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Efficiencies in Merger Review: Then & Now

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At the Beginning

- Brown Shoe (1962): “[S]ome of the results of large integrated or chain operations are beneficial to consumers….Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets.”

- Philadelphia National Bank (1963): “[Congress] proscribed anticompetitive mergers, the benign and the malignant alike, fully aware …, that some price might have to be paid.”

- Proctor & Gamble (1967): “Possible economies cannot be used as a defense to illegality. Congress was aware that some mergers which lessen competition may also result in economies but it struck the balance in favor of protecting competition.” Court viewed purchase of Clorox as likely to entrench Clorox’s market position because of P&G economies in advertising.

The Next Year--1968

- Williamson, Economies as an Antitrust Defense: The Welfare Tradeoffs. American Economic Review.

- AAG Turner's 1968 Merger Guidelines. Horizontal Mergers, Section 10:

- "Unless there are **exceptional circumstances**, the Department will not accept as a justification for an acquisition normally subject to challenge…the claim that the merger will produce economies (i.e., improvements in efficiency)…."

Efficiencies Get Respectable

- **Continental TV v. GTE Sylvania, 433 US 35 (1977):** Overruled Schwinn and held that nonprice vertical restraints should be viewed under the rule of reason because they promote interbrand competition by allowing manufacturers to achieve distribution efficiencies.
- **Broadcast Music v. CBS, 441 US 1 (1979):** Court declined to apply *per se* rule to blanket licenses because the practice is not one that "facially…would always or almost always tend to restrict competition and decrease output." Instead, the conduct lowers licensing costs and increases economic efficiency.

1982 DOJ Merger Guidelines (Baxter)

- Section V. Defenses: A. Efficiencies. In the overwhelming majority of cases, the Guidelines will allow firms to achieve available efficiencies through mergers without interference from the Department. Except in **extraordinary cases**, the department will not consider a claim of specific efficiencies as a mitigating factor for a merger that would otherwise be challenged. Plausible efficiencies are far easier to allege than to prove. Moreover, even if the existence of efficiencies were clear, their magnitude would be extremely difficult to determine.

- FN 53 At a minimum, the Department will require **clear and convincing evidence** that the merger will produce substantial cost savings …. In any event, the Department will consider such efficiencies only in resolving **otherwise close cases**.

McGrath 1984 Efficiencies Revision

- Post LTV-Republic revision adds well known introductory language that the "primary benefit of mergers to the economy is their efficiency-enhancing potential…."
- Moves efficiency section from "defenses" to general section on horizontal mergers.
- Introduces the idea that a merger may be reasonably necessary to achieve "**significant net efficiencies.**"

McGrath 1984 revision, (2)

- Revision removed the “extraordinary cases” language.
- Broadened the types of efficiencies to be considered.
- Adds the sliding scale: “The parties must establish a greater level of expected net efficiencies the more significant are the competitive risks…” The revision does not explain when the efficiencies are “enough.”

Courts Pay More Attention to Efficiencies

- **Cargill v. Monfort of Colorado, 479 US 104 (1986):** It is not a violation for a leading firm to merge to become more efficient and hence harder to compete against.

- **U.S. v. Rockford Memorial Corp. (1989):** Court noted the "little attention placed on savings by the defendants in planning for…the merger. The formal study was hastily commenced well after the announcement of the merger." After review, the court found that "defendants have failed to clearly and convincingly demonstrate that the merger will, in fact, create a **net economic benefit** for the health care consumer."

Courts Pay More Attention to Efficiencies

- **F.T.C. v. University Health (11th Cir. 1991):**

- "We conclude that in certain circumstances, a defendant may rebut the government's prima facie case with evidence showing that the intended merger would create significant efficiencies in the relevant market. Here, however, the appellees have failed to introduce sufficient evidence to demonstrate that their transaction would yield any efficiencies…." **"[E]vidence that a proposed acquisition could yield significant efficiencies…is useful in evaluating the ultimate issue—the acquisition's overall effect on competition."**

Joint 1992 DOJ/FTC Horizontal Merger Guidelines

- Important revisions to competitive effects analysis, but only change to the efficiencies section is deleting the clear and convincing evidence language.
- FTC hearings (1995) and Staff Report (1996) endorses integrating efficiencies into competitive effects analysis. Led to interagency working group to revise the Guidelines.

1997 Revision to the 1992 Horizontal Merger Guidelines (2)

- Press release: Revised to "clarify how the agencies analyze claims that a merger is likely to lower costs, improve product quality or otherwise achieve efficiencies…to better reflect existing practices…."
- Sets up model used today: introduces the concept of cognizable efficiencies (merger specific, verifiable, and not from anticompetitive action).
- Cautions on how efficiencies almost never justify a merger to monopoly or near monopoly. Keeps a sliding scale.
- Generally thought to take a consumer welfare approach—but with a escape hatch. Also discusses out of market efficiencies.

