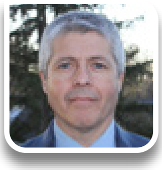
UPDATING THE MERGER GUIDELINES: A DYNAMIC REBOOT

BY JAY EZRIELEV & JOSEPH J. SIMONS[1]

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In this article we offer a number of recommendations for updating the merger guidelines. Our comments address six distinct areas: (1) the guidelines' structure, (2) guiding principles, (3) merger enforcement goals, (4) analysis of future competition, (5) innovation, and (6) efficiencies. The main theme of our comments is the importance of dynamic competition in merger analysis. Firms engage in dynamic competition by investing in innovation, product promotion, reputation, and productive capacity. We argue that preserving and enhancing dynamic competition should be a core goal of merger policy and that the new Merger Guidelines should reflect the importance of dynamic competition analysis in merger review.

I. INTRODUCTION

In this article we offer a number of recommendations for updating the merger guidelines. The Federal Trade Commission ("FTC") and the Department of Justice ("DOJ") (the "Agencies") have issued a Request for Information on Merger Enforcement (the "RFI"), seeking "public comment on how the agencies can modernize enforcement of the antitrust laws regarding mergers."[2] In the RFI, the Agencies seek information on how "new learning related to firm and market behavior" should inform the merger guidelines.[3] The Agencies' inquiry is aimed at "modernizing merger guidelines to better detect and prevent anticompetitive deals."[4] Our comments address six distinct areas: (1) the guidelines' structure, (2) guiding principles, (3) merger enforcement goals, (4) analysis of future competition, (5) innovation, and (6) efficiencies.

The main theme of our comments is the importance of dynamic competition in merger analysis. Dynamic competition may take several forms. Firms engage in dynamic competition by investing in innovation, product promotion, reputation, and productive capacity. We argue that preserving and enhancing dynamic competition should be a core goal of merger policy and that the new Merger Guidelines should reflect the importance of dynamic competition analysis in merger review.

II. THE GUIDELINES' STRUCTURE

The new Merger Guidelines should combine horizontal and vertical merger theories into a single comprehensive document. There is significant overlap between the current Horizontal Merger Guidelines and the 2020 Vertical Merger Guidelines, and combining both the horizontal and vertical theories of harm into one document would provide a more efficient organization of the Agencies' merger enforcement policies. We recommend adding a "Non-Horizontal Effects" section that would incorporate the theories discussed in the 2020 Vertical Merger Guidelines.

We also recommend adding two more sections to the new Merger Guidelines: "Future Competition" and "Innovation." The Future Competition section would focus on loss of future competition effects. The Innovation section would focus on innovation effects. Moving the current Innovation subsection from the Unilateral Effects section to be its own standalone section would improve the organization of the guidelines. The current Unilateral Effects section focuses on static competition, whereas the new Innovation section would cover dynamic competition. We also recommend adding a "Multisided Platforms" subsection under the Unilateral Effects section to address the unique issues raised by multisided platforms.[5] Other than these proposed changes to the structure of the guidelines, the new Merger Guidelines should retain the current structure of the Horizontal Merger Guidelines.

III. GUIDING PRINCIPLES

The overarching guiding principles for the new Merger Guidelines should be accuracy and transparency. The new Merger Guidelines should accurately describe current enforcement policies. The Guidelines should not include analytical approaches or policies that the Agencies would like to pursue in the future but are not currently pursuing. It may be important to have experience with specific policies before including them in the guidelines. Experience with actual enforcement may suggest the need to modify some aspects of the policy. Moreover, successful Agency experience with a new policy or technique for at least some significant period of time would likely make the new approach more attractive to the courts. We offer several recommendations, in response to the RFI, on how merger enforcement policies should change. However, we suggest that the Agencies gain some experience with the new policies before incorporating them in the new Merger Guidelines.

The new Merger Guidelines should stay within the confines of antitrust law. The Agencies may exercise prosecutorial discretion in enforcing merger cases, but the new Merger Guidelines should not include policies that exceed the Agencies' mandate of enforcing antitrust laws. Incorporating such policies in the new Merger Guidelines would make the guidelines a less credible authority for the courts.

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2 REQUEST FOR INFORMATION ON MERGER ENFORCEMENT (January 18, 2022) at 1, https://www.justice.gov/opa/press-release/file/1463566/download.

3 *Id.* at 2.

