MERGER ANTITRUST LAW

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READING GUIDANCE

Class 6 (September 10): Sanford Health/Mid Dakota Clinic (Unit 3)

Today is the third of four classes on Sanford Health/Mid Dakota Clinic. Having completed market definition in Class 5, today we turn to the anticompetitive-effect element of the prima facie case. We begin with the *Philadelphia National Bank* (*PNB*) presumption and then begin the explicit theories of anticompetitive harm with coordinated effects and recapture unilateral effects. In Class 7, we will complete the explicit theories of anticompetitive harm and then take up the defenses to the prima facie case.

Proving Anticompetitive Effect

Having delineated the product and geographic boundaries of the relevant market, the next step is to determine whether the transaction has the requisite anticompetitive effect. Section 7 of the Clayton Act prohibits mergers and acquisitions whose effect "may be substantially to lessen competition, or to tend to create a monopoly" (Unit 3D slides 4-5). Notably, the Supreme Court has interpreted the "may be" and "tend to" language to create an *incipiency standard*: A violation of Section 7 does not require proof that the merger will actually have the alleged anticompetitive effect; it is enough if there is a "reasonable probability" that the alleged effect will result (Unit 3D slides 6-8). Proof of a prima facie anticompetitive effect is the last part of Step 1 in the *Baker Hughes* three-step burden-shifting approach in Section 7 law (Unit 3D slides 9-11).

Remember that when assessing the potential effects of a merger or acquisition on competition, the impact is measured on a going-forward basis, comparing what would likely occur with the transaction against what would likely occur without it. If prices are falling in the relevant market before the transaction, for example, the fact that they continue to fall after the transaction does not necessarily mean that the transaction is secure from a Section 7 challenge. Rather, the question is whether prices will fall at least as fast and as far with the transaction as they would without it. If prices continue to fall with the transaction but at a slower rate than they would without it, an anticompetitive price effect is present, even though prices after the transaction will be lower than before.[1]

In horizontal transactions, while some mergers constitute "mergers to monopoly" or otherwise help create or maintain a dominant firm's monopoly power and therefore "tend to create a monopoly," most transactions are evaluated based on whether they "may substantially lessen competition." In these cases, plaintiffs most commonly establish prima facie anticompetitive effects in one or both of two ways: (1) by invoking the *Philadelphia National Bank* presumption based on market shares and concentration in a properly defined relevant market, and (2) by proving one or more explicit theories explaining the mechanism by which the merger is likely to

[1] *See* FTC v. Staples, Inc., 970 F. Supp. 1066, 1082 n.14 (D.D.C. 1997).

lessen competition. Under the *PNB* presumption, a plaintiff establishes a prima facie case of Section 7 anticompetitive harm by proof that the merger would create a firm with "an undue percentage of the relevant market" and result in a significant increase in "the concentration of firms" in that market. Explicit theories of anticompetitive harm focus on the specific mechanisms by which the merger is likely to reduce competition. These theories fall into three recognized categories: coordinated effects, unilateral effects, and the elimination of a maverick firm. After completing the PNB presumption, we begin those explicit theories today with coordinated effects and recapture unilateral effects; Class 7 will complete the remaining theories and the defenses.

The Philadelphia National Bank *presumption*. In 1963, the Supreme Court in *Philadelphia National Bank* established a presumption of anticompetitive effect based on the combined market share of the merging firms and the resulting increase in market concentration.

When the Supreme Court decided *PNB*, the dominant theory in industrial organization was the "structure-conduct-performance" (SCP) paradigm. The idea was that market structure would determine how firms behave, which in turn would determine how competitively the market would perform. As a special case, the paradigm held that as markets became more concentrated, with fewer or more dominant firms, firms would compete less aggressively, market equilibrium prices would increase, and the market would perform less competitively. This theory of oligopoly remains a mainstay in judicial antitrust opinions, and, beginning in 1992, the Merger Guidelines have refined it into coordinated effects.

