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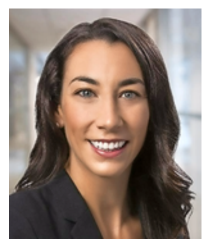
INSIGHT: The Unlikely Role of Labor Markets in Merger Antitrust Review

Mergers

Skadden attorneys David P. Wales, Tara L. Reinhart, Anjali B. Patel, and Danielle D. Drory explain that top U.S. antitrust enforcers are on the record that they will review proposed mergers' impact on labor markets. Given the lack of clear answers to the questions of how the agencies will define a relevant labor market, balance potential harms with efficiencies presented outside that market and devise remedies, it will be surprising to see challenges to mergers solely for competitive harm to workers.



By David P. Wales, Tara L. Reinhart, Anjali B. Patel, and Danielle D. Drory

Picture this: The Ultimate Fighting Championship (UFC), which is a multibillion-dollar league that promotes mixed martial arts (MMA) matches, seeks to acquire a rival league. Rather than investigate only the typical antitrust merger concern of whether viewers would pay more to watch MMA, the Federal Trade Commission (FTC) also considers the impact on labor markets—whether fighters may get paid less to fight.

While the vast majority of antitrust concerns stem from the impact mergers can have on the sale of products or services (*e.g.*, will consumers pay more for goods or services), in more rare cases, concerns can stem from monopsony or buyer power (*e.g.*, will sellers be paid less because the merger reduces the number of buyers to play off one another). Focusing on monopsony power—including looking at the impact on labor markets like those in the example above—may not be as farfetched as it once was. The top enforcers in the Justice Department's Antitrust Division and the FTC are on record in recent congressional testimony that, going forward in merger investigations, both agencies will investigate potential labor monopsony harms as part of their antitrust review.

While adding buyer-side labor effects to merger review may be possible under accepted U.S. antitrust law principles, it raises a number of questions that will make it difficult for the enforcers to bring such cases in practice. How is a relevant labor market defined? In the UFC scenario, what alternatives do fighters have for employment? Is the market for fighters limited to MMA leagues, or should it include boxing, wrestling or other professional sports that command similar skills of UFC fighters? Once a relevant market is defined, how should agency staff weigh the potential harms and benefits to competition in the labor market and the output market? For example, what happens if the UFC acquisition is good for viewers but bad for MMA fighters? And, assuming the merger would harm the labor market, is there a remedy? If so, would that remedy include blocking the deal outright or requiring that the company pay employees fairly? Though it appears a labor monopsony assessment will now be part of merger review, the agencies have not yet issued guidance, and how agency staff will approach these difficult questions is far from clear.

Recent Antitrust Enforcer Statements

On Oct. 3, 2018, Joseph Simons—current FTC Chairman—and Makan Delrahim—Assistant Attorney General in charge of the Antitrust Division—testified before the Senate Subcommittee on Antitrust, Competition Policy and Consumer Rights and explained the agencies' antitrust enforcement activity and policy under their watch. In the course of broad questioning and seemingly bipartisan populist pressure to increase antitrust enforcement, senators asked about the role of labor markets in merger review, including whether the merging parties would have more monopsony or buyer power that would allow them to pay workers less. Sen. Richard Blumenthal (D-Conn.) noted that, while he himself was not aware of any merger that had been challenged over labor market concerns, the agencies should consider labor in their investigations. Both Delrahim and Simons acknowledged the concern and the research showing increasing average concentration in many U.S. labor markets. Some believe that high labor market concentration can contribute to lower wages. Moreover, there is a concern that the increased labor market concentration coincides with an increase in merger activity over the past several decades, but there is limited research to show that the two are linked.

In response to these concerns, Delrahim pointed to the Antitrust Division's recent enforcement focus on anti-poaching and wage-fixing agreements and said that labor issues could factor into merger reviews. He said the traditional *Philadelphia National Bank* concentration thresholds used to predict whether a merger would have a negative impact on sell-side markets also would apply to potential effects on buy-side markets, including labor. Simons testified that FTC staff have been directed to include a proposed transaction's potential effects on the labor market in their merger investigations, and some already have raised these issues in pending merger investigations.

Simons previously described the potential role of labor markets in merger reviews during his Senate confirmation hearings. In a written response to a question asking him to identify the top three challenges facing the FTC, he said ''[s]ignificant concerns have been raised that the federal antitrust agencies have been too permissive in dealing with mergers and acquisitions, resulting in harm to consumer welfare via increased prices, limited consumer choice, and harm to workers.''

In June 2018, the FTC Bureau of Competition director Bruce Hoffman also weighed in. He said he does not view the antitrust laws as a ''device to protect the interests that are protected by labor laws,'' but that labor monopsony issues may exist separate from sell-side concerns in a merger. Under the FTC's traditional approach, he said, those concerns would be ''completely missed.'' In October 2018, the FTC devoted an entire morning at one of its Hearings on Competition and Consumer Protection in the 21st Century to a discussion of labor market concerns, and prominent antitrust practitioners, economists and academics spoke.

