

MERGER ANTITRUST LAW

LAW 1469
Georgetown University Law Center
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Tuesdays and Thursdays, 3:30 pm – 5:30 pm
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CLASS 16 WRITTEN ASSIGNMENT—INSTRUCTOR'S ANSWER

Instructions

Submit by email by 3:30 pm on Tuesday, October 21

Send to wdc30@georgetown.edu

Subject line: Merger Antitrust Law: Assignment for Class 16

Assignment: Calls for a memorandum to a partner (which may be sent to a client)

Dianne Lockhart has read your memorandum on recapture unilateral effects. She would now like you to write another memo explaining auction unilateral effects. As before, she would also like you to discuss the general idea behind this variation of unilateral effects as a theory of anticompetitive harm under Section 7, identify the required elements of the theory, and discuss the factors the agencies consider when deciding whether the theory applies to a particular merger.

If you have any questions, send me an email. See you in class.

ABLE & BAKER LLP

INSTRUCTOR'S ANSWER

TO: Dianne Lockhart
FROM: Dale Collins

Auction Unilateral Effects

Auction unilateral effects arise in winner-take-all procurement when A and B are the first- and second-lowest-cost suppliers to the same account and other rivals are materially higher cost. Suppliers are ranked by delivered cost for that account, which includes production costs, transportation, and any other account-specific expenses. Merging A and B raises the buyer's best alternative from c_2 to c_3 , where c_2 and c_3 are the delivered costs of the second- and third-lowest-cost suppliers, respectively. The theory predicts that, as a result of the merger, the winning bid tends to rise by roughly the gap between c_2 and c_3 .

This theory requires four conditions: (1) the merger involves the lowest- and second-lowest-cost suppliers to one or more customers; (2) the third-lowest-cost supplier has materially higher costs than the second-lowest; (3) suppliers can engage in price discrimination among customers without risk of arbitrage; and (4) barriers to entry, expansion, or repositioning are sufficient to prevent the rapid restoration of an equivalently low-cost second bidder. In addition, although not typically enumerated as a separate condition, for this theory to establish a cognizable harm under Section 7 of the Clayton Act, the affected accounts must be sufficiently large in the aggregate such that the predicted harm is likely to substantially lessen competition in the relevant market.

The idea behind the theory is straightforward. Premerger, the customer "plays off" competing suppliers to obtain the lowest price. When the customer receives a bid, it informs the other suppliers of the bid price they must now match or beat. When another supplier offers a lower price, the customer again informs rivals of the new target. As this process continues, suppliers drop out of the bidding as the required price falls below their costs until only two remain: the lowest-cost and second-lowest-cost suppliers. The customer continues to play these final two bidders against each other until the second-lowest-cost supplier drops out. The lowest-cost supplier then wins at a price just below the delivered cost of the second-lowest-cost supplier.¹

The auction process proceeds similarly after the lowest- and second-lowest-cost suppliers merge. Postmerger, however, the merged firms do not compete against each other, leaving the merged firm (with the lowest cost) and the third-lowest-cost supplier as the final competitors. Again, the lowest-cost firm wins, but this time at a price just below the cost of the third-lowest-cost supplier. The auction unilateral effect is the increase in price the buyer pays, which equals the difference between the costs of the second-lowest- and third-lowest-cost suppliers.

Auction unilateral effects often arise when suppliers travel to their customers and incur significant transportation costs in delivering their goods or services. Where suppliers have similar input costs, they are differentiated mainly by their location relative to customers, which

¹ Note that if the merged firm overestimates the cost of the third-lowest-cost supplier and loses the bid, then the customer still pays a higher price (this time to the third-lowest-cost supplier) than it would premerger, which itself is an anticompetitive effect of the merger.

determines their relative transportation costs. If the two most cost-effective suppliers to a specific customer merge, that customer will likely face higher prices since the price-constraining force on the merged firm becomes the third-lowest-cost supplier rather than the second-lowest-cost supplier.²

The following hypothetical illustrates the auction unilateral effects theory. Consider a steel mill in eastern Tennessee that regularly solicits bids for deliveries of chemical lime. While several companies operate regionally, only a few have plants close enough to serve the mill efficiently. Suppose Appalachian Lime has the lowest delivered cost to the mill at \$95 per ton, and Volcano Minerals has the second-lowest cost at \$100 per ton. A third supplier, RidgeRock Lime, operates farther away in West Virginia with a delivered cost of \$115 per ton. Premerger, the mill plays Appalachian and Volcano off each other. Volcano drops out when the price falls below \$100, and Appalachian wins the auction with a bid just below that—say, \$99 per ton. If Appalachian and Volcano merge, the customer can no longer play the two lowest-cost suppliers against each other. The next best alternative is RidgeRock. Postmerger, the combined firm can now bid just below RidgeRock’s delivered cost of \$115 per ton—say, \$114 per ton—and still win the business. The merger raises the buyer’s price from \$99 to \$114 per ton, a \$15 per ton increase, or roughly 15%, despite no change in production costs. That is the auction unilateral effect: prices rise because the second-lowest-cost supplier is no longer an independent competitive constraint.

The analysis, like the example above, typically assumes that the auction concludes with a winning bid just below the cost of the second-lowest-cost supplier. This assumption simplifies the analysis by isolating the competitive effect of the merger. In practice, actual auction outcomes may vary due to strategic bidding, asymmetric information, or other institutional features. Nevertheless, the theory remains useful because the difference in delivered costs between the second- and third-lowest-cost suppliers provides a reasonable estimate of the upward pricing pressure caused by the merger. Postmerger, the merged firm no longer faces the constraint of the second-lowest-cost rival, and its ability to raise price is bounded by the next-best alternative—typically the third-lowest-cost supplier. Even if the final price does not rise to just below that third supplier’s cost, the magnitude of the cost gap serves as a reliable indicator of the lost competitive tension and the potential price effect. Both the antitrust agencies and the courts have accepted this framework as a reasonable method for assessing unilateral effects in auction settings.

Please let me know if you have any questions or would like to discuss these theories further.

² See, e.g., *FTC v. Sysco Corp.*, 113 F. Supp. 3d 1 (D.D.C. 2015) (Sysco/U.S. Foods merger).