The *PNB* Court used this intuition of the SCP paradigm to create a rebuttable presumption of the requisite Section 7 anticompetitive effect whenever a horizontal transaction produces a firm with an "undue percentage" of the relevant market and results in a "significant increase" in market concentration. As the Supreme Court explained:

> Specifically, we think that a merger which produces a firm *controlling an undue percentage of the relevant market*, and results in a *significant increase in the concentration of firms in that market*, is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects.[2]

The italicized qualifier—"in the absence of evidence clearly showing" the contrary—is what makes the presumption rebuttable: once the plaintiff proves an undue share and a significant increase in concentration, the burden shifts to the defendant to come forward with evidence that the merger is not in fact likely to lessen competition. As we will see, that qualifier is the doctrinal hook for *General Dynamics*.

Once a relevant market has been established, market shares and market concentration can be determined using standard discovery tools, third-party statistics, market research reports, or regular course-of-business documents. Market shares do not have to be exact; a "reliable,

[2] *Philadelphia Nat'l Bank*, 374 U.S. at 363 *(emphasis added)* (citing United States v. Koppers Co., 202 F Supp. 437 (W.D. Pa. 1962)); *accord* United States v. General Dynamics Corp., 415 U.S. 486, 497 (1974); United States v. Phillipsburg Nat'l Bank & Trust Co., 399 U.S. 350, 366 (1970); United States v. Von's Grocery Co., 384 U.S. 270, 301 (1966); Polypore Int'l, Inc. v. FTC, 686 F.3d 1208, 1214 (11th Cir. 2012); United States v. Dairy Farmers of Am., Inc., 426 F.3d 850, 858 (6th Cir. 2005); FTC v. OSF Healthcare Sys., 852 F. Supp. 2d 1069, 1074 (N.D. Ill. 2012); FTC v. ProMedica Health Sys., Inc., 2011 WL 1219281, at *53 (N.D. Ohio 2011); FTC v. Lab. Corp. of Am., 2011 WL 3100372, at *14 (C.D. Cal. 2011).

reasonable, close approximation" of the relevant market share is sufficient for applying the *PNB* presumption.[3]

Without establishing a hard and fast threshold, the *PNB* Court held that a combined market share of 30% was "undue" and that an increase in the market share of the two largest firms from 44% to 59% and of the four largest firms from an unstated figure to 78% represented a "significant increase" in market concentration, so that the presumptive rule of illegality was triggered. The Court observed that because a 30% combined share presents a "clear" threat to competition, it was unnecessary to specify a minimum threshold, and emphasized that a combined share below 30% does not create an inference that the merger is lawful.[4]

During the 1960s, the Supreme Court condemned several mergers between companies with combined market shares of 10% or less and observed that even lower shares would be sufficient to establish a violation of Section 7 in concentrated markets and markets showing a trend toward concentration.[5] Courts focused almost entirely on market share statistics, giving little or no weight to other economic factors, and accepted increasingly artificial definitions of product and geographic markets. By the end of the 1960s, the *PNB* presumption had become almost conclusive, and significant horizontal mergers were all but per se unlawful.

With its 1974 decision in *United States v. General Dynamics Corp.*,[6] the Supreme Court returned to the admonition in *Brown Shoe* to look beyond market concentration statistics and reaffirmed that the *PNB* presumption was rebuttable, not conclusive.[7] The Court observed that while such statistics were "of great significance," they "were not conclusive indicators of anticompetitive effects."[8] In *General Dynamics*, the Court analyzed a merger between two leading coal producers that resulted in a firm accounting for approximately 23% of sales in the relevant

[3] United States v. H&R Block, Inc., 833 F. Supp. 2d 36 (D.D.C. 2011) (citing FTC v. PPG Indus., Inc., 798 F.2d 1500, 1505 (D.C. Cir. 1986)).

