ("Post-acquisition, Nexstar would gain the ability to threaten MVPDs in each of the DMA Markets with the simultaneous blackout of at least two major broadcast networks: its own network(s) and Media General's network(s). That threatened loss of programming, and the resulting diminution of an MVPD's subscribers and profits, would significantly strengthen Nexstar's bargaining position with MVPDs.").

depends, *inter alia,* on the curvature of the *hospital's* value function. If larger insurers exert greater leverage in their negotiations with hospitals, as would result from a diminishing incremental value of a hospital's access to an additional insured prospective patient similar to Figure 1, then the merger will reduce provider payments from the insurer.[78]

Our conclusion in Part I—that a harm to input markets suffices to establish an antitrust violation—applies not only to increased classical monopsony power but also to increased bargaining leverage. The cases discussed in Part I establish that a buy-side harm is sufficient, and cases such as *ProMedica* establish that increased bargaining leverage is an actionable harm. Once again, there is a harm to the competitive process that lowers the welfare of the merging parties' trading partners.

A recent example is the proposed merger of two health insurers, Anthem and Cigna. The government objected to the merger on the ground (among others) that it would harm competition in the purchase of services from health care providers in specified local markets.[79] The foregoing analysis supports the conclusion that if Anthem and Cigna were able to secure lower reimbursement rates to health care providers through increased bargaining leverage, this would constitute an actionable harm.

The Anthem-Cigna challenge illustrates another point: the parties to a merger that increases buy-side bargaining leverage are often also competitors in output markets. The loss of competition in output markets is usually the main focus of an antitrust challenge, and the claim of lost competition between competing buyers may never be decided. In Anthem-Cigna, the DOJ also objected to the merger as anticompetitive in two classes of product markets: the sale of insurance to national accounts and the sale of insurance to large groups in specified

78. To analyze effects of an insurer merger on the insurer's leverage, the vertical axis of Figure 1 would be replaced with the value to an individual hospital of adding insured lives to its potential patients, and the horizontal axis would measure the number of insured lives with contracts for service at the hospital. For evidence of this effect, see, for example, Leemore Dafny et al., *Paying a Premium on Your Premium? Consolidation in the U.S. Health Insurance Industry*, 102 AM. ECON. REV. 1161 (2012), and Ho & Lee, *supra* note 57. *See also* Brief of Professors as Amici Curiae in Support of Appellees and Affirmance at 5-6, United States v. Anthem, Inc., 855 F.3d 345 (D.C. Cir. 2017) (Nos. 17-5024, 17-5028), 2017 WL 1075800 (collecting evidence that higher insurer concentration is associated with lower payments to providers). Insurer mergers may also increase the insurer's leverage by improving its walk-away value.

79. Complaint at 26-27, United States v. Anthem, Inc., No. 1:16-cv-01493 (D.D.C. July 21, 2016) (quoting Anthem executive's statement that "the more patients doctors and hospitals see from [an insurance] carrier, the more leverage that carrier has to negotiate the best arrangements in the market" and alleging that Anthem recognized that "rate reductions would not result from any additional efficiencies or potentially procompetitive volume discounts").

local markets. The district court enjoined the merger on the basis of lost competition in product markets,[80] and this ruling was upheld on appeal.[81] The courts never reached the claim of lost competition between competing buyers.

The FTC has taken a different approach. In 2004, the FTC investigated a merger of two PBMs, Caremark and AdvancePCS.[82] PBMs negotiate the price paid to pharmacies, and hence play a role analogous to health insurers negotiating with health care providers. The FTC considered, as one theory of harm, whether the merged parties might exercise increased buy-side power and thereby reduce drug dispensing fees paid to the pharmacies. Ultimately, the agency decided to close its investigation without challenging the transaction and issued a statement explaining its decision.[83] The closing statement acknowledged a possible increase in PBMs' bargaining power, resulting in lower fees paid to the pharmacy.[84] Nevertheless, the FTC dismissed this effect as harmless. In its view, "competition" would be unaffected provided that the quantity purchased did not fall.[85]

In 2012, the FTC embraced the same position in a closing statement explaining its decision not to challenge a second PBM merger between Express Scripts and Medco.[86] This time, the agency concluded that pharmacy reimbursement rates would not be affected by the merger, but then proceeded to explain its analytical approach if post-merger reimbursement rates had been expected to fall. The FTC saw no problem unless there would be a quantity reduction on the part

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80. United States v. Anthem, Inc., 236 F. Supp. 3d 171, 178-79 (D.D.C. 2017).

