Comment on Modernizing Merger Enforcement:  
Strengthening Review of Small Mergers to Prevent “Stealth Consolidation”

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On January 18, 2021, the Federal Trade Commission and the Antitrust Division of the U.S. Department of Justice issued a request for information about “how the agencies can modernize enforcement of the antitrust laws regarding mergers.”2 This comment is based on my research concerning mergers that are not reportable under the Hart-Scott-Rodino (HSR) Act. My work indicates that these transactions face systematic underenforcement, create competition problems, and are much more prevalent than previously believed, as I describe below. This comment concludes with suggested actions the agencies can take to address these issues.

I. THE PROBLEM OF STEALTH CONSOLIDATION

Most US mergers escape premerger notification requirements because they fall below reporting thresholds. All else equal, a smaller transaction is less likely to be anticompetitive in a large market; however, very often firms compete in segmented markets. For example, hospitals serve a local geography, as do dialysis facilities, funeral homes, drug stores, and many others. In these instances, a merger that is relatively small in transaction value can nonetheless consolidate a large share of the market, thereby harming competition. For example, two hospitals in a city, both below the reporting threshold, could combine into a monopoly without being subject to the Hart-Scott-Rodino Act’s premerger notification requirements3 and escape the agencies’ attention—an outcome I call stealth consolidation. Were the agencies not to learn about an anticompetitive merger before it is consummated, significant and prolonged harm to consumers would be likely, since transactions are typically very difficult to unwind after they are completed. Thus, size exemptions can allow harmful transactions to take place. In addition, any lack of scrutiny of small mergers lessens the deterrence that normally accompanies an anticompetitive transaction. Moreover, while stealth consolidation is easiest to illustrate using non-tradeable (i.e., geographical segmented) service markets, the logic applies to any type of product differentiation, and the concern extends to many manufactured goods and tradeable services.

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II. ECONOMY-WIDE EVIDENCE

First, I will discuss “Stealth Consolidation,” which was published in American Economic Review: Insights in 2019. This article investigates whether premerger notifications affect merger-related enforcement actions and whether the threat of enforcement deters horizontal mergers. To study this behavior, I examine behavior around the 2001 amendment to the HSR Act, which raised the transaction value threshold from $15 million to $50 million. As a result of this change, premerger notifications fell by 70%.

In the article, I define “horizontal” mergers as those where the target and acquirer have the same 4-digit SIC code, and I refer to all others as “non-horizontal.” I define “newly exempt” mergers as those that would have required notification but for the amendment, and I define “never-exempt” mergers as those that are large enough to always require notification in the sample.

To estimate the effect of premerger notifications on antitrust enforcement, I compare the number of enforcement actions involving (a) newly exempt and never-exempt mergers (b) before and after the amendment. The basic idea is that if premerger notifications are essential to enforcement, then enforcement actions involving newly exempt mergers would fall sharply after the amendment. I find precisely this pattern in the data. That is, notifications are absolutely essential to enforcement.

If firms know they will face antitrust scrutiny, they might be deterred from attempting anticompetitive mergers in the first place. To identify deterrence, I compare (a) newly exempt mergers with never-exempt mergers and (b) horizontal mergers with non-horizontal ones (c) before and after the amendment. The basic idea is that if antitrust enforcement has a deterrent effect and if horizontal mergers are more likely to face enforcement than non-horizontal ones, then horizontal newly exempt mergers should increase sharply after the amendment. Again, I find precisely this pattern in the data. In other words, enforcement is a powerful deterrent of horizontal mergers.

III. INDUSTRY-SPECIFIC EVIDENCE

The preceding analysis has limitations. First, 4-digit SIC codes may not identify head-to-head competition. Second, price and quality changes are not considered, so it is very hard to quantify consumer harm. Third, the cost to the agency of expanding the premerger notification program is not considered. I address these limitations in my 2021 article “How to Get Away with Merger,” which studies dialysis providers.

