2009

Efficiencies in Merger Analysis: Alchemy in the Age of Empiricism?

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1 INTRODUCTION

One is hard-pressed to find in law an undertaking more fraught with uncertainty than the application of the efficiencies defence in merger analysis. Generalist fact finders (judges) and politically attuned government officials (prosecutors and regulators) are charged with two Herculean tasks: (1) predicting the outcome of organic changes in business enterprises and (2) comparing the magnitude of those changes to the equally uncertain amount of harm to future competition that the transaction will cause. Given the enormous, perhaps intractable, uncertainty of this inquiry, it is therefore paradoxical that many of the strongest advocates for strengthening the role of efficiencies analysis in merger reviews are self-described proponents of bringing a 'new empiricism' to antitrust analysis.[1]

This chapter focuses on the tensions inherent in incorporating an efficiencies defence (or evaluating efficiencies as part of the appraisal of mergers) and maintaining the rigour and impartiality promised by proponents of the 'empirical' approach. This argument should not be misconstrued as a brief for abandoning the efficiencies inquiry altogether. Rather, it is, first, an appeal for candour (and humility) by those undertaking the inquiry; and second, it is a brief for constraining discretion by imposing

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[1] For example, former FTC chairman Timothy Muris has contended that merger law should not rely on presumptions and economic theory alone. Questioning presumptions that increased concentration harms competition, 'without specific evidence relating to the precise characteristics of the industry under review . . . the current state of empirical work does not justify the conclusion . . . that challenged mergers are likely to increase price.' *See* TJ Muris, 'The Government and Merger Efficiencies: Still Hostile after all these Years' (1999) 7 *George Mason U L Rev* 729 (contending the government give more weight to efficiencies in those cases lacking clear factual evidence underpinning the presumption of a competitive concern).

more clearly delineated presumptive rules of law on judges and insisting on greater transparency by agencies in deciding whether to challenge mergers.

2 EFFICIENCY ANALYSIS IN AMERICAN MERGER CASES: A BRIEF HISTORY

The tenor of early antitrust treatments of efficiencies in merger cases ranged from suspicion to outright disfavour. Prompted by Supreme Court dicta, courts occasionally went so far as to view efficiencies as an aggravating rather than a mitigating factor. Whether based on legislative history, the belief (in the words of Judge Learned Hand) that 'great industrial consolidations are inherently undesirable', empathy for small producers and entrepreneurs, or worries about the political and social risks of concentrated power, suspicion warranted legal rules foreclosing consideration of efficiencies as a grounds for mergers. Today this outlook may seem quaint and long outmoded. The US federal enforcement agencies (the Department of Justice and the Federal Trade Commission) have explicitly recognized efficiencies as a possible defence to otherwise anticompetitive mergers for at least 30 years. Moreover, the triumph of the 'efficiency school' in informing the interpretation of the Sherman Act and shaping its doctrinal landscape for assessments of restraints of trade is indisputable.

Yet when one examines the case law and prosecutorial decisions in the American merger context, one finds that *in practice* efficiencies analysis follows a curious pattern. Despite protestations of the centrality of the issue for sound economic analysis, the case law in the US fails to reveal a single case in which efficiencies alone persuaded a court to permit an otherwise anticompetitive merger to go forward. It is not the case, however, that efficiency claims have simply failed to capture the attention of judicial fact finders. Indeed, conscious avoidance offers a better explanation. A well-recognized pattern of courts and the FTC is that efficiencies are cited as an 'add on' justification for finding that a merger was otherwise benign and the absence of efficiencies is noted only to support other findings that a merger will lessen competition. Whether courts are overwhelmed or intimidated by the task at hand or view the efficiencies question as intractable or not worth the considerable resources needed to appraise it accurately, one cannot escape the conclusion that courts do not place the issue at the forefront of issues they need to carefully explore.

