



ROUNDTABLE ON THE ROLE OF EFFICIENCY CLAIMS
IN ANTITRUST PROCEEDINGS

-- Note by the United States--

1. Introduction

1. The antitrust enforcement agencies in the United States (the Federal Trade Commission (“FTC”) and the Antitrust Division of the Department of Justice (“DOJ”), collectively the “Agencies”) have long recognized that consideration of efficiencies in the analysis of both mergers and non-merger conduct is an important part of proper competition analysis. In both types of cases, efficiencies may offer an explanation for the activity, and may show how it will benefit consumers and increase consumer welfare. The Agencies therefore consider efficiencies when evaluating whether a merger or conduct on balance harms competition.

2. With respect to mergers, demonstrating efficiencies allows the merging companies to provide the Agencies with a legitimate rationale for the proposed transaction that does not involve increased profitability through exercising additional market power obtained through the merger. Efficiencies from the transaction may increase the firm’s ability to compete, and may benefit consumers.

5. For single-firm conduct, efficiencies also may offer a procompetitive justification for the conduct that is being evaluated. Various forms of unilateral conduct, including exclusive dealing, tying, and loyalty discounts, may have procompetitive benefits, such as obtaining economies of scope, improved product quality or functionality, or lower prices for consumers. On the other hand, such conduct can also, in certain circumstances, harm competition. Accordingly, as with agreements, the Agencies, as well as U.S. courts, evaluate such conduct by considering both the anticompetitive effects and the procompetitive justifications offered by the company.

6. Typically evidence of potential efficiencies is in the hands of the merging parties or companies being investigated for anticompetitive conduct. Accordingly, the Agencies expect that the merging parties will bring forward evidence of efficiencies. Similarly, in a case involving unlawful conduct, the companies charged with anticompetitive conduct are expected to advance any procompetitive justifications for the conduct.

7. The Agencies do not consider efficiencies that are vague, speculative, or cannot reasonably be verified.⁶ Thus, generic predictions of cost savings or increased output generally will not suffice to establish efficiencies.⁷ Rather, a company must establish through concrete evidence that the efficiencies are likely to be realized.

2. Types of Efficiency Claims

2.1 Mergers

8. At the broadest level, mergers (or integrated joint ventures) may result in efficiencies that allow the merging firms to lower their costs, to offer new or improved product, or to offer increased innovation.⁸ All of these efficiencies benefit consumers and are taken into account by the Agencies when attempting to assess a merger's likely impact. Efficiencies achieved by the merging parties may in turn induce their competitors to attempt to achieve their own efficiencies.¹⁰

9. Firms can reduce their costs by (1) combining complementary assets, (2) eliminating duplicate activities, or (3) achieving scale economies.¹¹ Cost savings may accrue to the firm's variable costs or fixed costs. Variable costs are those costs which vary with a firm's change in output (raw materials are typically a variable cost), whereas fixed costs are those borne by a firm regardless of its level of output (e.g., a fixed-term lease for the firm's office space). Variable cost savings, once achieved, do not in turn spur other cost savings and so they are often called "static efficiencies."

⁴ See, e.g. U.S. Dep't of Justice and Federal Trade Commission, *Commentary on the Horizontal Merger Guidelines* (hereinafter *Commentary*) at 50 (2006), available at <http://www.ftc.gov/os/2006/03/CommentaryontheHorizontalMergerGuidelinesMarch2006.pdf>

⁵ *United States v. Microsoft Corp.*, 253 F.3d 34, 59 (D.C. Cir. 2001) (en banc); *United States v. Visa U.S.A., Inc.*, 344 F.3d 229, 238 (2d Cir. 2003); *Polygram Holding, Inc. v. FTI*, 416 F.3d 29, 36 (D.C. Cir. 2005).

⁶ *Merger Guidelines* § 10.

⁷ *Id.*

⁸ *Id.* See also *Commentary*, at 49.

⁹ *Merger Guidelines* § 10.

¹⁰ *Commentary*, at 49.

¹¹ *Id.*

10. A firm's level of output is set at the point at which its marginal cost equals its marginal revenue. Reductions in a firm's marginal cost will lead to a higher level of output which, all else equal, leads to a lower price. Because marginal costs are affected by variable (but not fixed) costs, variable cost savings are more likely to result in a reduction in price than fixed cost savings. Therefore, efficiencies gained from variable cost reductions are generally more likely to immediately result in lower prices than efficiencies gained from fixed cost reductions.¹² However, some fixed cost savings may in fact result in short-term price reductions (e.g., when selling prices are determined on a cost-plus basis that incorporates fixed costs).¹³ Additionally, fixed cost savings may also result in lower prices, but in the longer¹⁴ term.