81. United States v. Anthem, Inc., 855 F.3d 345, 349 (D.C. Cir. 2017).

82. *See Statement of the Federal Trade Commission, In re Caremark Rx, Inc./AdvancePCS, File No. 031 0239*, FED. TRADE COMM'N (Feb. 11, 2004), http://www.ftc.gov/sites/default/files/documents/cases/2004/02/040211ftcstatement0310239.pdf [http://perma.cc/65BG-8Z46] [hereinafter FTC *Caremark* Closing Statement].

83. *Id.*

84. *Id.* at 3 ("At most, the acquisition is likely to increase the bargaining power of the merged PBM and to increase its shares (and correspondingly reduce the pharmacies' shares) of the gains flowing from contracts between the PBM and the pharmacies.").

85. *Id.* at 2 ("Nor do competition and consumers suffer when the increased bargaining power of large buyers allows them to obtain lower input prices without decreasing overall input purchases."). The FTC asserted that if the benefit is passed through to consumers, the effect is not just harmless but procompetitive. *Id.* ("This bargaining power is procompetitive when it allows the buyer to reduce its costs and decrease prices to its customers."). We criticize this view, to the extent that the lower prices are the result of increased bargaining leverage, *infra* Part III.

86. FTC *Express Scripts* Closing Statement, *supra* note 50.

of the input providers.[87] That approach effectively limits buy-side cases to increased classical monopsony power and excludes many instances of increased bargaining leverage, an outcome the closing statement appears to contemplate.[88] (A more extreme reading of the closing statement is that the FTC employed an approach that we criticize in section I.B, by requiring a demonstrated harm to final consumers.[89]) Beyond PBMs, the FTC has taken a similar position in evaluating a grocery store merger.[90] Similarly, some commentators insist upon an adverse effect on the quantity or quality supplied.[91]

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87. *Id.* at 8 ("Moreover, even if the transaction enables the merged firm to reduce the reimbursement it offers to network pharmacies, there is no evidence that this would result *in reduced output or curtailment of pharmacy services* generally." (emphasis added)). The "output" referred to is the output of the pharmacies.

88. For example, the agency characterized the actionable theory of harm purely in monopsony terms. *Id.* at 1-2 ("Another question, raised by retail pharmacies and consumer groups, was whether the combined firm could exercise monopsony power, driving drug dispensing fees so low that that they would threaten the important services offered by local pharmacies."). In a footnote supporting its conclusion that reduced pharmacy reimbursement would have no effect on pharmacy output, the FTC stated: "The Commission has previously found [in Caremark/AdvancePCS] that the market for the retail dispensing of brand name and generic prescription drugs is not susceptible to monopsony power for several reasons, including the fact that dispensing fees are negotiated individually between each PBM and each pharmacy." *Id.* at 8 n.15. In other words, PBM-pharmacy agreements are negotiated, rather than dictated by a competitive supply curve.

89. The primary thrust of the FTC's buy-side analysis, quoted *supra* in text accompanying note 50, is the effect on consumers. See *id.* at 7 (noting the consumer benefit from lower input prices, asserting the rareness of consumer harm, and stating that the "Commission examined this concern closely," apparently a reference to a concern about consumer harm). The closing statement then turned, in the "Moreover" statement quoted *supra* note 87, to the secondary possibility of "reduced output or curtailment of pharmacy services generally." The pharmacies' output is not merely an input into the PBM's product, but also directly incorporated into the PBM's offering to its customers. Under the more extreme reading, the FTC considered the pharmacies' output not because input providers are relevant in their own right, but only to the extent that changes in input provision also alter the final product consumed.