At the same time, one finds considerable enthusiasm for the task expressed by federal enforcers and their staffs of economists when examining mergers informally, especially at the clearance stage. For at least two decades, Assistant Attorney Generals at the Department of Justice and FTC Commissioners have taken pains to give assurances that they do indeed take efficiencies into account at the evaluation stage in making the decision whether to challenge a merger. Moreover, they are quick to point out that the efficiencies defence has been outcome-determinative in a number of decisions to allow concentrative mergers to go forward. The casual observer might find this a curious state of affairs. At the investigatory stage, even with modern disclosure and discovery tools available after 'second requests' for information are filed under the Hart-Scott-Rodino law, enforcers lack detailed economic evidence about claimed economies that are produced in litigation. There is little doubt that the quantum of evidence, quality of sources, and, as discussed below, standards for evaluation are markedly different at the clearance stage than after an adversarial hearing. Yet that is where the defence has its most impact, while fully litigated adversarial proceedings never result in determining the outcome of cases.

3 THE PATH AND INFLUENCE OF ECONOMIC THINKING ON EFFICIENCY ANALYSIS IN MERGER CASES

The economic underpinnings for explicitly incorporating efficiencies into merger analysis can be traced to Oliver Williamson's influential article '*Economies as an Antitrust Defense: The Welfare Tradeoffs*', which threw down the gauntlet for enforcers: 'If neither the courts nor the enforcement agencies are sensitive to [efficiency] considerations, the system fails to meet a basic test of economic rationality. And without this the whole enforcement system lacks defensible standards and becomes suspect.'[2] Assumptions about demand elasticities and other factors led many to adopt working assumptions that rectangles (surpluses resulting from efficiencies) were likely to be larger than triangles (deadweight welfare losses) in conducting the welfare trade-off. At a minimum, the possibility that in a not insignificant proportion of cases empirical examination by courts would reveal that efficiencies outweighed potential harms led a chorus of academics and politically appointed agency heads to support adding an efficiencies defence to Clayton Act jurisprudence.

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[2] OE Williamson, 'Economies as an Antitrust Defense: The Welfare Tradeoffs' (1968) 58 *Am Econ Rev* 18.

Although it remains influential and is frequently cited, the Williamsonian model has been sharply criticized for a variety of shortcomings both conceptual and practical. As to estimating effects in homogeneous product markets, analysis based on assumptions of uniform price setting is largely unrealistic given that firms negotiate prices with customers and other market realities are ignored. In addition, the simplified trade-off model assumes that the merger takes place in a perfectly competitive market; when applied to markets already distorted by pre-existing market power, the potential reductions in social welfare from deadweight losses are greater.[3] Economists have noted that other important qualifications include the need to account for 'dynamic efficiencies'. Roberts and Salop have noted that efficiencies in some industries diffuse readily and that factor has important implications for trade-off analyses.[4] Further, ideally the trade-off calculus would include some measure of a merger's impact on the incentives (and hence probability) of inducing greater or lesser innovation. Finally and perhaps most critically, the model needs to be refined and qualified for application to heterogeneous products.

4 FEDERAL GOVERNMENT MERGER GUIDELINES

Revising an explication of their merger enforcement policies (albeit not committing themselves to adhering strictly to them in litigation), the FTC and Department of Justice issued an important amendment of their Merger Guidelines in 1997.[5] Notably, they recognize efficiencies as a defense to an otherwise objectionable merger only if of specified quality and sufficient magnitude to ensure that the post-market price will not increase. The guidelines enunciate first, a three part test to determine whether claimed efficiencies are 'cognizable': they must be (1) analytically valid, (2) verifiable and (3) merger specific. Those efficiencies clearing this hurdle will then be balanced (after a fashion) against the anticompetitve effects of the merger to determine the merger's net impact on price.

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[3] PE Areeda and H Hovenkamp, *Antitrust Law*, Vol IVA (2006).

[4] GL Roberts and SC Salop, 'Efficiencies in Dynamic Merger Analysis' (1996) 19 *World Comp* 5.

[5] US Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines, 2 April 1992 (revised 8 April 1997), http://www.usdoj.gov/atr/public/guidelines/hmg.htm (accessed 31 January 2008).

