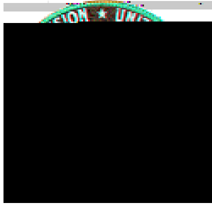

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Breaking the Vicious Cycle: Establishing a Gold Standard for Efficiencies

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The Other Side of the Coin: Proper Evaluation of Efficiencies in Merger Analysis

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antitrust attorneys sometimes advise merging firms not to bother with efficiencies analysis.[8] If, as a result, the overall quality of efficiencies presentations is low, courts and Agencies will lower the status of efficiencies evidence as a general matter, further eroding the incentive for merging parties to produce high quality evidence in the first place.

It is time for this vicious cycle to end, and I believe the Agencies are best positioned to lead us out of it. First, the Agencies should adjust their approach to treat evidence of efficiencies symmetrically with that of harms. Second, they should provide additional guidance to the antitrust bar and the business community about what types of efficiencies analysis will and will not meet their standards. In this speech, I suggest that the Agencies publish "gold standard" efficiencies analyses through one or more hypothetical cases accompanied by exhibits, explanations and guidance designed to amplify the language in the Horizontal Merger Guidelines. The goal is to establish a benchmark identifying what is needed for an efficiency to be deemed cognizable, and to commit the Agencies to crediting meritorious claims in the future.

Merging parties are in possession of most information that would allow the Agencies to evaluate efficiencies likely to result from a merger, so I am not disputing that parties should bear the burdens of production and proof on efficiencies. However, a more reasonable standard and clear guidance will incentivize higher quality efficiencies analyses in more cases, which in turn will at least gradually shift the priors of courts and the Agencies towards greater acknowledgement of efficiencies, even those that are no more certain than the harm that would be created by a merger.

II. Treatment of Efficiencies by Courts and the Agencies, 1950-2020

To be sure, there were green shoots even in this early era. The DOJ's 1968 Merger Guidelines, issued during the tenure of Assistant Attorney General Donald Turner and influenced by work that Oliver Williamson had begun as a DOJ employee, incorporated a limited efficiencies defense, effectively breaking with the Supreme Court.[14] Six years later, the Court's 1974 *General Dynamics* decision found that merging parties had rebutted the government's *prima facie* case, and is sometimes seen as opening the door to efficiencies defenses.[15] Merging parties began making serious efficiencies arguments to the Agencies in the late 1970s, and by the early 1980s each Agency appears to have closed an investigation in part because of efficiency considerations.[16] The DOJ's 1984 Merger Guidelines improved the efficiencies language and moved it to the section on competitive effects.[17]

Progress seems to have slowed since the 1980s. While the 1992 Horizontal Merger Guidelines removed a requirement that the parties present "clear and convincing proof" of efficiencies, only one year prior the FTC argued to the U.S. Court of Appeals for the Eleventh Circuit that the law did not permit an efficiencies defense.[18] The FTC repeated this argument in 1997, this time to the Sixth Circuit.[19] While both appellate courts disagreed with the FTC's view of efficiencies,[20] by 1998 the agency was back at it in a district court, questioning whether an

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[14] See William J. Kolasky & Andrew R. Dick, *The Merger Guidelines and the Integration of Efficiencies into Antitrust Review of Horizontal Mergers*, 71 ANTITRUST L.J. 207, 213 (2003).
[15] *U.S. v. General Dynamics Co.*, 415 U.S. 486 (1974); Kolasky & Dick at 214 ("That decision gave rise to what came to be known (somewhat loosely) as the "*General Dynamics* defense" and encouraged parties to begin advancing efficiency claims.").
[16] Kolasky & Dick, *supra* note 14, at 214-215.
[17] *Id*. at 220.
[18] *FTC v. University Health, Inc.*, 938 F. 2d 1206, 1222 (11th Cir. 1991) ("The appellees argue that the proposed acquisition would generate significant efficiencies and, therefore, would not substantially lessen competition. The FTC responds that the law recognizes no such efficiency defense in any form.").
[19] *FTC v. Butterworth Health Corp.*, No. 96-2440 (6th Cir. July 8, 1997) (per curiam).
[20] Kolasky & Dick, *supra*, note 14, at 232 ("the [Eleventh Circuit] held that efficiencies should not be a defense to a merger that was found to be anticompetitive, but should be instead integrated into the competitive effects analysis, where they could be used to rebut a prima facie case"); at 23

measured inputs, and business documents subject to interpretation. Neither type of analysis should be dismissed just because it is less than definitive.