4 JUSTICE DEPARTMENT AND FEDERAL TRADE COMMISSION SEEK TO STRENGTHEN ENFORCEMENT AGAINST ILLEGAL MERGERS (January 18, 2022), https://www.justice.gov/opa/pr/justice-department-and-federal-trade-commission-seek-strengthen-enforcement-against-illegal.

5 We defer the discussion of merger enforcement in the context of multisided platforms until a later time.

IV. MERGER ENFORCEMENT GOALS

The new Merger Guidelines should make clear that the goals of merger enforcement include protecting and enhancing dynamic competition. Dynamic competition analysis examines how firms compete over multiple periods. Firms engage in dynamic competition by investing in innovation, production capacity, reputation, and product promotion.[6] Dynamic competition (and innovation competition in particular) is a significant driver of economic growth.[7] The new Merger Guidelines should explicitly recognize the importance of dynamic competition for competition policy.

Early industrial organization research used static (single period) analytical frameworks to study competition.[8] Such frameworks do not allow for firm interactions that link current actions and future outcomes. Static models examine competition that occurs within a single period, but they do not consider the effects of competition across time periods. The economics literature on industrial organization has made significant advances in analyzing dynamic competition effects.[9]

The current Horizontal Merger Guidelines largely focus on static competition effects.[10] For example, the Entry section of the current Horizontal Merger Guidelines focuses on whether post-merger entry would be "timely, likely, and sufficient" to deter or counteract harmful static competitive effects (such as short-term price increases).[11] Indeed, the current Horizontal Merger Guidelines ("HMG") state that: "[t]he unifying theme of these Guidelines is that mergers should not be permitted to create, enhance, or entrench market power or to facilitate its exercise."[12] This statement of the "unifying theme" suggests a static focus. Competition to acquire market power (through investment in innovation, production capacity, reputation, and product promotion) is an inherent element of dynamic competition.[13]

Mergers may also enhance merging firms' market power by encouraging investment or through realization of efficiencies. Such merger effects should not be condemned as anticompetitive.[14] Seeking to acquire market power is not anathema to antitrust law. However, if a merger enhances market power by eliminating competition or weakening rivals, such an acquisition of market power may be anticompetitive.

6 Our usage of the term "product" encompasses both products and services.

7 One need look no further than the pharmaceutical companies' response to the COVID-19 pandemic to appreciate the importance of innovation competition to the U.S. economy.

8 See Robert S. Gibbons, Game Theory for Applied Economists 1-53 (1992).

9 See, for example, David Besanko, Ulrich Doraszelski, & Yaroslav Kryukov, *How Efficient Is Dynamic Competition? The Case of Price as Investment*, 109 Am. Econ. Rev. 3339 (2019); C. Lanier Benkard, Przemyslaw Jeziorski, & Gabriel Y. Weintraub, *Oblivious Equilibrium for Concentrated Industries*, 46 RAND J. Econ. 671 (2015); Richard Ericson & Ariel Pakes, *Markov-Perfect Industry Dynamics: A Framework for Empirical Work*, 62 Rev. Econ. Stud. 53 (1995); Gautam Gowrisankaran, *A Dynamic Model of Endogenous Horizontal Mergers*, 30 RAND J. ECON. 56 (1999); Ariel Pakes & Paul G. McGuire, *Stochastic Approximation for Dynamic Analysis: Markov Perfect Equilibrium and the 'Curse' of Dimensionality*, 69 ECONOMETRICA 1261 (2001); Gautam Gowrisankaran & Robert J. Town, *Dynamic Equilibrium in the Hospital Industry*, 6 J. Econ. Manag. Strategy 45 (1997); and Patrick Bajari, C. Lanier Benkard, & Jonathan Levin, *Estimating Dynamic Models of Imperfect Competition*, 75 ECONOMETRICA 1331 (2007); David Besanko, Ulrich Doraszelski, Yaroslav Kryukov, & Mark Satterthwaite, *Learning-by-Doing, Organizational Forgetting, and Industry Dynamics*, 78 ECONOMETRICA 453 (2010). Also, see discussion in Jay Ezrielev & Janusz A. Ordover, *The 2010 Horizontal Merger Guidelines: A Static Compass in a Dynamic World?*, ANTITRUST SOURCE, Oct. 2010.

10 Although there is some discussion of dynamic competition effects in the current Horizontal Merger Guidelines, the main focus is on static competition effects.

11 U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES § 9 (2010), https://www.justice.gov/atr/horizontal-merger-guidelines-08192010 ("A merger is not likely to enhance market power if entry into the market is so easy that the merged firm and its remaining rivals in the market, either unilaterally or collectively, could not profitably raise price or otherwise reduce competition compared to the level that would prevail in the absence of the merger. Entry is that easy if entry would be timely, likely, and sufficient in its magnitude, character, and scope to deter or counteract the competitive effects of concern.").