90. In evaluating the 2002 acquisition of Supermercados Amigo by Wal-Mart, the FTC considered the possibility of increased classical monopsony power but not other theories of enhanced buyer power. Its analysis was limited to a scenario in which the buyer reduces the input price by "scaling back purchases." *See* Letter from the FTC to Albert A. Foer, President of the American Antitrust Institute (Feb. 27, 2003), http://www.ftc.gov/sites/default/files/documents/cases/2003/02/ftc.gov-letterfoer.htm [http://perma.cc/P5LY-PR4B].

91. *See* Dennis W. Carlton & Mark Israel, *Proper Treatment of Buyer Power in Merger Review*, 39 REV. INDUS. ORG. 127, 128 (2011) (insisting upon a decrease in total surplus); John D. Shively, *When Does Buyer Power Become Monopsony Pricing?*, ANTITRUST, Fall 2012, at 87, 87; Jonathan M. Jacobson & Gary J. Dorman, *Joint Purchasing, Monopsony, and Antitrust*, 36 ANTITRUST BULL. 1 (1991) (arguing against liability where there is no demonstrated reduction in quantity supplied); Jonathan M. Jacobson, *Monopsony 2013: Still Not Truly Symmetric*, ANTITRUST SOURCE, Dec. 2013 (similar); *see also* BLAIR & HARRISON, *supra* note 6, at 230 (doubting the role for antitrust in "all-or-none" negotiations that transfer wealth to monopsonists).

Given the similarity between insurers negotiating with health providers and PBMs negotiating with pharmacies, the FTC statement strikingly contrasts with the DOJ's approach.[92] We disagree with the approach outlined in the FTC closing statements for reasons well illustrated by the FTC's successful challenges in *ProMedica* and other sell-side cases.[93] When a disruption of the competitive process results in harm to the trading partner, that harm is actionable, whether the trading partner is a buyer or a seller, and whether or not there is an additional effect on quantity.

To put the point more directly, insisting on a quantity effect is not required in sell side merger enforcement. Suppose a merger of sellers permitted the merged firm to raise prices to purchasers, whether intermediate purchasers or final consumers, but "merely" raised prices without any reduction in the quantity purchased. Arguing that the merger is harmless unless allocative inefficiency can be shown would not be an effective defense. Antitrust is not a blank check to engage in global welfare maximization. The right conclusion is that such a merger distorts the competitive process, with consequent harm to purchasers.

The normative basis for this approach mirrors the discussion in Section I.B. When a merger suppresses competition between rivals for a seller's business, ordinarily we may expect—in addition to the immediate harm to sellers—a welfare loss. The exercise of increased bargaining leverage is likely to have this effect, even where that effect is not directly measured. Once again, in a particular case it may be possible to argue that the merger is harmless or even beneficial. For example, a defendant might argue that an increase in buy-side "countervailing power" will offset sellers' existing market power and thereby move input prices closer to a social ideal of marginal costs. Courts are equally reluctant to adjudicate the defense that a merger of hospitals offsets the existing power of insurers, and the reciprocal claim that a merger of insurers offsets the existing power of hospitals. Here, once again, the trading partner welfare perspective reflects an implicit judgment that a fine-grained search for case-specific exceptions carries an unacceptable risk of false negatives.

In a bargaining leverage case, the most common harm is to the bargained-for price, but buyers may choose to exercise their increased leverage to extract

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92. *Compare* FTC *Express Scripts* Closing Statement, *supra* note 50 (concluding that reduced reimbursements to retail pharmacies are harmless), *with* Plaintiffs' Supplemental Memorandum on the Buy-Side Case at 6-7, United States v. Anthem, Inc., No. 1:16-cv-01493 (D.D.C. Dec. 19, 2016) (arguing that reduced reimbursements to health care providers is actionable, without needing to prove reduction in quantity or quality supplied). *See also* Sallet, *supra* note 9, at 82 (noting the difference in agency approach); Shively, *supra* note 91, at 90 (noting the contrast between the FTC closing statement in Express Scripts and contemporaneous statements by DOJ officials).