5 UNCERTAINTIES IN APPLYING EFFICIENCY ANALYSES

Efficiency analysis poses an almost endless number of conundrums and real world difficulties in application. This chapter next surveys some of the principal uncertainties that are particularly likely to undermine the hopes for an empirical foundation for efficiency appraisals. The claim advanced is that the problems associated with efficiency evaluations are distinct from, and more severe than those encountered in other areas of antitrust inquiry, while also being less susceptible to empirical verification.

5.1 Uncertainties Inherent in Ex Ante Evaluations

Virtually all merger challenges are brought before the fact. The ex ante evaluations required for analysing efficiencies confront multiple sources of uncertainty. Beyond the obvious difficulties inherent in foreseeing any future events, several problems peculiar to the posture of these inquiries should be noted. In many respects, the information needed to make an informed prediction is unavailable because it is unavailable to the parties themselves. In a yet-to-be consummated merger, the parties may be restricted in the degree to which they can share information, or may be unwilling to do so before consummation for business or legal reasons. Because the realization of efficiencies may be contingent on the presence of a variety of conditions within the merging firms, many important facts are unknowable ex ante. For example, corporate 'culture', learning curves, personality conflicts, impediments to knowledge transfers, and a host of other factors may limit the magnitude and feasibility of synergistic benefits flowing from a merger.

The procedural aspects of merger analyses also tend to impede acquisition of information that can be relied upon to support reliable predictions. The merging parties are the source of the most useful information, but have clear incentives to shade or conceal full disclosure of damaging proof. A central problem is that efficiencies claims lack adversarial perspective. In the case of pre-merger clearances, the assertions of efficiencies savings do not undergo the scrutiny afforded by litigation (testimony under oath, cross-examination, etc). Even in litigated cases, information is uniquely problematic because efficiency claims usually involve matters of internal resource allocation and capabilities specific to the merging parties. Hence, benchmark testing of claimed efficiencies is often not possible. Likewise, the experience of third parties (competitors and customers) is insufficient either because the circumstances of the merging firms is sui generis or they lack access to specific information that can rebut the self-interested claims of the merging parties. Finally, even if made fully available, internally generated estimates of efficiencies may lack reliability. Behavioural economists studying mergers have found that cognitive biases of corporate decision makers may underlie mistaken estimates of benefits from mergers.[6]

The lessons of failed mergers reinforce the argument that efficiency claims of merging parties are inherently imprecise. A large literature examining the high percentages of unsuccessful mergers underscores the uncertainty the corporations themselves face in ascertaining the likelihood of realizing hoped-for cost savings from mergers.[7] The business consulting literature reveals that a substantial number of merger transactions, perhaps more than half, do not achieve the shareholder benefits that were predicted. These studies suggest, first, that information on potential efficiencies is impacted and not easily interpreted. They also lend support to the behaviouralists' claims that managers of takeover firms overvalue targets' potential to realize synergies and other efficiencies. In sum, the spotty track record in evaluating efficiencies ex ante of those who have enormous financial stakes in the reliability of those outcomes counsels caution in relying on the accuracy of generalist judges and prosecutors undertaking similar investigations.

5.2 Uncertainties Flowing from the Applicable Economic Standard

The most sharply contested 'economic' issue regarding efficiencies, the choice of the applicable welfare standard, is one that ultimately turns on critical normative judgments by the decision maker. A long-running debate over the appropriate economic standard to be applied in antitrust law, and specifically in merger analyses, focuses on whether an aggregate economic welfare standard (or 'total surplus' standard) or a consumer surplus standard should apply. The aggregate economic welfare standard condemns mergers that decrease the aggregate welfare of consumers (ie buyers) plus producers (ie sellers and their competitors), without regard to any wealth transfers. In contrast, the consumer welfare standard would condemn conduct if it actually reduces the welfare of buyers, irrespective of its impact on sellers. Thus, under the consumer surplus standard, efficiencies count only if there is evidence that enough of the efficiency benefits would be passed through to consumers so that consumers would benefit from the

[6] ME Stucke, 'Behavioral Economists at the Gate: Antitrust in the 21st Century' (2007) 38 *Loy U Chi L J* 513.