[4] *Philadelphia Nat'l Bank*, 374 U.S. at 364 ("Without attempting to specify the smallest market share which would still be considered to threaten undue concentration, we are clear that 30% presents that threat."). For applications of the *PNB* presumption, see, for example, FTC v. H.J. Heinz Co., 246 F.3d 708, 716 (D.C. Cir. 2001) (three to two merger increasing HHI by 510 points to 5285 created presumption of anticompetitive effects by a "wide margin"); FTC v. OSF Healthcare Sys., 852 F. Supp. 2d 1069, 1078, 1079-80 (N.D. Ill. 2012) (three to two merger creating firm with a combined share of 59.4% and increasing HHI by 1767 points to 5179); FTC v. Promedica Health Sys., Inc., No. 3:11 CV 47, 2011 WL 1219281 (N.D. Ohio Mar. 29, 2011) (four to three merger creating firm with a combined share of 58.3% and increasing HHI by 1323 points to 6854); United States v. H&R Block, Inc., 833 F. Supp. 2d 36, 72 (D.D.C. 2011) (three to two merger creating a combined firm with a 28.4% share and increasing the HHI by 400 points to 4691); FTC v. CCC Holdings Inc., 605 F. Supp. 2d 26, 44-45 (D.D.C. 2009) (three to two merger with a two-firm fringe creating a firm with a combined share of 69% and increasing the HHI by 2035 to 5685); FTC v. Swedish Match, 131 F. Supp. 2d 151, 166-67 (D.D.C. 2000) (creating a 60 percent combined market share and increasing the HHI by 1514 to 4733).

[5] *See* United States v. Pabst Brewing Co., 384 U.S. 546, 550-52 (1966) (condemning merger with combined share of 4.49% in an industry marked by a trend toward concentration but with no significant barriers to entry); United States v. Von's Grocery Co., 384 U.S. 270, 281 (1966) (White, J., concurring) (noting that prohibited merger had a combined share of 8.9% in a market with a four-firm concentration ratio of 24.4%); *see also* Brown Shoe Co. v. United States, 370 U.S. 294, 343-44 (1962) (suggesting combined share of as low as 5% sufficient to create concern).

[6] United States v. General Dynamics Corp., 415 U.S. 486 (1974).

[7] *See* Hospital Corp. of Am. v. FTC, 807 F.2d 1381 (7th Cir. 1986) (noting that *General Dynamics* "casts doubt on the continued vitality of such cases as *Brown Shoe* and *Von's*" when read to hold that any nontrivial acquisition of a competitor violates Section 7).

[8] United States v. General Dynamics Corp., 415 U.S. 486, 498 (1974).

market. The Court upheld the merger, however, because substantially all the reserves of the acquired company had been committed to long-term supply contracts and its future ability to compete was negligible. Accordingly, its removal from the market as an independent company could not adversely affect competition.

Today, although the precise thresholds of the *Philadelphia National Bank* presumption remain elusive, courts are likely to find that a combined market share of around 30% to 40% in a market with only four or five firms is sufficient to make out a *prima facie* case of anticompetitive effect.[9] The presumption of anticompetitive effect becomes stronger as the number of competitors remaining in the market postmerger becomes smaller. Not surprisingly, the presumption in a merger to a duopoly is especially strong.[10]

The preferred measure of market concentration today is the *Herfindahl–Hirschman Index* (*HHI*).[11] The HHI is the sum of the squares of the market shares of each of the firms in the relevant market. So if there are *n* firms in the relevant market and firm *i* has a market share of s_i, then:

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[9] *See* FTC v. OSF Healthcare Sys., 852 F. Supp. 2d 1069, 1078 (N.D. Ill. 2012); United States v. Oracle Corp., 331 F. Supp. 2d 1098, 1110 (N.D. Cal. 2004); FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 129 (D.D.C. 2004); FTC v. Swedish Match, 131 F. Supp. 2d 151, 166 (D.D.C. 2000) (dictum); FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 52 (D.D.C. 1998); *see also* FTC v. University Health, Inc., 938 F.2d 1206, 1219 (11th Cir. 1991) (concluding that the FTC "clearly established a prima facie case of anticompetitive effect" where the merged entity would control approximately 43% of the general acute care inpatient services market with three remaining competitors); FTC v. Promedica Health Sys., Inc., 2011 WL 1219281, at *12 (N.D. Ohio 2011) (finding, "[b]y a wide margin," that the proposed acquisition was "presumptively anticompetitive" where the merged entity would control 58.3% of the general acute care inpatient market with two remaining competitors). *But see* United States v. Oracle Corp., 331 F. Supp. 2d 1098, 1110 (N.D. Cal. 2004) (finding that *PNB* presumption not triggered in a differentiated product market when the combined share of the merging parties is 35%). *See generally* FTC, Horizontal Merger Investigation Data, Fiscal Years 1996-2003 (Feb. 2, 2004); FTC and DOJ, Merger Challenges Data, Fiscal Years 1999-2003 (Dec. 18, 2003).

