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ON BEHALF OF
THE UNITED STATES DEPARTMENT OF JUSTICE**

**ANTITRUST MODERNIZATION COMMISSION
HEARINGS ON THE TREATMENT OF
EFFICIENCIES IN MERGER ENFORCEMENT**

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Competition is the most effective means to promote consumer welfare. We value competition for many reasons, not the least of which is that it promotes efficiency, helping to ensure that society's scarce resources are put to their best use and that companies are stimulated to work hard to lower costs and develop new and better products and services, thus raising our standard of living and promoting economic progress and growth. Efficiency is therefore rightly a cornerstone of sound antitrust policy.

Clearly, mergers play an important role in the competitive process. While mergers may at times enhance market power in a manner that threatens to harm consumers, mergers also have the potential to generate efficiencies, such as by combining complementary assets. They can thus produce a net benefit for consumers. For that reason, efficiencies are an integral part of our competitive effects analysis. The goal of merger enforcement is to identify and stop anticompetitive mergers without impeding those efficiency-enhancing mergers that may benefit consumers. The Merger Guidelines provide a sound analytical framework for achieving this goal.[1]

Broadly speaking, the reasons for supplementing the 1992 version of the

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[1] U.S. Dep't of Justice & Federal Trade Comm'n, Horizontal Merger Guidelines (with Apr. 8, 1997 revisions to Section 4 on efficiencies), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,104 [hereinafter Merger Guidelines].

Merger Guidelines with a section devoted specifically to efficiencies were twofold. The first was to recognize explicitly the critical role of efficiencies, merger-generated efficiencies in particular, in promoting the economic welfare of our citizens. We live in a world of limited resources, and it behooves us to organize these resources in ways that generate the greatest possible value for consumers. Mergers can help further this desirable goal, and therefore rightly occupy a central place in a sound antitrust policy.

A second reason for the revised Merger Guidelines was 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 identifying, evaluating, and treating these potential benefits to the economy. The Merger Guidelines explain concisely the role played by a number of key economic principles in our treatment of efficiencies.

As clarified in 1997, the Merger Guidelines underscore the central role of efficiencies in the evaluation of the likely competitive effects of proposed mergers. The Agencies take efficiencies into account – not as an affirmative defense, but as part of an integrated analysis of competitive effects. There is simply no way to evaluate whether a merger will give the merged firm the ability and incentive to raise prices, either unilaterally or in coordination with other firms, without examining the efficiencies a merger may produce. Efficiencies that reduce costs allow and motivate a merged firm to compete more vigorously and to lower prices, improve quality, enhance service, or provide new products.

There are two major issues in properly incorporating efficiencies into merger analysis: the first is determining when efficiencies are entitled to consideration – i.e., when they are “cognizable”; the second is determining how these cognizable efficiencies affect the competitive effects analysis.

A. Cognizable Efficiencies

Efficiencies are cognizable if they are merger-specific, have been verified, and do not arise from anticompetitive reductions in output or service. The Merger Guidelines provide explicit guidance on: (l) how the Agencies will determine if the claimed efficiencies are properly attributable to the merger; (2) what the parties must do to substantiate their efficiency claims; and (3) the circumstances in which efficiency claims are likely to be found persuasive.

Merger-specific efficiencies are those likely to be accomplished by the merger and likely not to be accomplished in the absence of the merger. At the same time, the Merger Guidelines make clear that merger specificity means practical alternatives faced by the merging parties, not a less restrictive alternative that is merely theoretical. Thus, to the extent that efficiencies generated by the merger could theoretically also be achieved by contract or joint venture, there may be obstacles – in particular, transaction costs – that make it unlikely that those alternatives would be adopted.

While we always remain open to consideration of claimed efficiencies, the information needed to make an informed and reasoned judgment about such claims is almost always uniquely in the hands of the merging parties. We cannot verify efficiency claims without their cooperation. It behooves the parties to submit their efficiency claims and supporting information early in the review process so that we can carefully evaluate the claims. The types of information that are of greatest assistance to the Agencies tend to be studies and other internal documents created in the normal course of business, along with studies performed for the Agencies with the use of objective, verifiable data or assumptions. Analysis of the type of benefits a proposed merger is expected to achieve, the likely magnitude of anticipated benefits, and even the extent to which such benefits are merger-specific, often may be part of any acquiring firm's "due diligence," if only to justify to the firm's decision makers the price being paid for the acquired firm. Where such information has been memorialized in writing as part of the decision to merge and has clearly not been created simply to help persuade the competition authorities, such documents can be especially valuable. Even where information of this type has not been committed to writing, the merging firms (or those they have hired to perform for them these analyses) tend to be uniquely in possession of it, and are perhaps uniquely knowledgeable about objective evidence bearing on the types and magnitudes of benefits that a proposed merger may (or may not) produce.

