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Cost Efficiencies in the Section 7 Calculus: A Review of the Doctrine

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COST EFFICIENCIES IN THE SECTION 7 CALCULUS: A REVIEW OF THE DOCTRINE

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Notwithstanding the well-known decline in antitrust enforcement over the past few years, merger enforcement at the antitrust agencies has remained extremely active. The near-perfect litigation record that has been amassed by the Federal Trade Commission and the Antitrust Division against mergers that they recently challenged underscores the need for antitrust lawyers to accurately assess the antitrust consequences of proposed acquisitions. Industrial efficiencies—cost reductions resulting from production synergies of the merging parties—have assumed near-paramount importance in this analysis. Despite their significance, however, the case law, the legal and economics literature, and the policy pronouncements of the antitrust agencies have provided confusing and contradictory guidance as to their role and their use in merger analysis.

This Article focuses on the very important role that industrial efficiencies have taken in merger analysis. Mr. Berg traces the development of the "efficiencies doctrine" in the policy pronouncements of the Federal Trade Commission and the Antitrust Division; he analyzes the treatment of efficiencies in the legal and economics literature; and he examines the role that efficiencies considerations played in an important recent case at the Federal Trade Commission, American Medical International. *The Article concludes by considering the role that the efficiencies doctrine will take in merger analysis in the future.*

INTRODUCTION

MERGER ANALYSIS IS in the midst of an historic revolution. Courts and antitrust enforcement agencies alike are abandoning quantitative merger analysis, once regarded as the tried-and-true measure of legality,[1] in favor of greater reliance on qualitative com-

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1. In *United States v. Von's Grocery Co.*, the Supreme Court sustained an enforcement action against the merger of two supermarket chains. 384 U.S. 270 (1966). The Court concluded that the resulting combined market share of seven and one-half percent of the Los Angeles market was potentially anticompetitive and gave little consideration to other relevant non-quantitative factors. *See also* United States v. Philadelphia Nat'l Bank, 374 U.S. 321,

petitive analysis.[2] Various qualitative considerations such as barri-

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362-63 (1963) (merger should be presumed illegal when market share information suggests that the merger will result in a significant increase in industry concentration); Brown Shoe Co. v. United States, 370 U.S. 294 (1962).

Under these early cases, the Supreme Court made evidence of substantial resulting market shares virtually irrebuttable proof of illegality. For instance, under the Justice Department's 1968 Merger Guidelines, the Antitrust Division indicated that it would challenge a merger between two companies, each with market shares as little as four percent, where the market was highly concentrated (shares of the four largest firms amounting to approximately 75% or more of the market). *See* U.S. DEP'T OF JUSTICE, MERGER GUIDELINES ¶ 5 (1968), *reprinted in* 2 Trade Reg. Rep. (CCH) ¶ 4510, at 6884 [hereinafter DOJ 1968 GUIDELINES]. *See also id.* ¶ 8, at 6884 (Department will attach primary importance to the market shares of the merging firms). However, in the Supreme Court's most recent substantive merger decision, *United States v. General Dynamics Corp.*, the Court indicated that factors other than concentration data must be considered in assessing the competitive impact of an acquisition. 415 U.S. 486, 495-504 (1974).

The quantitative or structural approach to determining section 7 illegality, with its heavy reliance on market concentration and the market shares of the merging firms, is based on the concentration-collusion hypothesis developed by Bain, Stigler, and Mann, which posits that increases in market concentration will lead to poor market performance because of collusion or oligopolistic interdependence. *See* Gellhorn, *Government Merger Policy and Practice—1983*, 52 ANTITRUST L.J. 419, 419 n.4 (1983) (citing seminal works of Bain, Stigler, and Mann).

2. For instance, entry conditions have played a dispositive role in several recent merger cases notwithstanding the high resulting market shares or high market concentration in each. *See* United States v. Waste Management, Inc., 743 F.2d 976, 981-82 (2d Cir. 1984) (where company had postmerger market share of 48.8% court concluded that ease of entry by potential competitors may be considered in appraising whether a merger will lessen competion); United States v. Calmar, Inc., 612 F. Supp. 1298, 1301 (D.N.J. 1985) ("If ease of entry in the market is such that the producers in the market could not long sustain an unjustified price increase, then in spite of a high degree of concentration there has not been a substantial lessening of competition."); *Echlin Mfg. Co.*, 3 Trade Reg. Rep. (CCH) ¶ 22,268, at 23,297 (FTC June 28, 1985) (in discussing its antitrust challenge to Echlin's acquisition of Borg-Warner's Automotive-Aftermarket Operations, the FTC held that "one of the most important considerations in deciding whether a merger is anti-competitive is the existence of barriers to entry."). *See also* United States v. Tracinda Inv. Corp., 477 F. Supp. 1093, 1109 (C.D. Cal. 1979) (in determining that the purchase of stock in a motion picture company by a corporation and an individual already owning controlling stock in another motion picture company was not anticompetitive, the court held that there were no significant economic barriers to entry into motion picture production); United States v. M.P.M., Inc., 397 F. Supp. 78, 92 (D. Colo. 1975) (in holding that an acquisition of two ready-mix concrete firms by another ready-mix firm was not anticompetitive, the court considered the fact that new entry had been recently made into the market, and that there was no reason to believe that the pattern would change).