[7] *See* RE Caves, 'Mergers, Takeovers, and Economic Efficiency: Foresight vs. Hindsight' (1989) 7 *Int'l J Ind Org* 151.

conduct.[8] The Federal Merger Guidelines and case law for the most part adopts the consumer standard, recognizing efficiencies only if they are sufficient to ensure that post-merger prices will not increase.

The choice of the appropriate welfare standard is usually not outcome-determinative on the efficiencies issue, but it may be in several cases. The first involves the treatment of fixed cost savings. Mergers that are found to cause price increases or lessen quality or innovations may sometimes result in an allocative efficiency loss that is less than production efficiency benefits arising from fixed cost savings. In this case, the consumer welfare standard would suggest condemnation of the merger because prices would rise, while the aggregate welfare standard would not. The welfare standard could also matter when the efficiencies from a merger involve a reduction in marginal cost that is not passed on to consumers sufficiently to prevent prices from rising. Such an agreement would be considered harmful under a consumer welfare standard, because price would rise. But if the production cost savings exceeded the allocative efficiency loss, the merger would not be considered harmful under an aggregate welfare standard.

Even where real cost savings can be demonstrated, they do not necessarily lead to lower prices. Further, the propensity of efficiencies to do so may vary significantly, with the theory of the claimed effect on competition arising out of the merger. In cases involving unilateral effects, even substantial reductions in marginal cost may not be sufficient to generate price declines if firms behave as is supposed by some common oligopoly models. And in cases involving coordinated effects, demonstrated efficiencies could under some circumstances lead to *higher* prices, such as in the case of imperfect industry coordination, where the effect of efficiencies may be to enhance threatened punishment facing a 'maverick' competitor that otherwise would constrain industry prices.

5.3 Which Efficiencies Count?

An admixture of economic and pragmatic considerations underlie legal determinations as to which efficiencies will gain recognition in antitrust merger analyses. The Federal Merger Guidelines list several criteria for efficiencies that will be 'cognizable'. First, they must be 'merger specific',

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[8] Fundamentally, the consumer surplus can be seen as a kind of entitlement under the policies endorsing competition through the antitrust laws. Professor Lande, for example, argues that legislative history and the logic of competitive markets imbue in consumers a right to receive the consumer surplus flowing from competition. RH Lande, 'Chicago's False Foundation: Wealth Transfers (Not Just Efficiency) Should Guide Antitrust' (1989) 58 *Antitrust LJ* 631.

that is, they must be likely to be accomplished through the merger and unlikely to be accomplished in the absence of the merger or through other means having fewer anticompetitive effects. A second criterion is that efficiencies be 'verifiable'. By this, the Guidelines intend that merging parties must substantiate their claims in a manner that permits the agencies to verify the likelihood, magnitude and cost of the efficiencies, the manner in which they will enhance incentives and abilities to compete, and the reasons why they are merger specific. Although both of these tests may be justified on theoretic and pragmatic grounds, they add to the uncertainty of the efficiencies evaluation process because they add complexity, lack precision and ultimately permit considerable discretion in their application by judges and prosecutors. To take one example, subsumed in the inquiry as to merger specificity are questions of whether internal expansion or joint ventures are feasible alternatives to merger. Other inquiries cascade from these questions: what are the minimum scale requirements? Are there capacity limits in the market that would make internal expansion unprofitable?

The Guidelines also list favoured and disfavoured efficiencies, stating that efficiencies result from shifting production so as to enable the merging firms to reduce the marginal cost in the former category and procurement, management, or capital cost in the latter. It is noteworthy that the Guidelines' categorization differs in detail and selection from those identified by leading treatises on antitrust law.[9] Further, many commentators (including Timothy Muris, former chairman of the FTC) assert that there is no economic or pragmatic basis for disfavouring certain efficiencies. At the same time, there is widespread agreement that informal practice by the FTC and DOJ departs significantly from this analysis, as federal officials have acknowledged that consideration of all efficiencies is commonplace.

