Are Efficiencies the Lie Detector Tests of Antitrust Law?

Interesting, but not reliable enough to be admissible

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Disclaimer

- **The views expressed in the presentation are my own and not those of the Pennsylvania Office of Attorney General or Attorney General Kathleen Kane.**

Most Mergers Fail

- **"Most Mergers are doomed from the beginning. Anyone who has researched merger success rate knows that roughly 70 percent of mergers fail."**
  - *Perspectives on Merger Integration, McKinsey & Company, June, 2010*

- **"Indeed, companies spend more than $2 trillion on acquisitions every year. Yet study after study puts the failure rate of mergers and acquisitions somewhere between 70% and 90%."**
  - *Christensen, Alton, Rising & Waldeck, The Big Idea: The New M&A Playbook, Harvard Business Review, March 2011.*

Many Publications Note Failure

- **Depending on whose research you choose to rely on, mergers have a failure rate of anywhere between 50 and 85 percent. One KPMG study found that 83 percent of these deals hadn't boosted shareholder returns, while a separate study by A.T. Kearney concluded that total returns on M&A were negative.**
  - *Heffernan, Why Mergers Fail, CBS MoneyWatch, April 24, 2012*
- **Most research indicates that M&A activity has an overall success rate of about 50%—basically a coin toss.**
  - *Sher, Why Half of All M&A Deals Fail, and What You Can Do About It, Forbes.com, March 19, 2012*

Comparisons to Marriage

- **Mergers fail more often than marriages**

    - *CNN.com, May 22, 2009*

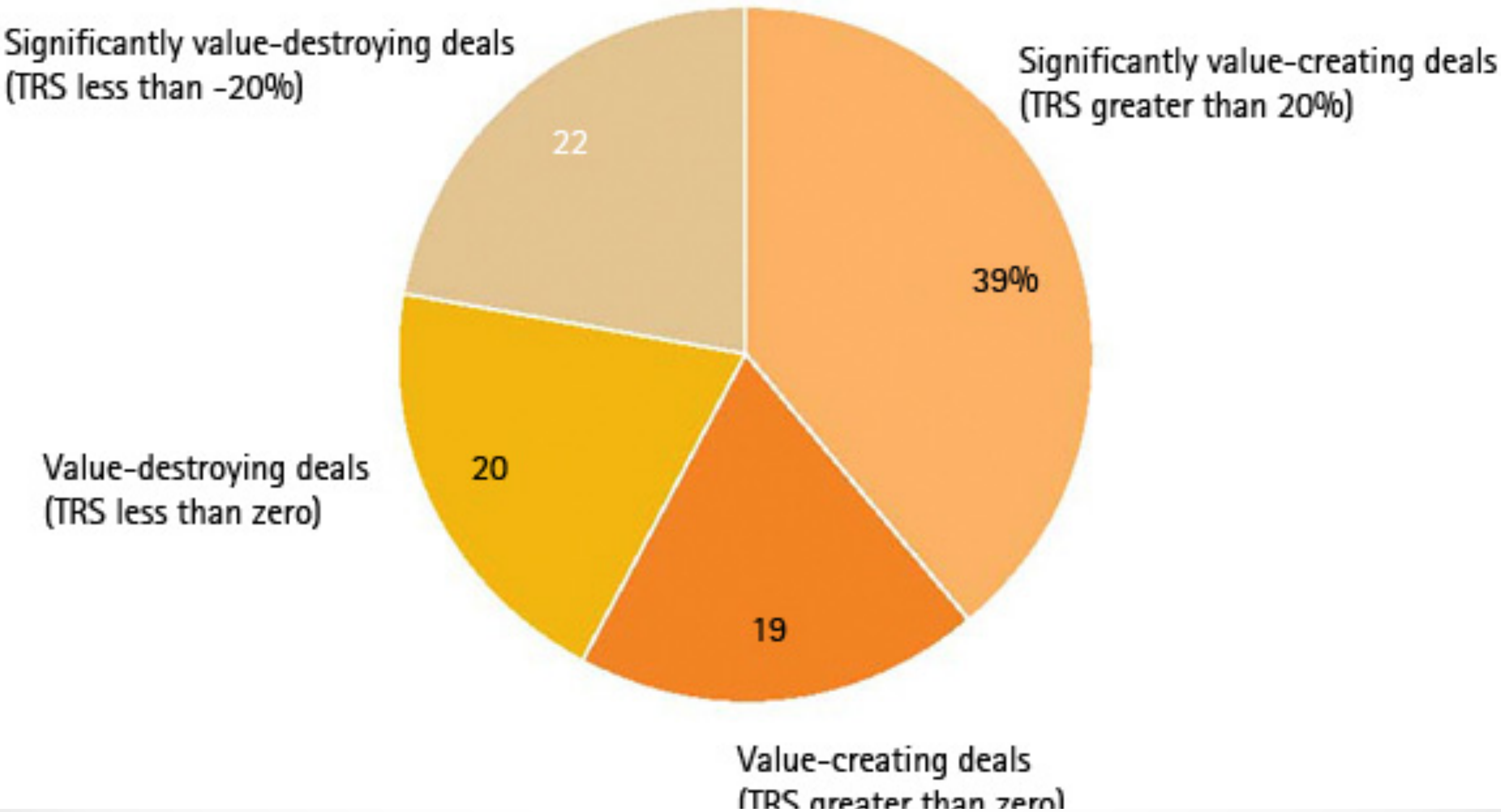
One Source Says, the High Failure Rate Claim is all Wrong