I've already discussed how the Horizontal Merger Guidelines text and case law appear to set different standards for demonstrating harms and efficiencies. Unsurprisingly, these disparate standards appear to result in disparate treatment. The 2014 merger of Ardagh and St. Gobain, two glass container manufacturers, may best exemplify this asymmetry. The parties put forward evidence of cost savings that they claimed would have resulted from overhead reduction and operation synergies. The majority of the Commission dismissed the efficiencies as either not being merger specific, or as not having been verified.[35] The FTC's complaint alleged that "nearly all" of the claimed efficiencies were non-cognizable.[36] In contrast, then-Commissioner Josh Wright's view was that the expected efficiencies were six times greater in magnitude than likely unilateral price effects.[37] Wright saw it as impossible to reach the Commission's conclusion of likely price effects and zero efficiencies without applying an asymmetric standard, despite the majority's protests to the contrary.[38] Ardagh and the FTC settled prior to trial. As is typical of mergers that are abandoned or settled, the Agencies got the final word on efficiencies.

I have called in the past for a symmetric treatment of merger harms and efficiencies.[39] An asymmetric approach has the obvious potential consequence of preventing some procompetitive

mergers that increase consumer welfare.

document likely efficiencies. Nonetheless, merging parties typically do go through the motions of invoking efficiencies, on a quixotic quest to meet the lofty standard of cognizability. Then-FTC Chairman Tim Muris observed that these desultory efforts contributed to Agency skepticism of efficiencies, making the task of convincing Agency staff even more difficult for the next set of merging firms.[44]

We can do better. The current vicious cycle disincentivizes all sides – merging parties, Agencies, and courts – from enga 17.05 0 TdTu (on a)-pr co betrvetei1 (r)gh2 (gi)3 of e dificincieson ahais-2 (t)-

rejected, the gold standard examples would allow parties to understand how their analyses fell short. Most importantly, this benchmark would incentivize more effective analyses in the first place.

The examples would provide much-needed clarity on the amorphous concepts of merger specificity, verifiability, and cognizability. For example, does the merger specificity of an efficiency hinge on the demonstration that it is unachievable in *any* conceivable counterfactual, including those involving as-of-yet uncontemplated mergers or contracts? A literal reading of the Horizontal Merger Guidelines might support such a view, which would make the demonstration of merger specificity an all but insurmountable obstacle.[45] As I have argued elsewhere, I would condition merger review on what the market actually looks like, and not what the Agencies think it ought to look like.[46] A gold standard for merger specificity could usefully clarify that only those efficiencies that would be imminently realized by either independent firm should be discounted as not merger specific.

As a practical matter, these gold standard hypotheticals may resemble the 2006 Commentary on the Horizontal Merger Guidelines.[47] Of course, the gold standard approach need not preclude other types of guidance from the Agencies to the antitrust bar and the business community on efficiencies. I am eager to hear any ideas my fellow panelists may have about what types of Agency guidance would be most effective.

V. Case Studies

I now turn to three case studies that illustrate how various types of efficiencies have been analyzed in practice.

A. Arch/Triton

In May 2003, Arch Coal agreed to purchase Triton.[48] The deal would have combined Arch's two South Powder River Basin, or SPRB, coal mines with Triton's two SPRB mines. Arch announced in August 2003 that it would divest one of Triton's mines to a third party, who did not operate a mine in the river basin. At the time, four companies operating ten mines supplied most high-heat coal emanating from the basin. The transaction plus divestiture resulted in a modest increase in concentration, but no change to the number of firms producing SPRB coal. The FTC sued to block the transaction on the theory that it would increase the likelihood of coordination among the major coal producers in the basin. The District Court disagreed, and after the D.C. Circuit declined to stay the merger pending appeal, the FTC ended its attempt to block the merger.[49]

At trial, Arch claimed between $130 and $140 million in efficiencies that would be realized during the period from 2004 through 2008. The FTC appears to have dismissed these claims.[50] The district court was somewhat less skeptical, but concluded that "most – perhaps $100 million – of the purported savings from the acquisition [...] have been called into question as either non-existent or overstated."[51] Instead, the court acknowledged that "some efficiencies