A central tension in the categorization approach is that some of the most economically salient efficiencies rank among the most difficult to predict or to measure. As a former FTC Commissioner stated, '[i]nnovation or managerial economies are probably the most significant variable in determining whether companies succeed or fail – or in determining whether certain

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[9] Several prominent commentators have endorsed a categorization approach that classifies efficiencies based on their relative importance and susceptibility of proof and contemplates that antitrust tribunals should, as a matter of law, limit the defense according to these classifications. For example, Professor Areeda and his co-authors proposed that economies of scale and scope should generally be recognized, while economies in distribution, promotion and R&D, which present relatively weak cases for consideration, should be subject to more rigorous analysis. Others, such as managerial economies and savings in capital cost, procurement, or overhead, should generally not be recognized.

more specific merger efficiencies are achieved or not. Yet, we do not overtly take them into account when deciding merger cases.'[10] A number of others have stressed that the processes that spur innovation, such as knowledge transfers, undergird innovation, which 'provides the greatest potential enhancement of social wealth. [And it is] the single most important factor in the growth of real output in the industrial world, representing over half the total gain in U.S. output over extensive time periods.'[11] Yet predictions of synergies strengthening the likelihood of innovation are among the most speculative undertakings.

Another issue giving rise to additional uncertainty is whether antitrust law should credit efficiencies obtained by the merging parties in markets different from the one in which the merger has an anticompetitive effect. While case law and the language of the Clayton Act seem to preclude such multi-market balancing, changes to the Merger Guidelines in 1997 opened the door slightly, stating the agencies would exercise prosecutorial discretion to take such efficiencies into account where they were 'so inextricably linked' to the market that no remedy could eliminate the anticompetitive harm without sacrificing the efficiencies in the other market.

5.4 Uncertainties in Measurement, Timing, and Balancing

Determining the magnitude of efficiencies necessary to offset anticompetitive harm has long perplexed enforcers and academic commentators. Because efficiencies must offset anticompetitive harms, most agree that a 'sliding scale' approach that would calibrate the magnitude of efficiencies required against the degree of predicted harm is, in theory, desirable.[12] However, enormous measurement and conceptual problems are present on both sides of this equation. As suggested above, many claimed efficiencies do

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[10] TB Leary, 'Efficiencies and Antitrust: A Story of Ongoing Evolution, Address at the Fall Forum of the ABA Section of Antitrust Law' (8 November 2002), www3.ftc.gov/speecheds/leary/efficienciesandantitrust.htm (accessed 31 January 2008).

[11] JF Brodley, 'Proof of Efficiencies in Mergers and Joint Ventures' (1996) 64 *Antitrust LJ* 575.

[12] *See* US Horizontal Merger Guidelines, 2 April 1992, §4, http://www.usdoj.gov/atr/public/guidelines/hmg.htm (accessed 31 January 2008) ('The greater the potential adverse competitive effect of a merger . . . the greater must be cognizable efficiencies in order for the Agency to conclude that the merger will not have an anticompetitive effect in the relevant market'). The Merger Guidelines include a caveat that would prohibit consideration of efficiencies in extreme cases: Efficiencies must 'not arise out of an anticompetitive reduction in output or service' and will 'almost never justify a merger to monopoly or near-monopoly'. *Id.*

not readily admit to quantitative measurement and are subject to qualifications that make even approximations difficult. Moreover, projected competitive harm is also not subject to precise, or even approximate, ex ante evaluation. Although some suggest using concentration measures as a tool for a crude risk assessment, it would need to be qualified by careful assessment of a host of factors, such as entry conditions, before even the crudest estimation of potential harm could be made. It seems highly doubtful that any form of balancing is feasible. As Professor Hovenkamp's treatise put it: 'Balancing implies an ability to assign a common unit of measurement to the two things being balanced, and determine which outweigh the other. Except in the clearest cases, this is simply not what courts are capable of doing.'[13]

