

## Summary of Antitrust Modernization Commission Hearing on the Treatment of Efficiencies in Merger Enforcement

November 17, 2005

The Antitrust Modernization Commission (“AMC” or “Commission”) held a hearing on November 17, 2005 to obtain testimony regarding the treatment of efficiencies in merger enforcement. The hearing focused on whether and to what degree the Agencies weighed evidence of efficiencies, and what types of evidence were most effective in persuading the Agencies that the claimed efficiencies would in fact manifest themselves should the merger be allowed to proceed.

The panel agreed that the Agencies were doing a better job of dealing with efficiencies, particularly since the last revisions to the Merger Guidelines. Additionally, there was general agreement that the best evidence for meeting the burden of persuasion was documents generated by the merging firms evaluating the potential efficiencies generated by the merger when calculating the price value of the merger. Such documents were viewed as having greater reliability, as they were generated for the use of the parties to the merger in their own decision making process, and not for the purpose of persuading the Agencies. The panel was also in general agreement that the Merger Guidelines provided sufficient guidance to the courts, and that there was no need for further legislation or agency action in this regard at this time, particularly in light of the anticipated upcoming release of annotations to the Merger Guidelines.

The hearing quickly moved from a general assessment of current practice to a debate on the Commission’s question as to whether the enforcement policy on measuring efficiencies should be based on a “consumer welfare” or a “total welfare” standard. This in turn became a debate as to whether the analysis of efficiencies should focus on price effects (*i.e.*, the likelihood that the transaction will raise price and reduce consumer surplus) or on impacts on productive or technical efficiency (*i.e.*, the prospect that the transaction will lower or eliminate costs), or both. The hearing ended with no apparent consensus on these questions.

### I. Summary of Written Testimony:

- A. Professor Jonathan Baker. Professor of Law, Washington College of Law, American University.

Professor Baker testifies that in his opinion courts and enforcement agencies were correct in their current undertaking to consider efficiency claims in reviewing horizontal mergers. He notes that, unlike prior practice, courts are grappling seriously with how to consider efficiencies, pointing to *Federal Trade Commission v. Staples*, 970 F. Supp. 1066 (D.D.C. 1997) and *Federal Trade Commission v. H.J. Heinz, Co.*, 116 F. Supp. 2d 190 (D.D.C. 2000), *rev’d*, 246 F.3d 708 (D.C. Cir. 2001) as examples showing that the courts no longer decline to consider efficiencies in evaluating challenges to horizontal

mergers. Because he feels that courts are moving in an appropriate direction, and are receiving detailed agency guidance on the analysis of efficiencies, Professor Baker feels that the courts should be given the opportunity to develop the jurisprudence on this issues without undue interference. He therefore encourages the Antitrust Modernization Commission not to make any legislative recommendations on this topic.

As for the standard to be applied when measuring efficiencies, Professor Baker states that in his experience, agency investigations rarely turn on the welfare standard, either consumer or aggregate. This is because of the difficulty and uncertainty involved in quantifying the magnitude of the welfare consequences of a given merger. However, Professor Baker argues that when the issue does arise, enforcers and courts should apply the consumer welfare standard as opposed to the aggregate welfare standard. He asserts that this is so even if the ultimate goal of antitrust enforcement is viewed as maximizing aggregate welfare, because applying the consumer welfare standard will likely deter firms from proposing some anticompetitive mergers that firms might be willing to attempt under an aggregate welfare test, but will likely make little difference in the willingness of firms to propose efficiency-enhancing mergers. He also points to the efficiencies section of the Horizontal Merger Guidelines as sympathetic to a consumer welfare standard, as the guidelines emphasize agency concern with protecting consumers against mergers that would lead to higher prices.

Professor Baker also argues against placing the burden of persuasion on merging firms, arguing that such a policy is not necessary to permit the fact-finder to test the probative value of the defendant's efficiency claims. Furthermore, Professor Baker argues that there is a cost to placing the burden of persuasion on the merging firms to demonstrate efficiencies, as it will make it more difficult for the merging firms to successfully prove that mergers will promote competition, and in consequence discourage firms from negotiating some such mergers, and is thus at least as likely to discourage good efficiency claims as it is to weed out bad ones.