11. Mergers may also allow the merging firms to combine complementary assets or capabilities in order to offer new or improved products or processes or to increase the level of innovation. For example, the FTC closed its investigation of Genzyme Corp.'s acquisition of Novazyme Pharmaceuticals, Inc. because the merger accelerated the development of drugs that treated Pompe disease.¹⁵ In particular, each firm had unique capabilities and technologies, and it was the combination of the capabilities and technologies that would accelerate innovations in the treatment of Pompe disease.¹⁶ Because a given product improvement or increase in innovation can in turn spur further product improvements or increases in innovation, these sorts of efficiencies are often called "dynamic efficiencies."¹⁷

2.2 Non-Merger Agreements and Conduct

12. Outside the merger context, procompetitive justifications and efficiency claims vary greatly, depending on the conduct or competitor relationship at issue. Arrangements that are identified as illegal (i.e., those that "always or almost always tend[] to raise prices or reduce output") are illegal regardless of any claimed business purpose or procompetitive justification.¹⁸ Nonetheless, the Agencies recognize that many collaborations between competitors, such as professional associations, licensing arrangements and strategic alliances, have procompetitive benefits, usually stemming from the pooled resources of two or more otherwise competing entities.¹⁹

13. Benefits from competitor collaborations are specific to the nature of the relationship itself; they may include lower production costs through the combined achievement of economies of scale, quality improvements generated through complementary capabilities between two firms, or accelerated innovation through combined research activities.²⁰ Courts, also, have acknowledged efficiencies and procompetitive

¹² Id., at 57.

¹³ Id., at 58.

¹⁴ Id.

¹⁵ FTC Press Release, FTC Closes its Investigation of Genzyme Corporation's 2001 Acquisition of Novazyme Pharmaceuticals, Inc. (Jan. 13, 2004), available at <http://www.ftc.gov/opa/2004/01/genzyme.shtml>. See also Commentary at 53.

¹⁶ See Commentary at 53.

¹⁷ Statement of Steven C. Salop, "Efficiencies in Dynamic Merger Analysis," Hearings on Global and Innovation Based Competition, Nov. 2, 1995, available at <http://www.ftc.gov/opp/global/saloptst.shtml>

¹⁸ See Competitor Collaboration Guidelines at § 3.2.

¹⁹ Id., at § 2.1.

²⁰ Id.

benefits stemming from horizontal agreements between competitors, including reduced transaction costs, increased consumer choice

3.2 Specific Criteria for Assessment in Merger Cases

18. According to the Merger Guidelines, “[t]he Agencies will not challenge a merger if cognizable efficiencies are of a character and magnitude such that the merger is not likely to be anticompetitive.” “Cognizable” efficiencies are (1) merger-specific, (2) verified, and (3) “do not arise from anticompetitive reductions in output or service.”²⁹

19. Although the Merger Guidelines do not explicitly require cost savings be passed on to consumers, they do note that “[t]he greater the potential adverse competitive effect of a merger, the greater must be the cognizable efficiencies, and the more they must be passed through to customers, for the Agencies to conclude that the merger will not have anticompetitive effect in the relevant market.”³⁰ Accordingly, the Agencies focus on ultimate effects on consumers.

20. Merger-specific efficiencies are “likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of . . . the proposed merger.” Alternative means of accomplishing the efficiency (e.g., joint venture or a contractual arrangement) must be “practical in the business situation” and not “merely theoretical.”³¹ The Commentary to the Merger Guidelines provide an example of an efficiency that was not merger-specific in the case of merging firms that proposed achieving cost savings by consolidating their packaging facilities. One of the merging firms planned to close some

23. Projections of cost savings may include savings that are not expected to be realized immediately. Such delayed cost savings are less likely to be realized, because the assumptions underlying the projections may change with time. Therefore, delayed cost savings are given less weight than cost savings that are projected to be achieved in the near term.

24. Additionally, efficiencies that are achieved by a reduction in output or service are not considered cognizable.³⁹ For instance, cost savings achieved by eliminating sales staff are likely to result in a reduction in customer service, and therefore are less likely to qualify as cognizable efficiencies.

25. Generally, the Agencies will challenge a merger that has anticompetitive effects in any relevant market.⁴⁰ However, the Agencies reserve the discretion to “consider efficiencies not strictly in the relevant market, but so inextricably linked with it that a partial divestiture or other remedy could not feasibly eliminate the anticompetitive effect in the relevant market without sacrificing the efficiencies in the other market(s).⁴¹ The Agencies will be more likely to credit such “out-of-market” efficiencies “when they are great while the anticompetitive effect in the relevant market(s) is small.”