93. *See supra* notes 69-74 and accompanying text.

non-price concessions instead.[94] For example, the DOJ and Federal Communications Commission (FCC) expressed concern that increased bargaining leverage resulting from the 2016 merger of Charter Communications with Time Warner Cable would be used to disadvantage emerging rivals in online video distribution (OVD):

> The combination . . . will result in a larger MVPD with a greater ability and incentive to secure restrictions on programmers that limit or foreclose OVD access to important content . . . . With more to gain from imposing . . . contractual restrictions and with greater bargaining leverage with programmers to insist on such provisions, New Charter will be well-positioned to restrain continued OVD growth by limiting or foreclosing OVD access to the video content that is vital to their competitiveness.[95]

Ultimately, the merged entity agreed to restrictions on its ability to obtain terms in contracts with video programmers that would limit or discourage provision of programming to OVDs.[96] The settlement put these provisions in place for seven years, "long enough to ensure that New Charter cannot harm OVD competitors at a crucial point in their development while accounting for the rapidly evolving nature of the video distribution market."[97]

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Recognizing the harm to sellers from a merger of buyers, whether due to increased classical monopsony power or increased bargaining leverage, has two important practical implications. First, addressing these harms to competitive markets is critical to preventing underenforcement of merger law. A collateral

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94. This effect is analogous to a seller's use of increased bargaining leverage to disadvantage competing sellers. *See supra* note 67 and accompanying text. The issue arises not only in merger cases but in single-firm conduct cases as well. *See, e.g.*, Complaint at 19-22, United States v. Blue Cross Blue Shield of Mich., No. 2:10-CV-14155 (E.D. Mich. Oct. 18, 2010) (alleging that the insurer used its market power to negotiate most favored nations clauses with hospitals that raised the price of hospital services to rival insurers). Competition agencies also may be concerned about a "waterbed effect," in which lower prices for a dominant buyer increase the input prices paid by its downstream competitors, reducing downstream competition. *See* OECD Report, *supra* note 13, at 47-53.

95. Complaint at 4, United States v. Charter Commc'ns, Inc., No. 1:16-cv-00759 (D.D.C. Apr. 25, 2016).

96. Final Judgment at 5, United States v. Charter Commc'ns, Inc., No. 1:16-cv-00759 (D.D.C. Sept. 9, 2016).

97. Competitive Impact Statement at 20, United States v. Charter Commc'ns, Inc., No. 1:16-cv-00759 (D.D.C. May 10, 2016).

benefit is avoiding an arms race in which sellers feel compelled to merge in response to a merger of buyers, in order to offset the resulting market power. Second, as discussed in the next Part, recognizing the buy-side harm plays an important role in ruling out certain claimed benefits from a merger.

III. LOWER INPUT PRICES AS A MERGER BENEFIT

In some instances, lower input prices can be considered a benefit of the merger, rather than (as discussed in Parts I and II) a manifestation of harm. For example, suppose two automobile manufacturers merge. Post-merger, they standardize the transmissions used in their vehicles. At the new higher level of production, the transmissions supplier enjoys economies of scale in manufacturing, reducing both its cost of supply to the merged firm and the price it charges to the firm.

Agencies and courts evaluate such an effect as part of a so-called "efficiencies defense."[98] Efficiencies evidence is deployed to rebut a plaintiff's evidence that the challenged transaction will tend to raise prices in output markets.[99] In particular, lower input prices, passed through to purchasers, may produce downward pressure on output prices. The downward price pressure counteracts upward price pressure from reduced competition in output markets. In our automobile example, the savings from the lower acquisition cost of transmissions would reduce the final cost of producing cars, all else equal, working against the auto manufacturer's incentive to raise prices. The defense applies only to the extent that the lower prices reduce marginal costs, and those benefits are passed through to purchasers.[100] The key factual question thus becomes: are