[10] *See* FTC v. PPG Indus., Inc., 798 F.2d 1500, 1503 (D.C. Cir. 1986); FTC v. H.J. Heinz Co., 246 F.3d 708, 716 (D.C. Cir. 2001); FTC v. ProMedica Health Sys., Inc., 2011 WL 1219281, at *56 (N.D. Ohio 2011); FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 52-53 (D.D.C. 1998).

[11] *See, e.g.*, FTC v. H.J. Heinz Co., 246 F.3d 708, 716 (D.C. Cir. 2001) ("Market concentration, or the lack thereof, is often measured by the Herfindahl-Hirschmann Index (HHI)."); FTC v. University Health, Inc., 938 F.2d 1206, 1211 n.12 (11th Cir. 1991) ("The most prominent method of measuring market concentration is the Herfindahl–Hirschman Index (HHI)."); FTC v. PPG Indus., 798 F.2d 1500, 1503 (D.C. Cir. 1986) ("The FTC and the Department of Justice, as well as most economists, consider the measure superior to such cruder measures as the four-or eight-firm concentration ratios which merely sum up the market shares of the largest four or eight firms."); FTC v. OSF Healthcare Sys., 852 F. Supp. 2d 1069, 1078-79 (N.D. Ill. 2012); FTC v. Promedica Health Sys., Inc., 2011 WL 1219281, at *56 (N.D. Ohio 2011) ("Courts have . . . adopted and relied on the HHI as a measure of market concentration."); FTC v. Swedish Match, 131 F. Supp. 2d 151, 166 n.11 (D.D.C. 2000) ("As a more accurate measure of market concentration, economists have created and courts have consistently relied upon the HHI."); FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 53 (D.D.C. 1998) (noting that "the courts turn to the Guidelines for assistance and over the years have come to accept the HHI as the most prominent and accurate method of measuring market concentration"). Given its wide acceptance, many opinions today use the HHI without comment. *See, e.g.*, Chicago Bridge & Iron Co. v. FTC, 534 F.3d 410, 421, 431 (5th Cir. 2008); AlliedSignal, Inc. v. B.F. Goodrich Co., 183 F.3d 568, 574 (7th Cir. 1999); United States v. Baker Hughes Inc., 908 F.2d 981, 983 n.3 (D.C. Cir. 1990); United States v. H&R Block, Inc., 833 F. Supp. 2d 36, 71-72 (D.D.C. 2011); FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 124 (D.D.C. 2004); FTC v. Libbey, Inc., 211 F. Supp. 2d 34, 50-51 (D.D.C. 2002); FTC v. Staples, Inc., 970 F. Supp. 1066, 1081-82 (D.D.C. 1997).

$$\text{HHI} = \sum_{i=1}^{n} s_i^2 .$$

So, for example, if there are five firms in the market, with market shares respectively of 40%, 30%, 15%, 10%, and 5%, then:

$$\begin{aligned}\text{HHI} &= (40)^2 + (30)^2 + (15)^2 + (10)^2 + (5)^2 \\ &= 1600 + 900 + 225 + 100 + 25 \\ &= 2850\end{aligned}$$

The increase in market concentration, which is often called the "delta" and denoted by the Greek letter Δ, is simply the difference between the postmerger HHI and the premerger HHI:

$$\Delta = \text{HHI}_{postmerger} - \text{HHI}_{premerger}$$

So, in our example, if the second and third largest firms merged, the postmerger HHI would be:

$$\begin{aligned}\text{HHI}_{postmerger} &= (40)^2 + (30+15)^2 + (10)^2 + (5)^2 \\ &= 1600 + 2025 + 100 + 25 \\ &= 3750\end{aligned}$$