12 HMG § 1.

13 For example, investing in a brand may increase a firm's short-term pricing power but may also spur dynamic competition among firms.

14 See CONGLOMERATE EFFECTS OF MERGERS – NOTE BY THE UNITED STATES, OECD Competition Committee Meeting at 4-5 (June 4, 2020), https://www.ftc.gov/system/files/attachments/us-submissions-oecd-2010-present-other-international-competition-fora/oecd-conglomerate_mergers_us_submission.pdf ("It is now recognized that efficiency and aggressive competition benefit consumers, even if rivals that fail to offer an equally 'good deal' suffer loss of sales or market share. Mergers are one means by which firms can improve their ability to compete. It would be illogical, then, to prohibit mergers because they facilitate efficiency or innovation in production. Unless a merger creates or enhances market power or facilitates its exercise through the elimination of competition—in which case it is prohibited under Section 7—it will not harm, and more likely will benefit, consumers." (emphasis in original, footnote omitted)).

Dynamic competition analysis has long been an integral element of antitrust, including merger enforcement.[15] Many recent merger challenges and investigations have focused on innovation effects (which are dynamic competition effects).[16] For example, the DOJ's recent challenge of the proposed Visa/Plaid transaction alleged that: "[i]f the acquisition were enjoined, Plaid – on its own or in combination with a company other than Visa – would continue to act as a disruptive competitor, developing and launching new, innovative solutions in competition with Visa," but "[i]n the hands of Visa, this would change dramatically."[17]

The new Merger Guidelines should also clarify other goals of merger enforcement. The guidelines should explain that merger enforcement goals do not include advancing the interests of one group of individuals at the expense of others. Rather, merger enforcement should aim to increase economic growth and prosperity.

V. ANALYSIS OF FUTURE COMPETITION

The new Merger Guidelines should include a Future Competition section dedicated to the analysis of future competitive effects. The Agencies have long recognized the importance of future competition in merger assessments. The current Horizontal Merger Guidelines state that the guidelines "reflect the congressional intent that merger enforcement should interdict competitive problems in their incipiency" and that "[m]ost merger analysis is necessarily predictive, requiring an assessment of what will likely happen if a merger proceeds as compared to what will likely happen if it does not."[18] However, the current Horizontal Merger Guidelines do not fully reflect the challenges and complexities of analyzing future competitive effects. The Future Competition section should provide a more comprehensive description of how the Agencies assess these effects.

Nascent competitor acquisitions represent an important category of mergers where future competition is the focus of the analysis. A nascent competitor is a firm that is not yet a significant competitor in the relevant market but may become one over time.[19] There have been numerous recent challenges of nascent competitor acquisitions.[20] The Agencies have pursued two distinct theories of harm in these cases.[21] The first theory is the loss of future competition. The second theory is the loss of innovation. We propose that the new Innovation section discuss innovation effects and that the Future Competition section focus on the loss of future competition effects.

The loss of future competition effects are substantially similar to the loss of current competition effects except that there is more uncertainty about future effects and the effects occur later. The assessment of loss of future competition effects requires the analyst to predict how markets would evolve over time, with and without the merger. In some cases, courts and Agencies may predict future market evolution by examining documents and testimony regarding the nascent competitor's plans for entering the relevant market. In certain industries, such as pharmaceuticals and electric utilities, market evolution may be relatively predictable, at least over the near term. Consider, for example, an acquisition of a drug in late stages of development. In this case, analysts may be able to predict what competition in the market will look like in the next few years by examining the market participants' drug development plans. Analysts may also be able to predict the likely future market structure based on which firms own critical assets, such as patents or mining rights. But other industries may be less predictable.

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15 See, for example, *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977) (discussing the role of product promotion in enhancing inter-brand competition), *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007) (discussing the role vertical restraints in providing incentives to invest in services and product promotion), *Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993) (discussing the need for future recoupment in a predatory pricing strategy), *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001) (discussing innovation and nascent competition), *California Dental Assn. v. FTC*, 526 U.S. 756 (1999) (discussing advertising restrictions), and *Polygram Holding, Inc. v. FTC*, 416 F. 3d 29 (D.C. Cir. 2005) (discussing advertising restrictions). See also Douglas H. Ginsburg & Joshua D. Wright, *Dynamic Analysis and the Limits of Antitrust Institutions*, 78 ANTITRUST L.J. 1 (2012).