The Justice Department's 1982 and 1984 Merger Guidelines identify several qualitative factors (relating to the ease and profitability of collusion) in addition to entry conditions that are considered in assessing the legality of a merger: the nature of the product and terms of sale, the availability of information about specific transactions and buyer market characteristics to firms in the market, the conduct of firms in the market, and market performance. *See* U.S. DEP'T OF JUSTICE, MERGER GUIDELINES § III(c) (June 14, 1982), *reprinted in* 2 Trade Reg. Rep. (CCH) ¶ 4503, at 6881-13 [hereinafter DOJ 1982 GUIDELINES]; U.S. DEP'T OF JUSTICE, MERGER GUIDELINES § 3.4 (June 14, 1984), *reprinted in* 2 Trade Reg. Rep. (CCH) ¶ 4493, at 6879-16 [hereinafter DOJ 1984 GUIDELINES]. *See generally* Greenfield, *Beyond* ers to entry, market conditions, and (especially) efficiency gains now take clear precedence over quantitative measures of market power in assessing the legality of transactions.[3]

"Efficiency" is the antitrust buzzword of the day.[4] Antitrust

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Herfindahl: Non-Structural Elements of Merger Analysis, 53 ANTITRUST L.J. 229 (1984); Yoerg, Leddy, Davis & Hill, *Non-Market Share Factors in Horizontal Merger Analysis*, 54 ANTITRUST L.J. 1255 (1986).

3. Quantitative merger analysis has evolved from a two-part measure of market power in the 1968 Merger Guidelines (examining the acquiring and acquired firms' market shares based upon concentration within the relevant market, determined by the aggregate market shares of the four largest firms in the market). DOJ 1968 GUIDELINES, *supra* note 1, ¶¶ 4-6, at 683-84. This analysis, however, has evolved in the 1982 and 1984 Merger Guidelines to a single measure of market power through the Herfindahl-Hirschman Index, which reflects both market share and share distribution. DOJ 1982 GUIDELINES, *supra* note 2, § III(A), at 6881-11; DOJ 1984 GUIDELINES, *supra* note 2, §§ 3.1, 3.11, at 6879-12.

The Herfindahl-Hirschman Index is calculated by summing the mathematical squares of the individual market shares of each of the firms within the relevant market. It reflects the distribution of market shares between firms by giving greater weight to market shares of the larger firms, thereby reflecting their greater importance in any anticompetitive activity. *See id.* § 3.1, at 6879-12. Under both the 1982 and 1984 Guidelines, the Justice Department will likely challenge an acquisition causing an increase in the Herfindahl-Hirschman Index in excess of 50 points, where the post-acquisition Herfindahl-Hirschman Index is above 1800 points. *Id.* § 3.11(c), at 6879-14. For a thorough description of the Herfindahl-Hirschman Index, see Calkins, *The New Merger Guidelines and the Herfindahl-Hirschman Index*, 71 CALIF. L. REV. 402 (1983). *See also* Greenfield, *supra* note 2, at 229-38 (explaining derivation and use of the Herfindahl-Hirschman Index in merger analysis).

Although the FTC does not endorse any particular measure of market power, it has indicated that "the Department of Justice's 1982 revisions to the 1968 Guidelines will be given considerable weight by the Commission and its staff in their evaluation of horizontal mergers." *See* FTC, STATEMENT CONCERNING HORIZONTAL MERGERS § I (June 14, 1982), *reprinted in* 2 Trade Reg. Rep. (CCH) ¶ 4516, at 6901 [hereinafter FTC STATEMENT or HORIZONTAL MERGER STATEMENT]. *See also id.* § II, at 6901 (suggesting utilization of the Herfindahl-Hirschman Index in examining market conditions). *See generally* C.A. HILLS, ANTITRUST ADVISER 185 (3d ed. 1985).