How should antitrust tribunals take into account the pervasive uncertainty described above? In their internal evaluation of claimed efficiencies, the government acknowledges it applies a rather rough discounting approach based on its evaluation of the quality and persuasiveness of the merging parties' substantiation proof:[14]

> The Agencies recognize that assessing a proposed merger's potential efficiency benefits, like its competitive effects, necessarily involves projections about the future. The Agencies do not automatically reject a claim due to minor discrepancies uncovered in the verification process. Nor do the Agencies reject an efficiency claim solely because the efficiency has never before been accomplished. Shortcomings in the substantiation of a particular efficiency claim may cause the Agencies to reduce the magnitude of the efficiencies associated with that claim rather than to reject the claim altogether. Similarly, the fact that one stand-alone efficiency claim cannot be verified does not necessarily result in rejection of other claims.

While this approach understandably seeks to motivate parties to submit reliable information so as to simplify its task, it may have the undesirable effect of further clouding the evaluation process. Parties risk having their claims 'discounted' to some unspecified degree based on the ability of the government to verify the accuracy of their claims.

Another factor introducing uncertainty in evaluating merger-specific efficiencies is the time horizon applicable to the analysis. The Guidelines are not clear as to when the price test is to be applied. For example, where synergies take time to develop, would a temporary increase in price negate an otherwise acceptable efficiencies defence? If not, how long a time lag is

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13 Areeda and Hovenkamp, *supra* note 3, at 314.

14 US Department of Justice and Federal Trade Commission, 'Commentary of the Horizontal Merger Guidelines' (2006) 52, http://www.usdoj.gov/atr/public/guidelines/215247.htm (accessed 31 January 2008).

acceptable? In addition, the Department of Justice states that considerations of a merger's effect on the pace of adoption of innovation will itself constitute a cognizable efficiency factor:[15]

> Claimed cost savings from combining sales and realizing economies of scale . . . might be realized from internal growth. If such unilateral changes are likely without the proposed merger (for example, if they have already been planned), they are not merger-specific. Timing can be an important factor in the consideration of such claims. If a merger can be expected significantly to accelerate the achievement of economies of scale due to increased sales as compared to internal growth, the Agencies credit the merger with merger-specific acceleration of the cost reduction.

Hence, the fact finder is called upon to estimate, in some rough fashion, how quickly efficiencies may be realized and compare that judgment to another (necessarily imprecise) estimate of how quickly the economies of scale might have been achieved by internal growth. The likely compounding effect of imprecision on multiple inquiries here is striking.

6 APPLYING THE EFFICIENCIES ANALYSIS

The government enforcers and the courts have adapted to uncertainty. However they have done so in a manner that is not geared to improving the likelihood of achieving the accuracy hoped for by proponents of the defence. For example, the foregoing analysis suggests that the Agencies themselves have sought to maximize their own flexibility on the efficiencies issue by publishing guidelines that speak in broad and ambiguous terms that provide almost unlimited room for discretion in exercising their prerogative as to whether to bring challenges to mergers. At the same time, they urge narrow readings by courts and insist that their Guidelines are not designed to guide judicial decision making. Faced with the imperatives of reviewing a large number of mergers under time and resource constraints, the Agencies have, perhaps understandably, opted for flexibility over precision.

Courts confronting efficiency issues in litigated cases fare no better. Even where sophisticated econometric data has been put forward, judges seem reluctant to dive in. An example is found in the *Staples* case,[16] in which the District Judge ignored voluminous economic evidence and relied instead

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15 Merger Commentary, *supra* note 14, at 'Efficiencies the Agencies Consider. Merger-Specific Efficiencies'.