History of Labor in Antitrust

The consumer welfare standard underlying antitrust enforcement typically focuses on the impact to a consumer as the purchaser of a good or service. As such, traditional merger review largely focuses on the sell-side, that is, whether a proposed transaction affects competition for the provision of a particular good or service to the detriment of consumers of that good or service through higher prices, reduced quality or diminished innovation. A proposed transaction that threatens to eliminate or substantially lessen competition in a defined relevant market may be challenged as a violation of Section 7 of the Clayton Act.

A similar analysis applies to potential monopsony concerns, *i.e.*, buyer power. As contemplated by the 2010 Horizontal Merger Guidelines, Section 12, ''mergers of competing buyers can enhance market power on the buying side of the market, just as mergers of competing sellers can enhance market power on the selling side of a market.'' The same framework that applies to a sell-side analysis is employed; however, the agencies note that reductions in input prices may not necessarily be a function of monopsony or buyer power, and may instead arise from efficiency gains. While both agencies have investigated monopsony issues in potential transactions, few mergers have been challenged under this theory. In 1965, in *United States v. Pennzoil*, the Western District of Pennsylvania blocked a merger of two of the three largest refiners of crude oil. The court determined it was unlikely that the merger would affect the sell-side—output in the downstream worldwide market for refined oil—but the court condemned the merger's creation of local monopsony power in the Pennsylvania crude oil market. The merger's resulting dominant buyer would have controlled 54 percent of the refining capacity in the market and could use that power to drive down the price of crude oil.

There is even less precedent as to concerns of labor monopsony power. The Horizontal Merger Guidelines are silent on such power as it relates to the labor market. In fact, the antitrust agencies typically have viewed a merger's impact on labor as an efficiency—*e.g.*, lower costs, redundancies—rather than a harm. Further, no merger challenge has turned on a proposed transaction's potential effects on the labor market.

Identifying Labor Monopsony in Merger Review

In reviewing a proposed transaction, the investigating antitrust agency identifies relevant markets in which to assess the potential competitive effects. Market definition has two aspects: the relevant product market and the relevant geographic market. A relevant product market is comprised of the products or services that customers find as relatively close substitutes. For example, a relevant product market can be retail gas stations. The relevant geographic market is the geographic area within which customers are willing to venture to find a substitutable product or service; depending on the product/service at issue, it can be quite broad (*e.g.*, worldwide) or very narrow (*e.g.*, within one mile or even less). In the gas station example, the relevant geographic markets typically are only a few miles wide—about how far a customer is willing to drive for cheaper gas. Both the product market and geographic market inquiries are specific to the nature of the goods or services in question.

To investigate market definition, the agencies often ask the merging parties to submit business records that reveal the companies' views on the competitive landscape, including each party's perceived competitors and each party's respective customers. Agency staff typically reach out to customers to test their reactions to the proposed transaction, views on the relevant markets and gauge possible remedies to cure any competitive concerns. These steps go a long way toward informing the agency staff's view of the relevant market and potential competitive effects of the proposed transaction.

Defining labor monopsony markets is more difficult than defining the traditional sell-side market. The Antitrust Division's approach to investigations of no-poaching agreements between firms—agreements that companies competing for labor will not recruit or hire each other's employees—is instructive. The Antitrust Division has brought and settled many cases challenging no-poaching agreements, and presumably the agency would be prepared to prove harm in a properly defined relevant market if a defendant company ever put the agency to its proof. In the many cases it has brought and settled, however, the Antitrust Division has not explicitly defined relevant markets, likely given that the agency alleges that no-poaching agreements are *per se* illegal. Like price-fixing, the alleged conduct is presumed to result in harm and the conduct has no redeeming value. In the past decade, the Antitrust Division brought a number of no-poaching cases in the technology sector. Instead of defining markets for categories of specific types of workers, like engineers, designers or coders, the complaints in those cases alleged harm to ''high tech labor,'' ''skilled employees'' and the like. These are broad descriptions of affected workers that lack the clarity necessary to analyze competitive effects the way agency staff do in merger investigations. In the most recent no-poaching case—brought and settled in April 2018—the Antitrust Division alleged that two firms agreed not to poach each other's employees and thus restricted competition for ''U.S. rail industry workers.'' It is difficult to imagine the Antitrust Division actually assessing the potential for competitive harm in such a broad, undefined ''market'' in the merger context.

In their recent article *Anticompetitive Mergers in Labor Markets*, Ioana Marinescu and Herbert Hovenkamp claim that the existence of a no-poaching agreement between firms suggests, by its very being, that there is a relevant market for the employees subject to the no-poaching agreement's terms. They posit that if the employees subject to the no-poaching agreement did not constitute a relevant market, the agreement itself would be irrelevant and worthless. In other words, the fact that the employers found such an agreement valuable in and of itself indicates there must be one or more relevant markets.