B. Dr. Michael A. Salinger, Director, Bureau of Economics, Federal Trade Commission.

Dr. Salinger states that efficiencies do play a key role in the analysis of horizontal mergers, but points out that they are considered in a less formal way than is suggested by the guidelines. While noting that in principle, the integrated analysis of competitive effects is done through scientific modeling, Dr. Salinger points out that in practice, due to data and other limitations, the agency often does not have a formal model of the effect of a merger on the market. Rather, the weighing of competitive and anticompetitive effects is less rigorous, requiring judgment. He states that efficiencies affect the judgments made by the agency, even if they are not cognizable.

Dr. Salinger points to several reasons why efficiencies do not play a more formal role at this time. The first of these is the combined effect of applying the "substantial lessening of competition" standard and the use of consumer welfare as the basis for enforcement. While he states that he is not confident that moving to a total welfare

standard would be more appropriate, he does argue that the measurement of efficiencies would become more central to merger analysis if a total welfare standard were applied. Secondly, Dr. Salinger notes that parties often do a poor job of demonstrating efficiencies.

C. Kenneth Heyer. U.S. Department of Justice, Antitrust Division, Washington, D.C.

Mr. Heyer states that because mergers have the potential to generate efficiencies and thus can produce a net benefit for consumers, efficiency analysis is rightly a cornerstone of sound antitrust policy. He points out that the 1992 Horizontal Merger Guidelines were supplemented in 1997 to include a section on efficiencies for two reasons. First to recognize the critical role of efficiencies, and second, to provide clearer guidance to businesses contemplating mergers, to their consultants and legal representatives, and to the world at large concerning the precepts and policies that the enforcement Agencies will employ in evaluating efficiencies.

Mr. Heyer makes a point of assuring critics that when the Division is presented with a serious efficiency claim, it takes the claim seriously. However, he notes that the Division is unlikely to credit claims of substantial merger-specific efficiencies where the parties fail to prove that the claimed benefits are cognizable. He notes that often parties do not provide such evidence, and makes a number of observations as to why that may be. First, he asserts that parties often elect to emphasize other factors, apparently feeling that devoting significant time and money preparing and presenting a compelling efficiencies analysis is not cost-justified. Second, he asserts that often deficiencies in the available information may make it difficult for the parties make the necessary demonstration.

Nevertheless, Mr. Heyer states that the Agencies take efficiencies into account as part of an integrated analysis of competitive effects. He further asserts that there are two major issues in properly incorporating efficiencies into merger analysis. The first of these is determining when efficiencies are cognizable and thus entitled to consideration. He points out that the most useful information in making this determination is where the firms have memorialized analysis of efficiencies as part of their “due diligence,” if only to justify to the firms decision makers the price paid for the acquired firm. However, Mr. Heyer warns against placing too high a burden on the parties to quantify the efficiencies.

The second issue in incorporating efficiencies into merger analysis is determining how efficiencies affect the competitive effects analysis. Mr. Heyer notes that Agency experience has shown that the efficiencies most likely to “reverse the merger’s potential to harm consumers” are those that reduce unit costs or improve the merging firm’s products. He notes that one of the debates in this area is whether efficiencies have to be passed on to consumers. He acknowledges the debate between those who argue for a “total welfare” approach that would consider all efficiencies, regardless of whether they were passed on to consumers, and those in favor of a “consumer welfare” approach

which counts efficiencies only if they are likely to be passed on to consumers through lower prices or expanded output. While noting that the guidelines do not explicitly adopt a particular welfare standard, he notes that in practice the Agencies give most weight to those efficiencies that benefit consumers in the short term through lower prices, but will consider other efficiencies as well.

- D. Charles F. Rule, Partner and Chair of the Antitrust Department at Fried, Frank, Harris, Shriver & Jacobson, LLP. Former Assistant Attorney General in charge of the Antitrust Division, U.S. Department of Justice (1986-1989).