98. *See, e.g.*, HORIZONTAL MERGER GUIDELINES, *supra* note 47, § 10, at 29-31 (describing consideration of efficiencies); FTC v. H.J. Heinz Co., 246 F.3d 708, 720, 721 (D.C. Cir. 2001) (discussing "offset[ing] . . . efficiencies" and considering asserted efficiencies that, according to merging parties, would "outweigh" anticompetitive effects); United States v. Long Island Jewish Med. Ctr., 983 F. Supp. 121, 147-49 (E.D.N.Y. 1997) (concluding that efficiencies counted in favor of permitting merger); FTC v. Butterworth Health Corp., 946 F. Supp. 1285, 1301 (W.D. Mich. 1996), *aff'd*, 121 F.3d 708 (6th Cir. 1997); *see also* United States v. Phila. Nat'l Bank, 374 U.S. 321, 332-33, 370-71 (1963) (considering and rejecting asserted efficiencies); *cf.* United States v. Anthem, Inc., 855 F.3d 345, 353 (D.C. Cir. 2017) ("Despite . . . widespread acceptance of the potential benefit of efficiencies as an economic matter, it is not at all clear that they offer a viable legal defense to illegality under Section 7." (citation omitted)).

99. We follow convention in using the term "defense" informally to refer to this rebuttal evidence. The Guidelines do not use the term.

100. The Merger Guidelines and case law thus exclude benefits retained by the merged party, a type of benefit that arguably would be included under a total welfare approach.

the input savings large enough, and passed through to purchasers to a sufficient degree, such that there is no net harm in the output market?[101]

A horizontal merger might produce the relevant efficiencies in input markets by reducing the cost of supplying the input to the merged firm. One possibility, as discussed above, is that the input producer may enjoy economies of scale in manufacturing. If there are economies in manufacturing inputs that are customized to buyer specifications, a merger combining volume from two buyers into a single, higher volume specification may reduce upstream costs of that input. Or greater scale may result in lower transport costs from increasing bulk deliveries to a larger firm. These reduced costs are the basis for the Guidelines comment endorsing certain volume-based discounts.[102] This type of efficiency is associated with a (weak) increase in quantity purchased.

Of course, as we have explained,[103] a merger might reduce input prices by reducing competition in input markets, rather than by increasing efficiency. Might these savings be passed through, and if so, could the savings be recognized in defense of the merger? In the case of increased classical monopsony power, the argument fails at the first step. A monopsonist recognizes that the marginal cost of its input, say, labor, is higher than the wage it pays, because hiring the last unit of labor costs the firm not only the wage paid to that worker, but also the increase in the prevailing wage paid to all other workers the firm employs. An increase in monopsony power increases the firm's perceived marginal cost and reduces output. Far from lowering output prices, the increased monopsony power *raises* price in output markets (if the firm faces downward sloping demand for its output) or else leaves it unchanged. By contrast, increased bargaining leverage could have the effect of lowering output prices (in addition to its adverse effect on input markets).

The argument also fails, for either form of reduced competition, at the second step. Purported purchaser benefits premised on reductions in competition are not cognizable.[104] This point is reflected in the Guidelines' consideration of price reductions resulting from a merger, provided that the reduction does not

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101. *See* HORIZONTAL MERGER GUIDELINES, *supra* note 47, § 10, at 30 (describing agencies' analysis of cognizable efficiencies in terms of "revers[ing] the merger's potential to harm consumers").

102. *See id.* § 12, at 33 ("A merger that does not enhance market power on the buying side of the market can nevertheless lead to a reduction in prices paid by the merged firm, for example, by reducing transactions costs or allowing the merged firm to take advantage of volume-based discounts."). As discussed below, however, lower input prices accomplished through increased bargaining leverage are different from a garden-variety volume discount.

103. *See supra* Parts I and II.

104. The same is true, for analogous reasons, of the argument that an increase in buy-side "countervailing power" will offset sellers' existing market power and thereby move input prices closer to a social ideal of marginal costs.