The delta then would be:

$$\begin{aligned}\Delta &= 3750 - 2850 \\ &= 900\end{aligned}$$

A simple way to calculate the delta is twice the product of the merging firms' market shares. In our example, the delta is $2 \times 30 \times 15 = 900$. [12]

Beginning in 1982, the Merger Guidelines also operationalized the *PNB* presumption. The 2010 Guidelines provided that mergers in markets with a postmerger HHI above 2500 and a delta of 200 or more "will be presumed to be likely to enhance market power" and be sufficient to predicate the PNB presumption. However, the 2023 Merger Guidelines significantly lowered the HHI thresholds and added a separate structural presumption based on the 30% combined-share benchmark identified in *Philadelphia National Bank*. The 2023 Guidelines now provide that mergers with a postmerger HHI greater than 1,800 and a delta greater than 100 will be presumed to enhance market power. The 2023 Guidelines also establish, adopting dicta from *PNB*, that any merger resulting in a firm with more than 30% market share and an HHI increase greater than 100 points is presumptively anticompetitive.

Courts continue to apply the *PNB* presumption in horizontal merger cases and expect plaintiffs to present a *PNB* analysis tailored to the alleged relevant market. Although the agencies reject in principle that a *PNB* analysis is a required element of a prima facie case, they have invoked the presumption in every modern horizontal merger challenge in recognition of the courts' expectations. In applying the presumption, courts typically rely most heavily on recent decisions upholding the presumption in markets with HHIs and deltas similar to or lower than those in the

[12] If the merging firms have market shares of *a* and *b*, respectively, then their premerger contribution to the HHI was $a^2 + b^2$. After the merger, the combined firm's contribution to the HHI is $(a + b)^2$, which is equal to $a^2 + 2ab + b^2$. Consequently, the difference between the postmerger HHI and the premerger HHI is $2ab$.

case before them. Courts also look to the Merger Guidelines thresholds as informative but not binding, treating them as persuasive economic evidence rather than legal standards. Finally, although tertiary, courts are increasingly citing the 30% combined market share threshold from *Philadelphia National Bank* itself as an independent basis for applying the presumption.

That said, as you can see from inspecting the table and chart in the class notes on the HHI/delta allegations in successful DOJ and FTC cases, the federal enforcement agencies hardly ever bring litigated cases where the HHIs and deltas are anywhere close to the merger guidelines thresholds (Unit 3D slides 22-25). Consequently, when citing judicial authority, it is important to know the cases with the lowest HHI/delta statistics that the court found sufficient to predicate the *PNB* presumption.[13]

Sanford Health is a useful first *PNB* case because the concentration evidence is not close once the alleged markets are accepted. The FTC alleged that the transaction would leave Sanford with extremely high shares in each of the four physician-service markets in the Bismarck-Mandan area, including 100% of general surgery physician services. The real work in the structural case, therefore, lies less in debating whether the concentration levels exceed any plausible *PNB* threshold and more in understanding why the relevant product and geographic markets were accepted and how the structural presumption fits into the *Baker Hughes* burden-shifting framework.

With this background, read the note (pp. 204-12) and the class materials on the *PNB* presumption (Unit 3D slides 12-29). Next, read the excerpts on the PNB presumption from the various Merger Guidelines to see how the agencies operationalize the presumption (pp. 213-29). With this background, read the *Sanford Health* complaint and answer on the presumption (Complaint ¶¶ 36-38, pp. 23-25; Answer ¶¶ 36-38, p. 53) and the district court's application (pp. 230-31). Finally, read the *IQVIA*, *Heinz*, and *JetBlue* excerpts to see how other courts have applied the presumption (pp. 232-50).

Explicit Theories of Anticompetitive Harm

Coordinated effects (or *coordinated interaction*). This mechanism of anticompetitive harm occurs when the merger facilitates tacit coordination among the remaining incumbent firms. This theory depends on competitors to the merged firm accommodating rather than resisting price increases or other anticompetitive conduct. In other words, coordinated effects require anticompetitive conduct by multiple firms in the market that is profitable for each of them only because of the accommodating reactions of the others.