Whether such analysis applies equally to merger review is doubtful. It is one thing to take a naked no-poaching agreement, with no possible procompetitive benefit, and infer that there may be a relevant market because the two companies must have seen some benefit from such an employment-restricting agreement. It is quite another to precisely define a relevant market in which the agencies must weigh the potential benefits and harms to competition flowing from a merger. As a practical matter, there likely will be much less evidence to determine the proper scope of a labor market than there is with a typical sell-side market. Companies are unlikely to engage in strategic analyses of employment considerations as they do for the goods and services they provide, particularly in the context of a ''competitive landscape'' or other potential employers. While the investigating agency could speak with company employees about competition for labor, much more evidence would be needed to conduct a proper analysis.

The UFC antitrust litigation, which includes a monopsony claim, highlights the practical difficulties in defining a relevant product market for labor. The plaintiff fighters allege in part that the relevant market is limited to MMA fighters, such that when the UFC acquires rival MMA leagues, the fighters are forced to take lower wages for their unique services. However, the recent experiences of at least two MMA fighters suggest otherwise. Conor McGregor, a prominent UFC fighter, fought Floyd Mayweather last year in a boxing match and made millions, despite switching to a different sport. Ronda Rousey also recently left the UFC for the World Wrestling Federation. Both of these suggest that an ''MMA fighter'' market may be too narrow.

Defining a relevant labor market in less colorful industries is no simpler. Would the antitrust agencies challenge mergers between the technology companies that it sued for no-poaching agreements based on a labor market? The categories of ''high tech labor'' or ''skilled workers'' identified in the no-poaching complaints are far too broad for a proper assessment of monopsony effects on labor. And, as discussed, a relevant market has two aspects: a relevant product market and a relevant geographic market. In this day and age, and given the boom of multinational corporations and technology-based work, as well as the ease of relocation, the way people work has changed drastically from even a decade or two ago, particularly for high-skilled workers. All of this makes it harder to imagine that at least some workers could not easily move to another city if they faced a layoff or cut in pay as a result of merger. Perhaps, it is possible to imagine a merger where the workers had a very specialized skill set in a set geographic area. For example, there could be highly trained and educated nuclear scientists that do certain types of tests for the only two companies in the United States doing this work. Would the Antitrust Division challenge a deal between these two companies over labor monopsony concerns if the deal otherwise presented no sell-side concerns (*e.g.*, the nuclear testing market is global and there are many competitors)?

Balancing Potential Labor Monopsony Concerns With Traditional Deal Efficiencies

Assume, for argument's sake, that one could define a relevant labor market and identify labor monopsony concerns. How then would the agencies balance labor monopsony concerns with traditional deal efficiencies? Enforcement agencies likely will find it difficult to disentangle whether low prices observed in the market result from encouraged deal efficiencies or labor market concerns.

At the Oct. 3, 2018, Senate hearing, Simons offered a ''classic'' example of a potential transaction that could raise labor issues, but present no other concerns. He considered the case of two automobile manufacturers who are the primary employers in a local town. A merger of the two may not raise any concerns on the selling side as their products are sold across the country and they compete with many other automobile suppliers. However, the deal may raise concerns on the employment side by merging the only two plants in town and eliminating potential jobs for local residents.

This is a troubling example on several levels. First, it assumes one can narrowly define a market to include a set of workers with specific skills (automobile manufacture) and a small geographic area (a local town). While the two automobile manufacturers may be the primary employers in a certain area, they are certainly not the only employers available to residents. The agency would have to conclude, for example, that automobile workers cannot find jobs in other local factories. Moreover, it also would have to be the case that the automobile workers are unwilling or unable to move to other towns with auto plants. It seems improbable that automobile workers could not take skills learned at that job and apply for employment elsewhere, including in different industries and, to some extent, different geographic locations.

Second, this example flies in the face of decades of deal-synergy analysis and ignores the potential procompetitive effects of a proposed transaction. For example, in the hypothetical automobile manufacturer deal, the merger could reduce the price of cars sold across the country by reducing the cost of labor and other inputs to make those cars, while at the same time driving down workers' wages in local areas. The ability to eliminate redundancy through a potential transaction and pass those efficiencies on to customers has long been a pillar of transaction rationale and is central to the consumer welfare standard. Merging parties count on being able to optimize and streamline inefficient operations through a proposed transaction, and often point to those synergies as a key benefit of doing the deal. Inserting a labor market assessment is sure to transform how parties rationalize and evaluate potential transactions. At its worst, it could have a chilling effect on merger activity, preventing companies from pursuing legitimately procompetitive transactions for fear of running afoul of labor monopsony concerns that they may not be able to fully assess.