In the article, I collect data on over 4,000 acquisitions of individual dialysis facilities in the United States, effectuated through about 1,700 mergers occurring between 1997 and 2017. Half

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of the facility acquisitions involved exempt mergers (i.e., they were never reported to the agencies). Precise market definitions in this industry provide good measures of competition because dialysis clinics have no meaningful substitutes and patients require treatments that are geographically close to their homes. The bulk of clinic revenue comes from Medicare, which sets a fixed price for dialysis service, so any anticompetitive effect will bear on quality.

Again, the first exercise studies enforcement actions. I compare (a) facility acquisitions that are part of exempt mergers with those that are part of reportable mergers and (b) facility acquisitions that are expected to significantly raise concentration with those that are not. I find that enforcement among reportable facility acquisitions looks very reasonable—there are no divestitures for acquisitions involving trivial HHI changes but very high rates of divestiture among acquisitions involving large HHI changes. However, in stark contrast to reportable facility acquisitions, I find that enforcement among exempt facility acquisitions is basically nonexistent, regardless of the predicted impact on concentration! (See the figure below for an illustration.) In short, I find that premerger notifications are critical to enforcement, consistent with a finding in my prior paper.

Figure: Divestiture rates by premerger market structure and HSR reportability

I plot HHI changes on the x-axis against an indicator for divestiture on the y-axis. (HHI changes are defined here as predicted changes in the concentration index that would result from the facility acquisition being completed without any divestitures.) To improve legibility, the data are sorted into equal-sized bins according to x-axis values, and averages within the bins are reported along the axes. The dashed line reflects reportable facility acquisitions, and the solid line reflects exempt ones.

My second exercise examines how risk-adjusted hospitalization and mortality rates respond to ownership changes. I compare health outcomes (a) at facilities experiencing reportable acquisitions with facilities experiencing exempt acquisitions and (b) at facilities experiencing large HHI acquisitions with those experiencing small HHI acquisitions (c) before and after these acquisitions. The basic idea is that facility acquisitions that consolidate ownership will reduce
incentives to compete, which reduces quality in equilibrium. However, if facility acquisitions are part of reportable mergers, then the FTC will be alerted to these acquisitions and block them (i.e., require the acquirer to divest these locations before completing the merger), so quality will not decline after these transactions. The data are consistent with both predictions. Exempt facility acquisitions involving large HHI changes cause risk-adjusted hospitalization rates to rise and risk-adjusted survival rates to fall. In contrast, reportable facility acquisitions that would result in similar market structure changes do not adversely affect risk-adjusted hospitalization and survival rates, since the affected facilities are divested to other firms. Since ill health, hospitalizations, and deaths all affect the value consumers derive from dialysis, I conclude that premerger notifications have an important effect on consumer welfare.

My third exercise compares the costs and benefits of (retrospectively) eliminating premerger notifications in the dialysis industry. I estimate a structural model of patient demand, firm profit, and enforcement costs, and I use the estimates to simulate counterfactual market outcomes under the alternative policy. I find that the benefits of eliminating premerger notification exemptions far exceed the costs. Importantly, the FTC must receive additional funding to handle the increased workload associated with this policy change; otherwise, resources may be drawn away from other enforcement matters, which are shown in this paper to save lives and improve consumer welfare.

IV. INVESTOR DISCLOSURES, ANTITRUST RISK, AND MISMEASUREMENT OF SUB-HSR MERGER ACTIVITY

In the process of analyzing the results, I compared dialysis industry merger activity measured by Thomson, which was the basis for my first paper, and Medicare, which was the basis for my second paper. Since registration with Medicare is required for reimbursement, its records are complete, so it provides a comprehensive source to compare against. I found that only about half of the facility acquisitions recorded by Medicare were reported by Thomson, even among large public companies, which is especially surprising given that Thomson is the most widely used data source for tracking US ownership changes. The “missing mergers” raise two important questions. First, do managers withhold disclosures to avoid alerting antitrust authorities? Second, is non-HSR reportable merger activity much greater than commonly reported? I examine these issues in my new coauthored article “A New Era of Midnight Mergers.”