Tacit coordination occurs when firms recognize their mutual interdependence and adopt accommodating conduct—such as avoiding price cuts or limiting output—without any explicit agreement. Postmerger, firms may find it easier to reach and maintain such mutual understandings, resulting in higher prices, reduced output, lower quality, or slower innovation. Coordinated effects require conduct by multiple firms, each of which finds its strategy profitable only because its rivals refrain from aggressive competition in return. The theory was introduced

[13] I would cite (in order of increasing deltas) United States v. UPM-Kymmene Oyj, No. 03 C 2528, 2003 WL 21781902 (N.D. Ill. July 25, 2003) (complaint alleging postmerger HHI of 2990; delta of 190); *In re* Evanston Northwestern Healthcare Corp., No. 9315, 2007 WL 2286195, at *4 (F.T.C. Aug. 6, 2007) (postmerger HHI of 2739; delta of 384); United States v. H & R Block, Inc., 833 F. Supp. 2d 36, 72 (D.D.C. 2011) (postmerger HHI of 4691; delta of 400); FTC v. H.J. Heinz Co., 246 F.3d 708, 716 (D.C. Cir. 2001) (postmerger HHI of 5285; delta of 510); United States v. Anthem, Inc., 855 F.3d 345, 351 (D.C. Cir. 2017) (postmerger HHI of 3000; delta of 537); and FTC v. CCC Holdings, Inc., 605 F. Supp. 2d 26, 46 (D.D.C. 2009) (postmerger HHI of 5460; delta of 545).

in the 1992 Merger Guidelines and is now well-accepted by courts as a cognizable Section 7 harm when supported by evidence that the merger increases the likelihood of such outcomes.

Courts apply a two-element test to determine whether coordinated effects are likely:

- The relevant market premerger must be *susceptible* to tacit coordination.
- The merger must make postmerger tacit coordination *more likely*, *more effective*, or *more stable* than premerger tacit coordination, usually by the merger eliminating a significant independent rival.

Notably, not all firms in the market need to coordinate for coordinated effects to arise: it is sufficient if a subset of firms—called a "collusive group"—can influence price or output meaningfully.

To assess whether the market before the merger is susceptible to coordination, agencies and courts consider both structural and behavioral factors, drawing on structural market features, past firm behavior, internal documents, and expert economic analysis. The most important factors include market concentration, any history of actual or attempted coordination (whether successful or not, and whether lawful or unlawful), and whether firms can observe each other's behavior on key competitive dimensions such as price or output. Additional factors include whether firms have aligned incentives to coordinate, whether tacit coordination would likely be profitable or otherwise advantageous, and whether potential disruption from fringe firms or new entrants is unlikely due to barriers to entry, expansion, or repositioning. Notably, some courts presume that this first element is satisfied whenever the *PNB* presumption applies to the relevant market.

The second element requires showing that the merger will make tacit coordination more likely, more effective, or more stable postmerger than premerger. The most common and compelling evidence is that the merger would eliminate a significant competitor in a market already susceptible to tacit coordination. For example, if a relevant market had four meaningful competitors premerger and the merger would reduce them to three, the agencies and the courts are likely to find this evidence sufficient to satisfy the second requirement.[14] The agencies may introduce, and courts have credited, economic expert testimony or simulation evidence showing that the merger increases postmerger payoffs to coordinated strategies by the firms remaining in the market. The agencies and the courts also may consider other factors that may cause the merger to facilitate tacit coordination, including:

- Increased similarity or symmetry among the remaining firms, which reduces the complexity of reaching and maintaining coordinated terms
- Higher barriers to entry resulting from the merger, which limits competitive pressure from potential new entrants; and
- Enhanced ability to monitor rivals' behavior, such as increased pricing transparency, which makes coordination more stable by reducing the risk that deviations from coordinated conduct will go undetected.

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[14] his is conventional wisdom. Surprisingly, there does not appear to be a case squarely on point. There are, however, cases holding that a merger of two significant competitors in a market with only three significant competitors (a "three-to-two merger") is sufficient to invoke the coordinated effects theory. *See, e.g.*, FTC v. IQVIA Holdings, Inc., 710 F. Supp. 3d 329 (S.D.N.Y. 2024); United States v. H&R Block, Inc., 833 F. Supp. 2d 36 (D.D.C. 2011); FTC v. CCC Holdings Inc., 605 F. Supp. 2d 26 (D.D.C. 2009).