Finally, U.S. antitrust law and policy discourages trying to weigh the potential effects in one market against those in another. This typically comes into play when merging parties try to overcome the competitive harm in one market by arguing efficiencies and other benefits in a second market. So-called out-of-market efficiencies are almost always dismissed. As the U.S. Supreme Court said in *United States v. Philadelphia National Bank* (1963), "[w]e are clear, however, that a merger the effect of which 'may be substantially to lessen competition' is not saved because, on some ultimate reckoning of social or economic debits and credits, it may be deemed beneficial." Further, in the Horizontal Merger Guidelines, both the Antitrust Division and the FTC explicitly acknowledge that there are instances in which they "will consider efficiencies not strictly in the relevant market," but limit it to those efficiencies that are "inextricably linked" to that market such that a divestiture would not be feasible.

Practically speaking, if labor monopsony concerns are given equal footing with the types of competition concerns that are more traditional to merger review (*i.e.*, sell-side effects), many deals that would greatly benefit the American consumer could be blocked. Take Simons' example of the two local automobile manufacturers. If a potential transaction could have the effect of creating significant and meaningful benefits for automobile consumers, is it the job of the U.S. antitrust agencies to challenge the deal because of a possible, and potentially immeasurable, effect on a small subset of workers?

Potential Remedies to Address Labor Monopsony Concerns

It is difficult to imagine a proposed transaction that raises only labor monopsony concerns, and not competitive issues in a sell-side market. In the UFC example, assuming a narrow, MMA relevant market, a merger with another league that eliminates employment options for fighters also could present traditional monopoly, sell-side concerns in the market for promotion of MMA matches. In most cases where a proposed transaction poses labor monopsony issues significant enough to warrant a challenge to the transaction, it is likely that the transaction also poses more traditional competitive concerns. In such instances, a remedy addressing the traditional competitive concern likely would also remedy the labor monopsony issue. A divestiture buyer would preserve competition for employment, and employees would have the same number of options of employers.

But assume that a proposed transaction only raises labor monopsony concerns and requires a remedy. What would an effective remedy to address labor monopsony concerns look like?

Remedying labor monopsonies in merger review is complicated by the bilateral nature of labor markets. While firms generally are concerned with a sell-side customer's willingness to pay for a good or service, the labor market involves a more complicated matching process. In the labor market, firms are concerned not only with the wages that they will pay an individual, but also with the personal characteristics of their employees, such as their competence, diligence and character fit. Remedies that disregard the job-matching process may result in unintended consequences. Take, for example, a remedy requiring companies to agree not to lower wages. To the extent that this artificially inflates the market wage for that specific industry, higher-skilled workers from other labor markets may apply, pushing out workers of lower-skill that were already in the industry. This agreement also could force companies to further eliminate positions in the newly merged company to ensure equal profitability. This remedy and others aimed at mitigating labor monopsonies in newly merged companies could have unintended consequences in the bilateral labor market.

Further, in exploring potential remedies for labor monopsony concerns, the current strong preference for structural remedies could lead to potentially disproportionate and extreme results. The U.S. antitrust agencies historically have expressed a strong preference for structural remedies above all else. Accordingly, the agencies typically require a divestiture of sufficient assets to a third party to preserve competition, and they typically reject behavioral remedies offered by the merging parties, such as commitments to freeze prices or enter into long-term contracts with customers. Hand-in-hand with that is a preference not to enter into settlements in which the agency is bound by any continuing entanglement or oversight. Using divestitures to address labor monopsony issues may require fixes that go far beyond the scope of the problem. Using the automobile manufacturer example highlights this issue. To remedy the labor impact in a local town where the merging parties have separate plants could require not only divesting one of the local plants to a third party, but divesting additional assets to ensure that the third party effectively could compete at the same level as the merging parties. For example, the third party also might need plants that supply important inputs to the local plant, marketing and sales teams, and other assets needed to compete. Such a broad remedy would, of course, likely decimate the pro-competitive rationale for the deal and could lead the merging parties to abandon the deal altogether. This may lead the agencies to block a disproportionate number of mergers presenting labor market buy-side issues relative to those presenting sell-side issues, where an anticompetitive merger can be cured through proven remedies.

Conclusion

The top U.S. antitrust enforcers are on the record that they will review proposed mergers' impact on labor markets. Given the lack of clear answers to the questions of how the agencies will define a relevant labor market, balance potential harms with efficiencies presented outside that market and devise remedies, it will be surprising to see challenges to mergers solely for competitive harm to workers. If one of the agencies concludes a merger has the potential to harm workers, it also almost certainly will find potential harm to competition in the output markets and will challenge the deal on that basis. At the end of the day, the one certainty is that merging firms will need to be prepared to address potential labor issues with agency staff.

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