4. In several recent opinions, the Supreme Court has identified economic efficiency as one of the principal goals of antitrust law. *See* Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 106 S. Ct. 1348 (1986); Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co., 105 S. Ct. 2613, 2617 (1985); Monsanto Co. v. Spray-Rite Service Corp., 465 U.S. 752 (1984); NCAA v. Board of Regents, 468 U.S. 85 (1984); Reiter v. Sonotone Corp., 442 U.S. 330, 342 (1979); Broadcast Music, Inc. v. Columbia Broadcasting System, 441 U.S. 1, 19-20 (1979); Continental T.V. Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 69 (1977). *See infra* note 67.

Several important commentators have identified the preservation of consumers' property rights, not economic efficiency, as the primary goal of the anti-merger laws. *See* A. FISHER, F. JOHNSON & R. LANDE, MERGERS, MARKET POWER, AND PROPERTY RIGHTS: WHEN WILL EFFICIENCIES PREVENT PRICE INCREASES? (FTC Working Paper No. 130, 3-7, Sept. 1985). But former Assistant Attorney General McGrath has asserted that the major goal of the Antitrust Division is "to reinforce the notion that the sole basis of antitrust enforcement should be that decisions should be based on economic efficiency notions." *60 Minutes with J. Paul McGrath, Assistant Attorney General, Antitrust Division*, 54 ANTITRUST L.J. 131, 131 (1985). *See generally* Areeda, *Economic Objectives of Antitrust Law*, 52 ANTITRUST L.J. 523 (1983).

scholars and lawyers cannot avoid encountering it—along with its close relation, consumer welfare[5]—in court decisions in both the vertical[6] and horizontal[7] contexts, or in policy decisions by the Federal Trade Commission (FTC or Commission) and the Antitrust Division to initiate enforcement actions.[8] Due to an overabundance of low-cost, high-quality, foreign-produced merchandise entering the United States every day,[9] production efficiency has become the principal goal of American industrial policy, even to the detriment of such traditional goals as full employment, local control of business, and economic atomism.[10] This sentiment has become so per-

5. FTC Commissioner Terry Calvani equates maximum consumer welfare with economic efficiency:

> because economic efficiency exists only when resources are allocated so that no feasible reallocation of either inputs or outputs would increase the welfare of at least one consumer without simultaneously decreasing the welfare of another consumer. In a competitive economy, economic efficiency and maximum consumer welfare occur when consumer surplus (the sum of the maximum price each consumer is willing to pay for purchased goods minus the market price) plus producer surplus (producer profits) is maximized.

Calvani, *Consumer Welfare Is Prime Objective of Antitrust*, Legal Times of Wash., Dec. 24-31, 1984, at 14 n.7. *See also* Calvani, *The Mushrooming* Brunswick *Defense: Injury to Competition, Not to Plaintiff*, 50 ANTITRUST L.J. 319, 340-45 (1981) [hereinafter Calvani, Brunswick Defense].

6. *See, e.g.*, Monsanto Co. v. Spray Rite Service, 465 U.S. 752 (1984) (resale price maintenance). *Accord* Calvani & Berg, *Resale Price Maintenance After* Monsanto: *A Doctrine Still At War With Itself*, 1984 DUKE L.J. 1163, 1179-87. *See generally* U.S. DEP'T OF JUSTICE, VERTICAL RESTRAINTS GUIDELINES (Jan. 23, 1985), *reprinted in* 5 Trade Reg. Rep. (CCH) ¶ 50,473, at 56,185.

7. *See, e.g.*, Broadcast Music, Inc. v. Columbia Broadcasting System, 441 U.S. 1 (1979) (blanket copyright licensing).

8. Well-known recent examples include the FTC's decision regarding the General Motors-Toyota joint venture, *see General Motors Corp. and Toyota Motor Corp.*, 48 Fed. Reg. 57,314, 57,315 (1983) (statement of FTC Chairman James C. Miller III, Commissioner George W. Douglas, and Commissioner Terry Calvani), and the Antitrust Division's decision not to oppose the merger of LTV Corporation and Republic Steel, *see LTV-Republic Steel Merger—Justice Clearance*, 5 Trade Reg. Rep. (CCH) ¶ 50,465, at 56,125 (March 20, 1984). For a discussion of the role of efficiencies in these two cases, see *infra* notes 32, 78-81 and accompanying text.