"aris[e] from the enhancement of market power."[105] A concurring opinion in *Anthem* made the same point: "there is no dispute that, to have any legal relevance, a proffered efficiency cannot arise from anticompetitive effects."[106] And even an *Anthem* dissent agreed that purported benefits amounting to "the fruit of a poisonous tree" are not cognizable.[107] The same point is often made in horizontal agreement cases. For example, engineers cannot refrain from price competition on the ground that competition will result in shoddy bridges.[108] As the Supreme Court explained, "the Rule of Reason does not support a defense based on the assumption that competition itself is unreasonable."[109] Nor may a horizontal agreement be defended on the ground that the resulting extra profit induces or is spent on increased innovation.[110]

This conclusion depends on the recognition that the harm to sellers from lost upstream competition is actionable under antitrust law. Otherwise, a defendant may argue that purchasers in output markets are benefited, on balance, thanks to a pass-through of the savings. The FTC appears to have accepted this position in its assessment of the PBM mergers discussed in Part II.[111]

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105. HORIZONTAL MERGER GUIDELINES, *supra* note 47, § 12, at 33; *see also id.* ("Reduction in prices paid by the merging firms not arising from the enhancement of market power can be significant in the evaluation of efficiencies from a merger, as discussed in Section 10.").

106. United States v. Anthem, Inc., 855 F.3d 345, 369 (D.C. Cir. 2017) (Millett, J., concurring). The concurrence cited the dissent on this point, quoting the Guidelines' statement in § 10 that "[c]ognizable efficiencies . . . do not arise from anticompetitive reductions in output or service." *Id.* (quoting *id.* at 378 (Kavanaugh, J., dissenting)). The statement in § 10 is fairly read as a statement about output markets but, as the concurring and dissenting judges in *Anthem* recognized, the logic applies symmetrically to input markets.

107. *Id.* at 378 (Kavanaugh, J., dissenting). The *Anthem* dissent recognizes increased classical monopsony power as a source of harm. *Id.* at 377-78. The opinion does not make a similarly clear statement about increased bargaining leverage. Its concerns about monopsony do not appear to include bargaining leverage that effects transfers without associated output reductions. *See id.* at 378 (citing treatise discussion limited to monopsony); *id.* (quoting defendant's concession that savings premised on increased monopsony power would not be cognizable, including counsel's statement that such an exercise "means a constraint in output"). The dissent also contrasts monopsony (harmful) with "ordinary bargaining power" (harmless), *id.* at 377, though without making any clear reference to increased bargaining leverage.

108. Nat'l Soc'y of Prof'l Eng'rs v. United States, 435 U.S. 679, 696 (1978).

109. *Id.*

110. *See, e.g.*, FTC v. Actavis, Inc., 133 S. Ct. 2223 (2013).

111. The view is reflected in the FTC's *Caremark* and *Express Scripts* closing statements. *See* FTC *Caremark* Closing Statement, *supra* note 82, at 3 ("It is likely that some of the PBM's increased shares would be passed through to PBM clients. Although retail pharmacies might be concerned about this outcome, a reduction in dispensing fees following the merger could benefit consumers." (footnote omitted)); FTC *Express Scripts* Closing Statement, *supra* note 50, at 8 ("[E]ven if the transaction enables the merged firm to reduce the reimbursement it offers to network pharmacies . . . it is likely that a large portion of any of these cost savings obtained

There is a further possibility. Even if the harm to input markets from (say) increased bargaining leverage is actionable, it might nevertheless also be accepted as a source of savings passed through. The "out-of-market" benefit in an output market would be weighed against the harm in input markets. For example, the DOJ might decline to challenge an airline merger that raised prices on a few routes if it also lowered prices substantially on many other routes. Such an approach finds some support in the Guidelines, which tolerate, as a matter of prosecutorial discretion, a small harm in one market where it is inextricably linked to larger benefits in second market.[112] Tugging the other way is section 7 of the Clayton Act, which prohibits lost competition "in any line of commerce,"[113] and substantial case law rejecting out-of-market benefits.[114] *If* balancing across markets is permitted, the relevant economic condition would then be that the net effect on purchasers *and suppliers* is positive. In other words, purchasers benefit on balance (thanks to the pass-through), *and* that benefit is larger than the loss in input markets.[115]