The article centers on the idea that investor disclosures involve a tradeoff. Assuming the deal will close, an acquisition of a competitor is good news to the owner of a business. Thus, disclosing the event will cause share prices to rapidly rise, benefiting incumbent shareholders. However, this disclosure may also alert antitrust authorities to a deal they would not have otherwise discovered. Hence, it has a cost. Regardless of whether the agencies actually scan

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6 Note that there is an ongoing debate over whether the antitrust laws protect consumers from lower quality and innovation, as well as from higher prices. These results provide a concrete example of consumer harm in a market where price is fixed.

investor disclosures for anticompetitive mergers, nearly every major “handbook” addressing practical aspects of antitrust law warns practitioners that the agencies may be looking for disclosures. Hence, we assume firms behave as if the agencies scan these documents. (For further evidence, see several colorful quotes in the article.)

The data we use in the article cover the universe of US public companies from 2002 to 2016. For these firms, securities laws require that investors must be informed about any acquisition whose transaction value exceeds 10% of the assets of the acquiring firm. Separately, as stated above, premerger notifications are required for mergers whose transaction value exceeds $50 million in 2002 (or $90 million in 2020).

The first exercise tests whether investor disclosures pose antitrust risk. We restrict attention to non-HSR reportable mergers and rely on the fact that when a merger’s transaction-value-to-acquirer-assets ratio exceeds 10%, the transaction must be disclosed to investors. The basic idea behind the test is that if investor disclosures pose antitrust risk, which disproportionately affects anticompetitive mergers, then the proportion of horizontal mergers should fall abruptly at the 10% cutoff value. We find precisely this pattern in the data.

Notice that if a transaction requires a premerger notification, then the agencies are already fully informed about it, so an investor disclosure does not pose any additional antitrust risk. Based on this logic, if we repeat the test described above but restrict attention to HSR reportable mergers, then the aforementioned discontinuity should not appear in the data. Consistent with that prediction, we find that the horizontal proportion of mergers trend smoothly through the 10% cutoff value. This specification represents a falsification test, which helps rule out alternative explanations of the patterns we observe in the data.

This finding implies that managers may hide the mere existence of some mergers from investors in order to conceal them from the antitrust authorities. To evaluate this possibility, we rely on an idiosyncratic feature of financial accounting standards, which allows us to measure the total value of “undisclosed” mergers (i.e., ones for which no individual public record exists). Our method reveals that publicly traded US companies completed over $2 trillion in mergers that were never divulged (i.e., there is no record of them in Thomson’s merger database, which is widely considered the gold standard for reporting merger activity and serves as the basis for private sector “league tables”). Moreover, theory suggests that these mergers are especially likely to be anticompetitive in nature.

The full articles can be found on my research page: https://sites.google.com/view/thomaswollmann.

V. CONCLUSIONS

These results suggest the following revisions of the merger guidelines.

- The agencies should increase enforcement of small mergers based on evidence of systematic underenforcement and competition problems they create. These mergers are often anticompetitive because the markets in which the firms operate are small.
• The agencies should request that Congress lower HSR transaction value thresholds (or provide the agencies discretion to reduce the thresholds below their current value), which will facilitate additional enforcement and prevent stealth consolidation.

• The agencies should request that Congress provide resources to handle the additional workload so that staff are not drawn away from other enforcement matters.

• New disclosure requirements should be created for mergers that fall below the current thresholds. Specifically, the agencies could create a category of notification for small transactions that allows firms to choose their type from a prepopulated set of options (e.g., dialysis clinic, surgery center, funeral home, gas station, supermarket, et cetera). The agencies would then design the list of options and review mergers that affect industries of concern and involve geographic overlap.

• With respect to dialysis facilities in particular, the FTC should revisit past acquisitions where the transaction would have required divestitures (or been blocked altogether) had the merger it was part of been reportable. The firms could be required to divest the facilities they acquired in this way, thereby restoring the lost competition.