16 These cases include the FTC's challenges of the *Thoratec/HeartWare, Illumina/Pacific Biosciences, AbbVie/Allergan, Illumina/Grail*, and *Nvidia/Arm* transactions and the DOJ's challenges of the *Bayer/Monsanto, Applied Materials/Tokyo Electron*, and *Visa/Plaid* transactions. See START-UPS, KILLER ACQUISITIONS AND MERGER CONTROL – NOTE BY THE UNITED STATES, OECD Competition Committee Meeting (June 4, 2020), https://www.ftc.gov/system/files/attachments/us-submissions-oecd-2010-present-other-international-competition-fora/oecd-killer_acquisiitions_us_submission.pdf.

17 Complaint (Nov. 5, 2020) at 18, *United States v. Visa Inc. and Plaid Inc.*, (N.D. Cal.) (No. 3:20-cv-07810), https://www.justice.gov/atr/case-document/file/1334736/download.

18 HMG § 1.

19 Some mergers may also be the reverse of nascent competitor acquisitions where the merging parties are current competitors but the competitive significance of one of the merging parties is declining. In these cases, the merger-induced change in market concentration may overstate concerns about future effects.

20 See START-UPS, KILLER ACQUISITIONS AND MERGER CONTROL – NOTE BY THE UNITED STATES, *supra* note 16.

21 See Jay Ezrielev, *Uncertainty and Two Theories of Harm in Nascent Competitor Acquisitions*, CPI ANTITRUST CHRON. (Feb. 2022); and Nancy L. Rose & Carl Shapiro, What Next for the Horizontal Merger Guidelines? (Forthcoming) Antitrust Magazine, Spring 2022.

Another important factor for the assessment of loss of future competition effects is the ease of entry and expansion. Impediments to entry and expansion may keep firms from countering any future competition losses. Loss of future competition effects may be significant in cases where the acquisition target owns key assets (such as patents) that give it a unique ability to challenge the acquirer. Conversely, firms in markets without significant entry and expansion impediments may rapidly counteract any future competition losses. Nascent competitor acquisitions in such markets may encourage more entry as potential entrants may view entry for buyout as a profitable strategy.[22] Rapidly changing market shares or frequent entry and exit may indicate an absence of significant entry and expansion impediments.[23]

Overall, however, the applicability of the loss of future competition theory may be limited by uncertainty about future competition. In cases where the expected entry by the nascent competitor is relatively distant in time and in markets that are relatively unpredictable, determining what the future state of competition will look like at the time of entry by the nascent competitor may be difficult.[24] In these cases, any assessments under the loss of future competition theory may be unreliable, making challenges under this theory difficult.[25] The new Merger Guidelines should discuss the limits of the loss of future competition theory in challenging nascent competitor acquisitions. When are the effects too speculative for merger challenges?

A number of commentators argue that nascent competitor acquisitions may produce significant competitive harm (in the expected value sense) even if there is a low probability of future competition between the merging parties, absent the merger.[26] Low probability of harm is still harm, particularly when the potential harm (if it materializes) would be large. However, a nascent competitor acquisition may also lead to efficiencies or new entry with a similarly low-probability. It is important for the analysis of future competitive effects to treat harms and benefits symmetrically to avoid bias.

VI. INNOVATION

The stakes are high for getting antitrust policy right when it comes to innovation because of the enormous economic benefits of innovation. Courts and Agencies should weigh innovation effects heavily in merger review. Innovation effects are particularly important in nascent competitor acquisitions. Nascent competitor acquisitions can become "killer acquisitions" when the acquirer terminates the target's innovation because the innovation poses a competitive threat to the acquirer's existing business.[27] However, nascent competitor acquisitions can also spur innovation.[28] It is critical for the Agencies and courts to take advantage of economic tools in analyzing mergers' innovation effects.

The new Merger Guidelines should provide a clear and comprehensive framework for determining when mergers raise innovation competition concerns. Innovation effects analysis need not rely on predictions about future competition. Instead, Agencies and courts may consider how a merger would affect the merging firms' incentives and abilities to engage in innovation, based on currently available information. What ultimately matters is whether the acquirer intends to reduce innovation investment because of any loss of dynamic competition. To answer this question, Agencies and courts may assess the evidence of post-merger innovation investment plans. However, it is also important to gauge innovation effects using economic analysis.