16 *FTC v Staples, Inc* 970 F Supp 1066 (D. D.C. 1997).

on internal documents and his own visit to the stores. Triers of fact or those with discretion to prosecute seem reluctant to deal with complex statistics if there are other grounds for decision. While such data is sometimes cited as reinforcing judges' decisions on other issues, according to one FTC commissioner, no court or FTC decision turned on econometric evidence or engineering and accounting studies, standing alone.

In this regard, the experience of the American courts is instructive and discouraging. Faced with the inherent uncertainties and complexities of the efficiency inquiry, courts have resorted to evidentiary shortcuts and other measures that fall far short of a meaningful balancing of efficiencies and harms. In some instances, they have developed tests that make little economic sense (eg a rigid passing on requirement). In others they have resorted to evidentiary sleight of hand (eg relying on findings concerning the 'credibility' of experts or assigning dispositive weight to internal studies). In the end, the results of judicial efficiencies inquiries seem preordained by the courts' conclusions on competitive effects. Most courts finding substantial efficiencies do so only where they also conclude that the merger would not be likely to substantially lessen competition.

Efficiency claims are evaluated by the FTC and DOJ internally when reviewing mergers in a manner that is far less precise than published merger guidelines would suggest. As FTC Commissioner Leary candidly observed:[17]

> Experienced counsel know that in actual practice the vast majority of efficiency claims are resolved internally in the agencies in a much less formal way [than the Guidelines specify]. For mergers that do not involve extreme concentration levels, efficiencies are not analyzed as a 'defence', and rigorously quantified, but rather included in the description of the overall business rationale for the transition. Because there is no need to strike a mathematical balance, the presentation can include not only scale effects on production but also things like improved potential for innovation and managerial efficiencies.

As a general matter, in the case of informal clearances of mergers, antitrust agencies rarely supply enough information to provide an empirical record for appraising the basis for their decision. One reason for this of course may be that the empirical basis for the claim is so slender. Further, as noted above, the lack of information from an adversarial process contributes to the lack of hard information on which to base efficiency evaluations.

Several conclusions flow from the enforcement patterns just discussed. First, the lack of transparency and disregard of standards in the clearance

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[17] Leary, *supra* note 10.

process breeds problems besides judicial or administrative error. Where empirical judgments necessary to bring enforcement actions are prone to high rates of error or ambiguity, merging parties may have strong incentives to opportunistically seek out mergers that they would otherwise forego. Second, transparency, though desirable for purposes of ensuring accountability of public officials, cannot cure many of the problems identified in this chapter. The inadequacy of evidence to provide convincing answers to the several facets of efficiency analysis will not be cured by wider inspection of that evidence. At best, transparency might reveal that the emperor has no clothes, which in turn might spur greater efforts to establish workable presumptions that dispense with factual questions that are impossible to answer.

7 A CAUTIONARY TALE: ANTITRUST EVALUATIONS OF HOSPITAL MERGERS

For better or worse, hospital mergers have become a proving ground in American courts for weighing efficiencies in antitrust cases. These cases are instructive in that they demonstrate the problems antitrust tribunals encounter and spotlight the intractable nature of many of the factual issues. As a result, most courts have employed evidentiary presumptions and relied on the placement of the burden of proof to evade trade-off analyses.

In some respects, the hospital industry in America is well-suited for efficiencies analysis; in others, decidedly not. Clearly, the industry suffers from significant overcapacity attributable to government policies, inefficient reimbursement methodologies and rapid technological change, causing shifts in where many procedures are performed. Moreover, conditions on both the demand and supply side are changing rapidly to deal with the new environment. These cataclysmic changes occurring in heath care financing and delivery make it extraordinarily difficult to predict with confidence what kinds of savings are attributable to a given merger and what less restrictive alternatives might exist.

Federal courts have closely examined defendants' efficiencies claims in seven hospital merger cases with a variety of results and approaches.[18]

[18] In three of those cases, the district courts made rather cursory findings to the effect that defendants had presented plausible efficiency claims. *FTC v Freeman Hospital* 911 F Supp 1213 (W.D. Mo. 1995), aff'd, 69 F.3d 260 (8th Cir 1995); *United States v Carilion Health Sys* 707 F Supp 840 (W.D. Va.), aff'd, 892 F.2d 1042 (4th Cir 1989); *FTC v University Health, Inc* 1991–1 Trade Cas (CCH) P 69,444 (S.D.