While efficiencies are critical in promoting economic growth, they can be hard to measure. Placing too high a burden on the parties to quantify efficiencies and to show that they are merger-specific risks prohibiting transactions that would be efficiency-enhancing. On the other hand, we are not able simply to take the parties' word that the efficiencies they have identified will actually materialize. Ultimately, we evaluate evidence related to efficiencies under the same standard we apply to any other evidence of competitive effects.

B. <u>Cognizable Efficiencies in the Competitive Effects Analysis</u>

Cognizable efficiencies are incorporated into competitive effects analysis. The Merger Guidelines state that the 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 in any relevant market."[2] The Agencies consider 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

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[2] Merger Guidelines at § 4.

increases in the market."[3] Thus, the greater the potential adverse competitive effects of a merger, the greater must be the cognizable efficiencies.

The Agencies' 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 firms' products. In particular, the Merger Guidelines note that "certain types of efficiencies are more likely to be cognizable and substantial than others," singling out "efficiencies resulting from shifting production among facilities formerly owned separately, which enable the merging firms to reduce the marginal cost of production."[4]

Some appear to wonder whether the Agencies, in practice, actually pay attention to efficiency arguments and credit them when deciding whether to challenge mergers. Allow me to make several points here. First, when the Division is presented with a serious efficiency claim, it takes the claim very seriously. We regularly evaluate, and in many situations "count," efficiency claims presented to us by merging parties. Second, the Division is unlikely to credit claims of substantial merger-specific efficiencies in circumstances where the parties and their economist consultants fail to prove that these claimed benefits are cognizable. And, very often

[3] *Id.*

[4] *Id.*

they do not. Indeed, very often they seem not even to try very hard to do so.

Why, given that mergers are frequently entered into in order to obtain efficiencies, do we not see more and better efficiencies presentations from the merging parties? A number of possible reasons suggest themselves. Sometimes, as part of their overall strategy for trying to persuade the reviewing Agency not to challenge the merger, the parties elect to emphasize other factors – for example, why in their view the relevant product market is so broad or the number of competitors so large as to make anticompetitive effects post-merger implausible. The parties may feel that devoting significant time and possibly substantial money to preparing and presenting a compelling efficiencies defense is not cost-justified.

Another reason why compelling efficiencies presentations are not made routinely may be that, through no fault of either the parties or of the Agency, informational deficiencies make it extremely difficult for the parties to demonstrate whether efficiencies are likely to be substantial and cognizable. Not every consideration and calculation bearing on a firm's acquisition decision is necessarily recorded internally. Moreover, in reaching the decision to merge, parties do not always break down the anticipated benefits in ways that an antitrust-savvy consultant might, i.e., by the types of anticipated benefits that would properly qualify as cognizable under the Merger Guidelines. As unfortunate or unavoidable as this may be, it does not justify a policy of crediting non-cognizable efficiency claims in cases where a merger might otherwise generate competitive harm.

One of the inveterate debates in this area is whether efficiencies have to be passed on to consumers to be cognizable. Some economists and antitrust scholars argue for what they refer to as a "total welfare" approach that would consider all efficiencies, regardless of whether they were passed on to consumers, maintaining that all resource savings benefit society. Others argue for a "consumer welfare" standard, which counts efficiencies only to the extent that they are likely to be passed on to consumers through lower prices and expanded output.

Although the Merger Guidelines do not explicitly adopt any particular welfare standard, they do state that the Agencies will consider "the effects of cognizable efficiencies with no short-term, direct effect on prices in the relevant market" although they "will be given less weight because they are less proximate and more difficult to predict."[5] In short, 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. We believe this approach best ensures that mergers resulting in a substantial lessening of competition are stopped.

Efficiencies are but one of many factors that go into an ultimate decision on

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[5] *Id.*

whether to clear, or attempt to block, a merger. Even where efficiencies are found to be cognizable, the efficiencies may be insufficient to deter or prevent harm to competition from the merger. Similarly, where efficiencies play a role in clearing a merger, they are seldom the only factor weighing on the side of not filing a case. In short, efficiencies currently play an important role in merger analysis and will continue to play an important role in merger analysis. Since the 1997 revisions to the Merger Guidelines – which focused exclusively on efficiencies – both the Division and the FTC have gained substantial experience evaluating efficiency claims. The Agencies intend to provide additional guidance on how they have treated efficiencies in their merger analysis in their upcoming joint Commentary to the Merger Guidelines.