These factors are secondary in probative value to the reduction in the number of significant competitors and expert economic evidence. However, they still may be significant when the reduction in the number of competitors is probative, but not dispositive, that the merger would facilitate coordinated effects, for example, in a six-to-five or perhaps even a five-to-four merger. With this background, read the class notes introducing explicit theories of anticompetitive harm generally (Unit 3D slides 31-32) and examining coordinated effects in particular (Unit 3D slides 33-35).

Unilateral effects. The 1992 DOJ/FTC Horizontal Merger Guidelines introduced a second theory of anticompetitive harm in horizontal mergers: unilateral effects in differentiated product markets. The core idea is straightforward. When two firms sell similar but not identical products—such as competing breakfast cereals or smartphone brands—a merger can eliminate direct head-to-head competition between them. This elimination of "local competition" can occur even if all other competitors in the market continue behaving exactly as they did before the merger.

The economic logic works like this: Before the merger, if Company A raised its cereal price, it would lose customers—some to Company B's cereal and others to other breakfast options. Company B makes additional profit from customers who switch from Company A, but this externality is irrelevant to Company A premerger. After the merger, if the combined firm increases the price of Product A, it "internalizes" or "recaptures" the profit Product B earns from the switching customers. *This recapture effect can make a price increase in Product A profitable even when other competitors hold their prices steady, provided that the profits "recaptured" by Product B are greater than the net profit loss from the price increase on Product A.* Modern antitrust law deems a price increase (or other adverse change in the terms of sale) resulting from unilateral effects to be a cognizable harm under Section 7.

Unilateral effects may manifest not only as higher list prices but also as reduced promotional activity, less aggressive discounting, or weaker responses to rivals' price cuts. The 2010 Guidelines expanded this framework. In practice, unilateral effects has become a central theory of harm in horizontal merger analysis.

Unilateral effects analysis focuses on two key factors: the number of customers who switch between the merging products, and the profit the recapturing firm earns from those customers. The first factor is called the "diversion ratio"—the percentage of Product A's lost marginal sales that switch to Product B following a price increase in Product A. For example, if Product A raises its price and loses 100 customers, and 30 of those customers switch to Product B while the other 70 go elsewhere, then the diversion ratio from A to B is 30%. The diversion ratio does not need to be high in both directions—the theory can apply as long as it is high in at least one direction. Before a merger, when Product A raises its price, the company loses money on all its lost marginal sales, including sales that switch ("divert") to Product B. After the merger, the combined firm "internalizes" the incremental profit from Product B in the recaptured sales. The firm will raise Product A's price whenever the incremental profit gained on Product B from recaptured sales exceeds the incremental profit lost on Product A's lost marginal sales. The higher the diversion ratio or the profit margin on Product B, the more likely a price increase becomes profitable.

In applying the unilateral effects theory, the agencies and courts focus on four core considerations.

1. The merging products must be meaningfully differentiated, each with downward-sloping residual demand curves.

2. The merging products must be close substitutes, reflected in a high diversion ratio from at least one product to the other.
3. Most rival products must be relatively poor substitutes, so the diversion ratio from the merging product whose price is expected to increase to most individual rival products should be low. A few third-party products may nevertheless have high diversion ratios.
4. Barriers to entry, expansion, or repositioning must prevent other firms from quickly and effectively constraining any postmerger price increase.

These four conditions are necessary but not sufficient for a unilateral effects theory to hold. To establish that a price increase is likely, the plaintiff must further show that the incremental profit earned on the recaptured sales of Product B would exceed the incremental profit lost on the foregone marginal sales of Product A. Only if this final condition is met will the merged firm have a profit-maximizing incentive to raise the price of Product A.

Now read the class notes on unilateral effects (Unit 3D slides 36-45) and Section VI of the *Sanford Health* complaint (pp. 26-34). We will complete the remaining explicit theories of anticompetitive harm in Class 7 before turning to the defenses.

Enjoy the reading! Email me if you have any questions.

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