3.3 Specific Criteria for Assessment in Non-Merger Cases

26. The Agencies will consider efficiencies claims and procompetitive justifications for competitor collaborations that are found to cause, or are likely to cause, competitive harm, but are not illegal.⁴³ The evaluation of efficiencies parallels the Agencies’ approach to efficiency claims in merger cases. The efficiencies must be “cognizable,” that is: verified, not resulting from a restriction in output or services, and unable to be achieved through practical, less restrictive means.⁴⁴ The cognizable efficiencies are also net of the costs of achieving them and of the competitor agreement itself.⁴⁵

27. An important element of the Agencies’ analysis is that the competitor agreement be “reasonably necessary” to achieve the asserted efficiencies.⁴⁶ In evaluating whether the agreement is overbroad or unnecessary, the Agencies generally consider whether there are practical, realistic business alternatives that can achieve the same benefits.⁴⁷ Factors that may be relevant are the duration of the agreement and its necessity to prevent opportunistic conduct that may thwart procompetitive aims.⁴⁸

28. Courts rely on a “rule of reason” analysis to evaluate competitor agreements that are not illegal. Although the specific formulations vary, courts usually apply some version of a burden-shifting framework: after a plaintiff has established an anticompetitive effect, the defendant may rebut with evidence of the agreement’s procompetitive virtues; in response, the plaintiff may offer evidence that there are less restrictive means of achieving the asserted benefits or that the agreement is not reasonably

³⁹ Id.

⁴⁰ Merger Guidelines § 10, n. 14.

⁴¹ Id.

⁴² Id.

⁴³ See Competitor Collaboration Guidelines, at § 3.36.

⁴⁴ Id.

⁴⁵ Id.

⁴⁶ Id., at § 3.36(b).

⁴⁷ Id.

⁴⁸ Id.

necessary⁴⁹. Some courts apply a fourth “balancing” factor to the analysis, weighing the overall harm against the gain⁵⁰. However, courts will reject a procompetitive justification for anticompetitive conduct that is pretextual (i.e., that did not actually motivate the business to act the way it did).

29. Importantly, the procompetitive justifications of efficiencies must depend on the challenged conduct itself, and not simply be permissible or desirable goals that can be achieved through other means. Courts may also reject claims that fail to demonstrate that consumers genuinely benefit from the conduct, for example, where a restraint is justified solely by the need to preserve a firm’s profitability or reduce its costs.

30. In unilateral conduct cases, some courts have used a similar burden-shifting analysis, as in *States v. Microsoft*⁵¹.

4. Ex-post Assessment of Efficiency Claims

31. In reviewing mergers, the Agencies evaluate efficiency claims made by the parties that may counter or outweigh the anticipated anticompetitive effects from the merger. In most investigations, the mergers under scrutiny are proposed, not consummated, so that claimed efficiencies are conjectural. In a relatively small proportion of investigations, the mergers under scrutiny have been consummated, making it possible to take into account at least some of the actual effects of the merger, including efficiencies, in an overall assessment of its consequences.

32. Under certain conditions, ex-post evaluations of efficiency claims may be possible, and such evaluations may even be relevant to the prospective assessment of efficiency claims in investigations of proposed mergers. The use of ex-post evidence of efficiencies occasionally becomes possible in situations in which the parties to a merger under review are making efficiency claims which, if valid, might be

then retrospective evidence bearing on whether parties did in fact generate efficiencies like those now being claimed by the parties may be relevant to an assessment of the parties' claims.

33. While ex-post evaluations have been made in a number of cases, the most extensive retrospective studies of merger efficiencies in the United States have been conducted in connection with hospital mergers. Parties to hospital mergers have often claimed that an important efficiency resulting from those mergers would be enhanced clinical quality.

34. Economists and medical clinicians have developed methods by which to measure the clinical quality of hospital services from available data. Several recent studies have used these methods to measure the effects of mergers on the quality of clinical services provided by US hospitals.⁵⁵ The studies show mixed effects on clinical quality from hospital mergers. In other words, there is no basis to presume that a particular hospital merger will improve quality of care. In fact, some studies observe the opposite effect. Similarly, one recent FTC challenge to a consummated hospital merger in the Chicago metropolitan area was based, in part, on direct evidence that clinical quality had either deteriorated or shown no improvement after the acquisition.⁵⁶ Given this evidence, the Agencies will not rely on generic claims that mergers