1997 Revision to the 1992 Horizontal Merger Guidelines

- "Efficiencies generated through merger can enhance the merged firm's ability and incentive to compete, which may result in lower prices, improved quality, enhanced service, or new products.... **In a coordinated interaction context**, … marginal cost reductions may make coordination less likely or effective by enhancing the incentive of a maverick to lower price or by creating a new maverick firm. **In a unilateral effects context**, … marginal cost reductions may reduce the merged firm's incentive to elevate price. "

- "[T]he Agency considers whether cognizable efficiencies likely would be sufficient to **reverse the merger's potential to harm consumers** in the relevant market, e.g., by preventing price increases in that market."

Post 1997 Cases

- **F.T.C. v. Staples (1997):** Court recognized the new 1997 Guidelines, and the split between old Supreme court cases and more recent willingness of lower courts to consider efficiencies. Court assumed the viability of a defense, but did not find the defendants' evidence to be credible. Efficiency claims 500% higher than estimates given to the board of directors. Largely unverified and not merger specific. Court finds pass-through rate unrealistically high given actual past pass-through rate.
- **U.S. v. Franklin Electric (2000):** "[T]here is no evidence that…this is 'an acquisition that is likely to lead to lower prices via expansion of output through…efficiencies [that] will benefit consumers'….Defendants have not made the necessary showing that efficiencies would result and they would lead to benefits for consumers in the relevant market."

Post 1997 Cases

- **F.T.C. v. CCC Holdings (2009**): "**The record is far from clear what the net savings would be**; hence, Defendants have not demonstrated that the cost savings are likely to counteract the potential anticompetitive effects." "[T] here is no evidence to suggest that a sufficient percentage of those savings will accrue to the benefit of consumers to offset the potential for increased prices."
- **US. v. Oracle (2004):** "The court finds Oracle's evidence on the claimed cost-savings efficiency to be **flawed and unverifiable**. Catz and Ellison's personal estimations regarding the potential cost-savings to Oracle are much too speculative to be afforded credibility."

Post 1997 Cases

- **Commentary on the Horizontal merger Guidelines, DOJ/FTC (2006):** The Commentary discussed how efficiencies relate to analyzing competitive effects. Most importantly, it gives insight into how efficiencies were analyzed in specific matters. Examples include merger specific efficiencies (Nucor-Birmingham); and verification(Oracle and IMC Global/WesternAG).

2010 Merger Guidelines

- Largely substantively unchanged from 1997.
- **10. Efficiencies:** "In adhering to this approach, the Agencies are mindful that the antitrust laws give competition, and not internal operating efficiency, primacy in protecting customers."
- **"**Projections of efficiencies may be viewed with skepticism, particularly when generated outside of the usual planning process."

2010 Merger Guidelines

- **Section 6.1 Differentiated Products**: "Where sufficient data are available, the Agencies may construct economic models designed to quantify the unilateral price effects resulting from the merger….They can also incorporate merger specific efficiencies."
- **ALJ, The 2010 Horizontal Merger Guidelines: From Hedgehog to Fox in Forty Years, Carl Shapiro**
- Discussing the value of diverted sales, Shapiro noted how "efficiencies create downward price pressure that can reduce or reverse the incentive to raise price" and how the new Guidelines "easily and naturally" integrate efficiencies into competitive effects analysis.

Post 2010

- **U.S. v. H&R Block (2011): "**TaxACT's recurring cost estimates were largely premised on its managers experiential judgment about likely costs, rather than a detailed analysis of historical accounting data… .[T]he **lack of a verifiable method of factual analysis resulting in the cost estimates renders them not cognizable by the Court**. If this were not so, then the efficiencies defense might well swallow the whole of Section 7 of the Clayton Act because management would be able to present large efficiencies based on its own judgment and the Court would be hard pressed to find otherwise."

Where Are We?

- There is a continuity of decisions from Staples onward that accept the legitimacy of considering efficiencies as part of merger analysis.
- The integration of efficiencies with competitive effects creates a framework that makes the review administrable, although costly.
- Courts apply an exacting standard to ensure that efficiencies are cognizable.
- "The difficulty in substantiating efficiency claims in a verifiable way is one reason why courts generally have found inadequate proof of efficiencies to sustain a rebuttal of the government's case." H&R Block, citing Heinz and Staples.

Where Are We?

- The Agencies usually win on efficiencies in court. But efficiencies play a real role in prosecutorial discretion. Strong efficiency claims take theories of harm off the table, narrow the scope of an investigation, more likely will be settled and may result in investigations being closed.
- Staffs spend considerable time understanding efficiency claims and have for years employed experts to evaluate claims —both technical industry experts and accounting experts who can verify the documentation, factual foundation and methodologies of measuring efficiencies.