We propose an economic framework for analyzing the innovation effects of nascent competitor acquisitions and other types of mergers.[29] For nascent competitor acquisitions, the economic framework contemplates a situation where an incumbent firm is seeking to acquire a nascent competitor that is developing a new product that is a potential competitive threat to the incumbent's existing (legacy) market. We refer to this new product as the "nascent market." In addition, the merging firms may each be developing competing new products. The economic framework includes nine key factors (described below) for the assessment of innovation effects.

22 See Eric Rasmusen, *Entry for Buyout*, 36 J. Ind. Econ. 281 (1988).

23 Conversely, stable shares and little history of entry may indicate significant impediments to entry and expansion.

24 See Ezrielev, *supra* note 21.

25 It may still be possible to pursue these cases under an innovation theory of harm. See Ezrielev, *supra* note 21.

26 See C. Scott Hemphill & Tim Wu, *Nascent Competitors*, 168 U. Pa. L. Rev. 1879 (2020), https://scholarship.law.upenn.edu/penn_law_review/vol168/iss7/1.

27 Colleen Cunningham, Florian Ederer, & Song Ma, *Killer Acquisitions*, 129 J. Political Econ. 649 (2021).

28 See Carl Shapiro, "Competition and Innovation: Did Arrow Hit the Bull's Eye?" in *The Rate and Direction of Inventive Activity Revisited* 361-404 (eds. Josh Lerner and Scott Stern 2012); Richard Gilbert, *Five not so Easy Pieces to Make Antitrust Work for Innovation*, CPI ANTITRUST CHRON. (Oct. 2018); and Jay Ezrielev, *An Economic Framework for Assessment of Innovation Effects of Nascent Competitor Acquisitions* (March 22, 2021), https://ssrn.com/abstract=3810486.

29 The economic framework is discussed in greater detail in Ezrielev, *supra* note 28.

1. Replacement: Replacement measures the degree to which a successful nascent market replaces or cannibalizes the incumbent's profits from an existing (legacy) market. The nascent market's replacement of the incumbent's legacy market may be full or partial. The merged firm's incentive to reduce investment in developing the nascent market increases with the degree of replacement. The presence of replacement is a prerequisite for any harm to innovation for nascent competitor acquisitions.

2. Nascent Market Size: This factor represents the potential profitability of the nascent market relative to the legacy market. The greater is the nascent market size (or potential profitability of the nascent market), the greater is the merged firm's incentive to invest in developing the market. Nascent market size may mitigate the acquirer's incentives to reduce innovation.

3. Synergies: This factor represents the enhancement in the merged firm's innovation capability relative to that of the standalone merging firms. Mergers generate synergies by combining complementary assets of the merging firms.

4. Appropriability: This factor represents the degree to which firms are able to capture the value generated by their innovative activity. Appropriability strengthens the incentives to innovate. The acquisition may increase appropriability by internalizing spillovers from innovation or by enabling the merged firm to obtain greater value from using or licensing its technology (for example, by bundling patents).

5. Third Party Competition: This factor gauges competition from non-merging firms in developing the nascent market. Any attempts by the merged firm to eliminate or significantly reduce nascent market innovation may induce additional investment by other firms. Competition from non-merging firms mitigates any reduction in post-merger innovation investment by the merged firm.

6. Entrenchment: This factor represents the extent to which the incumbent may defend its legacy market from the competitive threat of the nascent market by engaging in "entrenchment" conduct. Entrenchment may impede nascent market innovation. Entrenchment may include negative advertising about the nascent market or lobbying the government to impose stricter regulations on the nascent market. The acquisition would limit or eliminate entrenchment, which may spur nascent market innovation.

7. Innovation Competition: This factor represents potential competition between the merging firms in developing a new product. The elimination of this innovation competition may reduce incentives to engage in innovation.

8. Merger Incentives: This factor considers whether a merger between the incumbent and the nascent competitor may be mutually beneficial. The merger may not be mutually beneficial (in the absence of efficiencies) if there is competition from non-merging firms in developing the nascent market.[30] In this case, the acquisition of the nascent competitor suggests the presence of mitigating factors (such as synergies) that incentivize the parties to merge.

9. Entry Incentives: This factor considers the notion that prohibiting nascent competitor acquisitions may reduce entry incentives. Prohibiting acquisitions that are ex post anticompetitive may raise ex ante entry impediments and deter entry by nascent competitors.