Mr. Rule answers the Commission's question as to whether antitrust policy should be based on "consumer welfare" or "total welfare" by stating that, but for forgotten history, the terms originally meant the same thing. Rule argues that while advocates of highly interventionist antitrust enforcement policy have attempted to confuse the meaning of the term "consumer welfare" to mean "consumer surplus," antitrust policy cannot serve the objective of maximizing the welfare of consumers as a whole if that policy is focused on price effects alone (*i.e.*, the likelihood that the transaction will raise price and reduce consumer surplus) and is oblivious to its impact on productive or technical efficiency (*i.e.*, the prospect that the transaction will lower or eliminate costs). According to Rule, merger enforcement should only condemn mergers that have a clear potential for resulting in significant price increases (as a proxy for output restrictions). Only then would the parties be required to establish that their transaction will generate substantial efficiencies that cannot be achieved without the merger and which will outweigh the merger's threat to allocative efficiency.

Rule asserts that those who wish "consumer welfare" to refer only to consumer surplus have created a concept which is hostile to property rights, which carries the implicit assumption that in any given market, consumers are more worthy than producers, and which sees antitrust enforcement as a means of wealth redistribution. Rule rejects the assumption, noting that in the end, everyone is a consumer. He argues that an antitrust policy that seeks to support the tendency of competitive markets to drive participants to maximize productive as well as allocative efficiency is inherently superior to a policy that ignores half of the welfare equation. He also points to the difficulty the "consumer surplus" concept has in dealing with monopsony power.

Rule attributes the very existence of the current debate to forgotten history. Reacting to changes in the world economy and other factors, the Department in the mid 1980's embraced the proposition that productive efficiencies could be a defense to a merger that otherwise threatened to increase price only if they were likely to be passed on to consumers in the market in which the merger posed a threat to allocative efficiency. Under prior practice, and the 1982 guidelines, there was no such defense. Rule argues that practitioners today have forgotten that this language was a compromise position and that its design reflected an attempt to minimize enforcement costs. Rule notes that it is ironic that a rule that was intended to make merger enforcement more sensitive to traditional consumer welfare has provided opponents of traditional consumer welfare

with a justification for claiming that productive efficiencies are conceptually irrelevant unless they increase consumer surplus.

E. George S Cary, Cleary Gottlieb Steen & Hamilton LLP, Washington, D.C., [Written Testimony Not Yet Available]

## II. Highlights from Questions and Answers (Paraphrased):

Q: Do you have any suggestions for dealing with the lack of specificity in the guidelines for dealing with research and development efficiencies?

A: No suggestions by any panelist.

Q: Is equipoise resolved by the Agencies against finding efficiencies and in favor of harm?

A: Mr. Heyer (D.O.J.): No

A: Mr. Salinger (F.T.C.) No

Q: If the standard applied is “consumer welfare” as opposed to “total welfare,” how does one deal with the problem of monopsony power?

A: No panelist had a solution. However, Mr. Heyer noted that in practice the Agencies give most weight to those efficiencies that benefit consumers in the short term through lower prices, but will consider other efficiencies as well. Thus “consumer welfare” is not applied in a rigid doctrinaire manner which would lead to absurd results.

Q: Should the Agencies follow the Canadian example on dealing with efficiencies as set forth in the *Superior Propane*<sup>1</sup> Case?

A: No panelist felt the *Superior Propane* example was one the Agencies should follow.

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<sup>1</sup> Comm'r of Competition v. Superior Propane Inc., [2000] C.C.T.D. No. 15, 7 C.P.R. (4th) 385 (Can. Comp. Trib.) (original decision); [2001] 3 F.C. 185 (Fed. Ct. App.) (first Court of Appeal decision), available at <http://reports.fja.gc.ca/fc/2001/pub/v3/2001fc28500.html>; [2002] C.C.T.D. No. 10, 18 C.P.R. (4th) 417 (Can. Comp. Trib.) (re-determination); [2003] 3 F.C. 529 (Fed. Ct. App.) (second Court of Appeal decision), available at <http://reports.fja.gc.ca/fc/2003/pub/v3/2003fc31974.html>