Of course, in most cases where no challenge is made, the reviewing enforcement agency will not enunciate publicly the reasons underlying the decision not to initiate an enforcement action, so the potentially dispositive role that efficiencies play in these prosecutorial decisions cannot be ascertained. *Accord* Fisher, Johnson & Lande, *supra* note 4, at 11 n.26 ("Neither the Antitrust Division nor the [Federal Trade Commission] has ever publicly stated that it had declined to challenge a particular merger, despite the expectation of higher prices, because of sufficient anticipated efficiencies.").

9. *See generally Proposed Amendments to the Clayton Act: Hearings on S. 2160 and S. 2022 Before the Senate Comm. on the Judiciary*, 99th Cong., 2d Sess. 20-21 (1986) [hereinafter *Proposed Amendments*] (statement of Malcolm Baldrige, Secretary of Commerce).

10. *Id.* ("[T]he declared policy of the Congress [is] that the Government should aid, counsel, assist, and protect, insofar as is possible, the interests of small-business concerns."). *See* Calvani, Brunswick Defense, *supra* note 5, at 340-45.

vasive that the Reagan administration has recently borrowed a suggestion first made some twenty years ago by economist Joe Bain[11] to amend section 7 of the Clayton Act[12] to require consideration of efficiency gains in every case.[13]

It is one thing for the antitrust lawyer to recognize the significance of industrial efficiencies in contemporary merger analysis, and quite another to understand when such efficiencies will be considered, what type will be considered, and how they should be formulated and quantified. These issues frequently tip the balance for or against a government challenge to a proposed transaction, which in recent years has proven to be the biggest obstacle to consummation of transactions.[14] These issues are also central to entertaining the efficiencies defense in private merger litigation. Thus, an understanding of the nuances of these issues, both from an intellectual and from a practical perspective, is crucial for antitrust lawyers today. Unfortunately, the decisions by the courts and the policy pronouncements of the antitrust enforcement agencies fail to provide significant and consistent guidance on these issues.

The goals of this Article are relatively modest. Its principal focus is to review the treatment of industrial efficiencies in contemporary merger analysis. First, the policy bases used by the Antitrust Division and the Federal Trade Commission in deciding whether to

11. *See* J.S. BAIN, INDUSTRIAL ORGANIZATION 658 (2d ed. 1968) [hereinafter J.S. BAIN, INDUSTRIAL]. *See also* Bain, *Discussion*, 40 AM. ECON. REV. 64-66 (1950) [hereinafter Bain, *Discussion*]; *infra* note 161 and accompanying text.

12. Section 7 of the Clayton Act provides that:

> No person engaged in commerce . . . shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no person subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another person engaged also in commerce or in any activity affecting commerce, where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.

15 U.S.C. § 18 (1983).

13. *See* The Merger Modernization Act of 1986, S. 2160, 99th Cong., 2d Sess., __ CONG. REC. __ (1986) (introduced by Senator Thurmond on March 7, 1986) and H.R. 4247, 99th Cong., 2d Sess., __ CONG. REC. __ (1986) (introduced by Congressman Fish on February 26, 1986). *See infra* notes 33-44 and accompanying text.

14. The antitrust enforcement agencies have amassed an enviable record of success over the past few years in those cases where they have decided to challenge a particular transaction. For instance, since 1984, the FTC has prevailed in each of the seven times that it sought a preliminary injunction in federal court. Of course, this record does not reflect several acquisitions that were dropped after the FTC authorized its staff to seek a preliminary injunction but before the staff actually got to court, or transactions that were abandoned after opposition generated within the Commission became known publicly but before the Commission actually voted on the matter. *See 60 Minutes With Terry Calvani, Acting Chairman, Federal Trade Commission*, 55 ANTITRUST L.J. 275, 280 (1986).

challenge a proposed transaction are examined;[15] second, the courts' acceptance of the "efficiencies defense" in assessing the legality of a challenged transaction is reviewed;[16] and third, the treatment of industrial efficiencies in the merger context by the legal and economics literature is considered.[17] This Article then analyzes the application of the efficiencies defense in an important recent merger case, *American Medical International,* in which the FTC attempted to harmonize the recent policy pronouncements of the antitrust enforcement agencies with the treatment of efficiencies in the legal and economics literature.[18] The Article concludes by speculating on the future direction of efficiencies considerations in merger analysis.[19]

I. POLICY STATEMENTS REGARDING THE "EFFICIENCIES DEFENSE"

A. *Department of Justice Merger Guidelines*

The efficiencies defense has attracted considerable attention from the Antitrust Division over the past twenty years. In that period, starting with the promulgation of the first Merger Guidelines in 1968, the Antitrust Division has come to accept the important role that efficiencies considerations should play in merger analysis.