Note that the two factors that can result in harm to innovation competition are Replacement and Innovation Competition. The presence of at least one of these two factors is a necessary condition for any loss of innovation competition. The Replacement factor is unique to nascent competitor acquisitions, whereas the Innovation Competition factor may be present in all types of mergers. To assess a merger's net innovation effect, analysts must compare the effects of the Replacement and Innovation Competition factors with the beneficial effects of the other factors.

The Replacement effect can be measured as the product of the replacement percentage (the expected share of the incumbent's existing product that will be replaced by the nascent product) and the future expected margin of the legacy product to be replaced. The replacement percentage is essentially a dynamic diversion ratio. The replacement percentage multiplied by legacy product margin is a dynamic version of the value of diverted sales.[31] The Innovation Competition effect can be similarly measured as the product of the expected dynamic diversion ratio between the two future products and their expected margins.[32]

30 This effect is comparable to that of mergers between firms in a static Cournot model. Such mergers are usually unprofitable (other than mergers to monopoly) for the merging firms in the absence of cost efficiencies. (See Stephen W. Salant, Sheldon Switzer, & Robert J. Reynolds, *Losses from Horizontal Merger: The Effects of an Exogenous Change in Industry Structure on Cournot-Nash Equilibrium*, 98 Q. J. Econ. 185 (1983).) The fact that we observe such mergers suggests that the mergers produce cost efficiencies.

31 The current Horizontal Merger Guidelines discuss a static version of the value of diverted sales in the Unilateral Effects Section. See HMG § 6.1.

32 This dynamic diversion ratio would incorporate the probabilities of successful development of the two future products as well as the expected substitutability (or cross-elasticity of demand) between the products.

VII. EFFICIENCIES

Agencies and courts should credit dynamic competition and operational efficiencies in merger review. Dynamic competition efficiencies include innovation efficiencies, but they also include efficiencies that enhance other forms of dynamic competition. Firms engage in dynamic competition by investing in innovation, product promotion, production capacity, logistics, reputation, distribution capacity, training, human resources, and customer service. In addition, firms engage in dynamic competition by securing supply and service agreements, adopting new technologies, and entering strategic partnerships. Dynamic competition efficiencies reduce investment costs, increase investment incentives, and enhance the capabilities of the merging firms.

The economics literature provides many examples of dynamic competition efficiencies. A merger may spur additional investment by solving the "holdup" problem associated with relation-specific investments.[33] As we discuss in the previous section, a merger may create innovation synergies by combining complementary assets. For example, a merger may create innovation synergies by combining the technological know-how of one firm with the other firm's superior ability to commercialize new technology. Mergers may also enable faster and more widespread adoption of new technologies.[34] Moreover, a merger between a firm with low capital costs and another firm with promising investment prospects may spur investment by matching low financing costs with better investment opportunities.[35]

The Efficiencies section of the current Horizontal Merger Guidelines focuses largely on static competition efficiencies. Although the guidelines discuss innovation efficiencies, the discussion generally takes a skeptical view of these efficiencies.[36] Nonetheless, innovation efficiencies can produce significant benefits, and it is important that the Agencies and courts give these efficiencies due consideration in merger review.

It is likewise important for the Agencies and courts to recognize operational efficiencies in merger review.[37] These efficiencies may eliminate the use of redundant resources, freeing up resources for more efficient use, which can stimulate economic growth. Operational efficiency may also reduce the use of physical resources, thereby generating environmental benefits. The new Merger Guidelines should make it clear that operational efficiencies are cognizable even if they do not lower the static marginal cost of supply.

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33 See Oliver E. Williamson, *Transaction-Cost Economics: The Governance of Contractual Relations*, 22 J.L. & Econ. 233 (1979); and Sanford J. Grossman & Oliver D. Hart, *The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration*, 94 J. Polit. Econ. 691 (1986).

34 See Boyan Jovanovic & Peter L. Rousseau, *Mergers as Reallocation*, 90 Rev. Econ. Stat. 765 (2008).

35 Finance literature shows a positive relationship between firm cash flow and investment. See, for example, Steven M. Fazzari, R. Glenn Hubbard, & Bruce C. Petersen, *Financing Constraints and Corporate Investment*, 1988 Brookings Papers on Econ. Activity 141 (1988).

36 See HMG § 10 ("Other efficiencies, such as those relating to research and development, are potentially substantial but are generally less susceptible to verification and may be the result of anticompetitive output reductions.").

37 The current Horizontal Merger Guidelines attribute little weight to operational efficiencies in merger assessments. See HMG § 10 ("[T]he Agencies are mindful that the antitrust laws give competition, not internal operational efficiency, primacy in protecting customers.").