As we have explained, lower input prices can result either from efficiencies or from conduct that suppresses competition in input markets. These alternatives are not exhaustive: merging parties could gain a bargaining benefit that does not neatly fit within either category. For example, in *Anthem*, one argued source of savings was to force providers, under the "affiliate clause" of Anthem's existing provider contracts, to provide service to Cigna customers at Anthem's

by the merged company would be passed through to the PBM's customers. Although retail pharmacies might be concerned about this outcome, a reduction in dispensing fees following the merger could benefit consumers by lowering health care costs." (footnote omitted)).

112. HORIZONTAL MERGER GUIDELINES, *supra* note 47, § 10, at 30 n.14; *see also Commentary on the Horizontal Merger Guidelines*, *supra* note 75, at 58 (discussing the DOJ's decision not to challenge joint venture of bakeries where merger-specific efficiencies would benefit all customers, despite possible adverse competitive effects for a subset of customers).

113. 15 U.S.C. § 18; *see also* HORIZONTAL MERGER GUIDELINES, *supra* note 47, § 10, at 30 & n.14 (indicating that agencies will normally challenge transaction if "likely to be anticompetitive in any relevant market").

114. United States v. Phila. Nat'l Bank, 374 U.S. 321, 371 (1963).

115. This approach was apparently taken by the United Kingdom Competition Commission in its analysis of a merger between the Safeway and Morrisons grocery chains. *See* OECD Report, *supra* note 13, at 63-64 (acknowledging harm to suppliers from weakened bargaining position, but concluding that benefits to consumers, apparently including the financial benefits from a stronger bargaining position passed through to consumers, would "offset" "any detriment to suppliers").

lower reimbursement rate.[116] The *Anthem* court concluded that the claimed savings from use of the affiliate clause was not verifiable.[117] Setting the verifiability issue aside, taking advantage of an existing contract provision in this manner does not represent a true efficiency, but neither is it the result of suppressed rivalry, and hence the noncognizability argument discussed above does not apply.[118] If the court admits an efficiencies defense to an otherwise anticompetitive merger, the merger should be permitted if and only if the savings fully counteracts the upward pricing pressure in output markets.

CONCLUSION

An anticompetitive merger of buyers can manifest harm in input markets by increasing the merged firm's exercise of classical monopsony power, enabling it to cut back on input purchases in order to suppress the price of the input; or by increasing the merged firm's bargaining leverage by worsening the sellers' alternatives to an agreement, enabling the firm to force input price reductions or extract anticompetitive nonprice concessions from sellers. In some mergers, both channels may be operative, as with a health insurance merger that increases both monopsony power as to physicians and bargaining leverage against hospitals. Neither theory of harm requires demonstration of adverse impact on output markets, although such harms may be present too. Neither mechanism provides a cognizable basis for an efficiency claim.

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116. United States v. Anthem, Inc., 855 F.3d 345, 352 (D.C. Cir. 2017). The point here is not that the combined entity would renegotiate any existing contracts, but that *existing* provider contracts—for a period of time, until the contracts were subject to renewal—provided a basis under the affiliate clause to lower the reimbursement level for existing Cigna customers.

117. As a Blue Cross/Blue Shield licensee, Anthem is required under so-called "best efforts" rules to keep most of its business "Blue." *Id.* at 350. The rules limited Anthem's ability to exploit affiliate clauses in this fashion, because if the Cigna customers stayed Cigna (rather than being converted to Anthem's Blue product), the merged entity would fall out of compliance with the best efforts obligation. The D.C. Circuit concluded that, as a consequence, the merged entity would be unable to take advantage of affiliate clauses. *Id.* at 359-60.

118. By contrast, the district court took the position that efficiencies premised on "mere redistribution" are never cognizable. *See id.* at 352, 355-56 (discussing the district court's view). As discussed in the text, the key issue is not redistribution as such, but redistribution enabled by reduced competition between buyers.