The 1968 Merger Guidelines took a fairly strict position opposing the efficiencies defense, stating that "[u]nless there are exceptional circumstances, the Department will not accept as a justification for an acquisition normally subject to challenge under its horizontal merger standards the claim that the merger will produce economies (*i.e.*, improvements in efficiency)."[20] The 1968 Guidelines clearly focused on size efficiencies, i.e., economies of scale.[21] Similarly, the Justice Department's 1982 Merger Guidelines only recognized efficiencies as a mitigating factor in "extraordinary cases":

> In the overwhelming majority of cases, the Guidelines will allow firms to achieve available efficiencies through mergers without interferences [sic] from the Department. Except in extraordinary

15. *See infra* notes 20-32 and accompanying text.
16. *See infra* notes 57-81 and accompanying text.
17. *See infra* notes 82-163 and accompanying text.
18. *See infra* notes 164-213 and accompanying text.
19. *See infra* notes 214-45 and accompanying text.
20. DOJ 1968 GUIDELINES, *supra* note 1, ¶ 10, at 6885. According to the 1968 Guidelines, the principal reasons for rejecting the efficiencies defense were the "severe difficulties" in establishing the existence and magnitude of the claimed efficiencies and the likelihood that these same efficiencies could be accomplished through internal expansion. *Id.*
21. *Id.*

> cases, the Department will not consider a claim of specific efficiencies as a mitigating factor for a merger that would otherwise be challenged.[22]

However, it appeared that the Antitrust Division in the 1982 Guidelines was implicitly inviting the assertion of efficiencies in future cases by identifying the types of efficiencies that it would consider and the quantum of proof required:

> At a minimum, the Department will require *clear and convincing evidence* that the merger will produce *substantial cost savings* resulting from the realization of *scale economies, integration of production facilities, or multi-plant operations* which are already enjoyed by one or more firms in the industry and that equivalent results could not be achieved within a comparable period of time through internal expansion or through a merger that threatened less competitive harm. In any event, the Department will consider such efficiencies only in resolving otherwise close cases.[23]

Under the Justice Department's recent 1984 Merger Guidelines, consideration is given to "significant net efficiencies" when they are established by "clear and convincing evidence."[24] More importantly, however, the 1984 Guidelines broaden the focus of the inquiry well beyond scale economies to include additional efficiencies:

> Cognizable efficiencies include, *but are not limited to*, achieving economies of scale, better integration of production facilities,

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22. DOJ 1982 GUIDELINES, *supra* note 2, § V(A), ¶ 4505, at 6881-19 (footnote omitted). The 1982 Guidelines also cited difficulties in proof and measurement as the basis for limiting the efficiencies defense. *Id.*

In March 1984, three months before issuance of the 1984 Guidelines, Assistant Attorney General McGrath focused on the treatment of efficiencies under the 1982 Guidelines in his remarks to the National Association of Manufacturers. Addressing the Antitrust Division's merger enforcement policy, McGrath stated:

> Recent analysis of merger policy also indicates that most acquisitions are procompetitive, or at least not anticompetitive. For example, many mergers permit firms to realize scale economies in production, distribution, and marketing. Where there are technological similarities, mergers may allow for the consolidation of operations, longer production runs, and the elimination of duplication that lower fixed costs and reduce overhead. Mergers may also allow firms to develop complementary product lines, reduce transaction costs, and lower the costs of transporting and obtaining needed raw materials. . . .
>
> The 1982 [G]uidelines also address the treatment of efficiencies in merger analysis. Because efficiencies are difficult to prove, let alone quantify, we are cautious about accepting a claim that specific efficiencies would save a merger which would not otherwise pass muster. We do not ignore efficiency claims, but we do require a factual showing that an otherwise problematic merger proposal is likely to generate substantial cost savings that cannot be achieved otherwise.

Remarks by Assistant Attorney General J. Paul McGrath to the National Association of Manufacturers (March 8, 1984), *reprinted in* 5 Trade Reg. Rep. (CCH) ¶ 50,463, at 56,117, 56,118-20. *See generally* Greenfield, *supra* note 2, at 248-51.

23. *See* DOJ 1982 GUIDELINES, *supra* note 2, § V(A) n.53, ¶ 4505, at 6881-19 (emphasis added).