- **It is really only 40%**

  - *Herd and McManus, Who says M&A does not create value?, Accenture.com, March 2012*

Although much of the existing M&A literature suggests that M&A usually destroys shareholder value, new Accenture research shows that nearly 60 percent of the large transactions studied actually created value for the acquirer.

Total return to shareholders versus industry benchmarks
(TRS measured 24 months after deal announced)



What is the Failure?

- Diminution in Stockholder Value

- Meaning the value of the merged companies is less than the combined value of the two companies pre-merger

Competitive implications of Merger Failure

- **None!**
  - *If the merging companies fail, then how can they exercise market power.*
- **Dramatic!**
  - *Efficiencies are never achieved but, output is reduced.*
  - *An oligopoly is created.*

Oligopoly Creation

- Most merger challenges involve markets with a small number of players, i.e. 4-5, 3-2.
- Small number of players leave to greater possibility of coordinated effects.

The Great Efficiency Defense Contradiction

- If a merger is anticompetitive, but approved on the basis of an efficiency defense and creates an oligopoly, who is around to encourage the merged companies to pass on their efficiency savings to consumers?

Why Do Mergers Fail

- Too much debt
- Variance in business cultures
- Inability of management to manage a larger organization (deficiencies of scale)
- Adverse outside event (9/11, the 2008 financial crisis)
- Poor merger planning.

Efficiencies
May Never Get Implemented Because of Merger Failure

- Capital needed for efficiencies is needed elsewhere

- Corporate focus is on other problems

What Have Enforcement Agencies Done to Insure: a) Efficiencies are created; and b) Efficiencies get passed onto consumers?

- Pennsylvania had two settlements in the 1990s. Pennsylvania v. Divine Providence (Williamsport) and Pennsylvania v. Capital Health (Harrisburg/ Polyclinic)
- Required documented efficiencies of $40 million in the case of Williamsport and $70 million for Harrisburg/Polyclinic.
- Hospitals required to pass back 80% of savings to customers in the form of lower prices.

Results

- Both systems achieved at least double their projections.
- Savings passed on in the form lower net inpatient case mix adjusted revenue.
- But commercial insurers saw little benefit as lowering of Medicare reimbursements consumed savings.

One Decree Actually Resulted in Years of Litigation

- *See HealthAmerica Pennsylvania, Inc. v. Susquehanna Health System, 278 F. Supp. 2d 423 (D.M.O. 2003).*

How Much Weight Should We give Efficiencies

- High merger failure rate suggests that efficiencies may not be achieved.
- Even if they are achieved they may not end up in the hands of consumers.

Commissioner Wright's Dissent in Ardagh Group and Saint-Gobain Containers

- **Enhanced burden of proof of efficiencies.**
- **Efficiencies and anticompetitive effects should be offset against one another.**

Enhanced Burden of Proof Arises from Asymmetry of Skepticism of Efficiencies

- Agencies say that only "merger specific" cognizable efficiencies count as a defense.
- In practice, all claims whether of anticompetitive conduct or efficiencies are viewed skeptically.

Offsetting Efficiencies Against Anticompetitive Harm

- **Assumes that we can do either with sufficient certainty that this makes sense.**

- **Does not address what to do about the portion of efficiencies not passed on because of a return of investment to business.**

    - ***Note PA required 80% pass through assuming that 20% would compensate hospitals for the capital they invested to create efficiencies.***

Are Consumer Welfare Enhancing Efficiencies Being left on the Table?

- **Could study predictions in white papers.**
  - *But this is not a sample of efficiency attainment, generally only suspect merger.*
  - White papers are confidential and contain most sensitive business plans.

We Can Look at Certain Industries Generally

- **Hospital mergers almost always have significant efficiencies.**

Where are the Efficiencies?

The New York Times

August 12, 2013

Bigger Hospitals May Lead to Bigger Bills for Patients

By JULIE CRESWELL and REED ABELSON

Study After Study Shows Hospital Consolidation Leads to Higher Prices

- **Either:**
  - *Efficiencies not achieved.*
  - *Efficiencies are pocketed and not passed on.*

Conclusion

If a merger that potentially creates efficiencies does not occur, we most likely are not worse off and probably are better off because we are not losing competition.