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[48] A different transaction involving Arch Coal is currently in active litigation before the Commission. This document expresses no view on that matter.
[49] *FTC v. Arch Coal, Inc.*, 329 F. Supp. 2d 109, 153 (D.D.C. 2004).
[50] *Id.* at 71 ("Plaintiffs have systematically pointed out defendants' estimates of efficiencies and shown that defendants have not been able to quantify with precision the savings netted by the proposed transaction."). Neither the FTC's complaint nor its closing statement mentioned efficiencies.
[51] *Id.* at 75.

will naturally result from the transactions" and found that "[t]he realized efficiencies are more likely to be in the $35 to $50 million […] range."[52]

realized the same cost savings. It rejected other claim

finding similar effects in other industries.[63] Had these mergers been blocked because their efficiencies were discounted, consumers today would be worse off.

C. Alpha/Beta (masked FTC matter)

Two competing companies, Alpha and Beta, proposed to merge. The parties claimed the merger would lower their costs in three ways. First, the parties stated they would be able to consolidate all Atlantis production into Alpha's plant, and all Pangea production into Beta's plant, reducing shipping costs and fees paid to third-party logistics providers. Second, the parties expected to realize purchasing efficiencies, both by using the lower-cost source for each of various components and by obtaining volume discounts. Finally, Alpha planned to eliminate roughly forty percent of Beta's workforce.

The parties projected that efficiencies would reduce the combined firm's costs by roughly nine percent, based on a consultant's estimate prepared as part of Alpha's due diligence in evaluating Beta for purchase. The consultant had access to both parties' information and conditioned its projections on an algorithm which incorporated assumptions provided by Alpha. The consultant delivered its findings to Alpha in the form of a report. While Alpha shared the report with FTC staff, it shared neither the consultant's algorithm underlying the report nor justifications for the assumptions on which the algorithm was constructed. Consequently, FTC staff did not feel the consultant's report was an adequate basis for assessing the magnitude of these efficiencies. Moreover, Alpha and Beta had invested few resources into integration planning, and were unable to persuade FTC staff that any such planning had vindicated the consultant's algorithm.

[63] *Id.* at 668.

To take one specific example, the consultant's report concluded that Alpha could eliminate 84 percent of Beta's back office workforce, including Beta's entire IT department. The report did not explain how it arrived at this number, and Alpha did not provide any additional substantiation. In another example, the parties projected savings on logistics from reducing outsourcing, but provided little documentation on the cost of outsourcing relative to in-house logistics. They likewise declined to provide information on available capacity of in-house warehouses and trucks.

FTC staff thought it likely that the merger would lead to the types of efficiencies identified in the consultant's report. However, they found the consultant's report to be conclusory, and Alpha and Beta did not engage with FTC staff either to explain the methodology of the consultant's report or to provide ordinary course documents and data that would substantiate the report. Consequently, FTC staff viewed the efficiencies claims as lacking. While the consultant's report may have been useful for Alpha's due diligence, it was viewed by staff as inadequate to establish possible merger efficiencies as cognizable. When feasible, merging parties should hire an efficiencies expert to work in a clean room.

VI. Conclusion

Procter & Gamble's observation that "[p]ossible economies cannot be used as a defense to illegality" is the Supreme Court's latest statement on merger efficiencies.[64] Although it is unlikely that the language continues to reflect the Court's views, it has been instrumental in enabling lower courts and the Agencies to minimize efficiencies, or even to deem them irrelevant.[65] However, Justice John Harlan's concurrence in *Procter & Gamble* has perhaps

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[64] *Procter & Gamble*, *supra* note 12.
[65] *See, e.g.*, *U.S. v. Anthem, Inc.*

proven even more durable. Harlan appears to strike a moderate tone in noting that the FTC "correctly[] seemed to accept the idea that economies could be used to defend a merger,"[66] even if they are advertising efficiencies, which the majority decision seemed to view as a harm. But in resolving the tension between the merger's apparent efficiencies and anticompetitive effects, Harlan provided a template for generations of jurists, stating that "I do not think, however, that on the record presented Procter has shown any true efficiencies in advertising."[67] In other words, plaintiffs and courts can reject efficiencies by saying they do not meet some amorphous standard, rather than having to weigh efficiencies and harms.