Several observations may be made about the decided cases. First, with one exception, courts have followed a pattern of symmetry between their findings on the merits of the government's merger case and their treatment of efficiencies. That is, courts ruling for defendants on other grounds uphold their efficiency claims, while those concluding that the merger will lessen competition reject efficiencies claims. Courts thus may be taking the easy way out on this complex issue.

While a wide variety of efficiencies have been considered in various cases, those involving economies in scale and scope, as well as savings resulting from combined administrative functions, have proven the most successful. Indeed, in litigation, the government has often conceded the validity of such efficiencies in principle, while vigorously disputing their magnitude or the feasibility of their being implemented. As a general matter, the agencies take the position that preferred efficiencies include better use of fixed cost assets and elimination of duplicative services, while other kinds of efficiencies, such as savings in the cost of capital and shared inputs, are suspect, primarily because they can often be accomplished without merger. Scale economies and other savings, from consolidating programs operated at less than efficient levels, are readily identifiable and estimated. Courts have been sceptical of purported savings resulting from improved information and use of 'best practices' resulting from mergers, contending that such savings readily obtained through other means and were difficult to quantify. However, in one hospital merger case, the appellate court faulted the district court for failing to weigh quality-enhancing aspects of the merger against anticompetitive harms under an efficiency analysis.[19] Thus, the litigated cases have sidestepped many important, but hard-to-quantify efficiencies.

Ga. 1991), rev'd, 938 F.2d 1206 (11th Cir 1991). One other district court relied in part on evidence of efficiencies in finding that the hospitals had rebutted the government's prima facie case, *FTC v Butterworth Health Corp* 946 F Supp 2385 (W.D. Mich. 1996), and another endorsed in dicta the defendants' claim. *United States v Long Island Jewish Hospital* 983 F Supp 121 (E.D.N.Y. 1997). In the only appellate case, *FTC v University Health, Inc* 938 F.2d 1206, 1222 (11th Cir 1991), three district court cases, and several FTC administrative proceedings on the subject, *see eg In Re Evanston Northwestern Healthcare Corporation*, 2007WL4358355 (9 November 2007), defendants' proof on the efficiencies has been found wanting. For their part, the federal enforcement agencies have taken the position that they may weigh efficiencies in deciding whether or not to challenge a merger, while occasionally arguing that efficiencies considerations are not cognizable by federal courts. *See* TL Greaney, 'Chicago's Procrustean Bed: Applying Antitrust in Health Care' (2004) 71 *Antitrust LJ* 857.

19 *FTC v Tenet Healthcare Corp*. 186 F.3d 1045 (8th Cir 1999).

8 CONCLUSION

This chapter has focused on the dilemmas posed by the efficiency question in antitrust merger analysis. In some respects, the problem is not unique to efficiencies. Antitrust necessarily relies on economic theory to help shape its rules of thumb and presumptions and to inform its analysis of facts. The push to incorporate efficiencies into merger evaluations has been driven by unquestioned economic theory. All that is part of the evolutionary process that has long characterized antitrust doctrinal development. However, matching theory with workable rules of law on the efficiencies issue has generated extensive debate and doctrinal development has failed to isolate critical issues of fact that courts can meaningfully evaluate. Attempts to incorporate efficiencies have been particularly problematic because of the multiple levels of uncertainty that attend the inquiry. The outcome has also been somewhat sui generis among controversial antitrust issues. Courts have taken pains to avoid the issue, while prosecutors have embraced it, but only for purposes of conducting their pre-merger reviews. While this caution is certainly commendable given the problems associated with the defence identified in this chapter, the absence of clear judicial standards may have allowed the defence to flourish behind the scenes without being subject to examination and validation.