24. DOJ 1984 GUIDELINES, *supra* note 2, § 3.5, at 6879-17.

plant specialization, lower transportation costs, and similar efficiencies relating to specific manufacturing, servicing, or distribution operations of the merging firms. The Department may also consider claimed efficiencies resulting from reductions in general selling, administrative, and overhead expenses, or that otherwise do not relate to specific manufacturing, servicing, or distribution operations of the merging firms, although, as a practical matter, these types of efficiencies may be difficult to demonstrate.[25]

One of the stated purposes of the 1984 Guidelines was to correct the earlier restrictive application of the efficiencies defense:

> The language of the 1982 Guidelines, however, had a restrictive, somewhat misleading tone and indicated that the Department would explicitly consider efficiency claims only in 'extraordinary cases.' In practice, the Department never ignores efficiency claims. Rather, as the revisions now make clear, the Department considers and gives appropriate weight to efficiency claims in all cases in which they are established by clear and convincing evidence.[26]

Another very significant change made by the 1984 Guidelines is that, as a technical matter, efficiencies will only be one of many factors considered by the Justice Department in deciding whether to challenge a merger rather than being treated as a defense to a challenged merger.[27] However, it is unclear from the language of

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25. *Id.* (emphasis added). However, efficiencies that can be reasonably achieved by some means other than the acquisition will be rejected. *Id.*

26. UNITED STATES DEP'T OF JUSTICE, STATEMENT ACCOMPANYING MERGER GUIDELINES (June 14, 1984), *reprinted in* 2 Trade Reg. Rep. (CCH) ¶ 4490, at 6879, 6879-5 [hereinafter STATEMENT ACCOMPANYING DOJ 1984 GUIDELINES].

One former antitrust enforcement official, Tyler Baker, has questioned whether there is any significant difference between the 1982 and 1984 Guidelines' treatment of efficiencies. Mr. Baker contends that although the 1984 Guidelines specifically state that the Antitrust Division "will consider *any* efficiency and it will consider it in *any* case," both the 1982 and 1984 Guidelines send a clear message that such arguments do not make much difference very often. Baker, *The 1984 Justice Department Guidelines*, 53 ANTITRUST L.J. 327, 333 (1984) (emphasis in original).

> The 1984 Merger Guidelines can be read as saying, 'We will consider it, but it is not going to be a winner very often.' This interpretation is consistent with the general statement in the Attorney General's announcement that the changes would not have affected any merger decisions in the past several years. If, in fact, the point is that efficiencies will make a difference more often, I question the wisdom of the change. My concern is not that efficiency is irrelevant in some ultimate sense, but rather, that the staff—for which I have great respect—will be hard pressed to apply the standard in a principled or consistent way.

Id. But see Furth, *Applying the Merger Guidelines*, 53 ANTITRUST L.J. 335, 338-39 (1984) (consideration of merger-related efficiencies in LTV-Republic and canned sweet potato cases).

27. STATEMENT ACCOMPANYING DOJ 1984 GUIDELINES, *supra* note 26, at 6879-5. Both the 1968 and 1982 Guidelines either explicitly or implicitly treat efficiencies as a defense. *Compare* DOJ 1968 GUIDELINES, *supra* note 1, § 10, at 6885, *and* DOJ 1982 GUIDELINES, *supra* note 2, § V(A), ¶ 4505, at 6881-19, *with* DOJ 1984 GUIDELINES, *supra* note 2, § 3.5, at 6879-5. The impact of this recharacterization by the 1984 Guidelines may be to

the 1984 Guidelines whether efficiencies should be considered in any context other than the exercise of prosecutorial discretion by the Antitrust Division.

B. *Federal Trade Commission Statement Concerning Horizontal Mergers*

Although the FTC Statement[28] recognizes the efficiency-enhancing aspects of mergers, it stops short of adopting efficiencies as a legally cognizable defense.[29] Instead, the FTC will consider "measurable operating efficiencies, such as production or plant economies of scale,"[30] only in the exercise of its prosecutorial dis-

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substantially reduce or altogether eliminate a defendant's burden of proving the existence of such efficiencies and instead make proof of the absence of efficiencies an element of plaintiff's affirmative case, a distinction that may be crucial in the litigation context. Wes Liebeler has propounded a very similar view:

> If this analysis of the impact of merger-created productive efficiencies is pushed a bit farther, it raises interesting questions about who has the burden of proof on the productive efficiencies question. If productive efficiency creation is regarded as a matter of defense, then the burden clearly should be on the defendant.
>
> But there is another view, implicit in the discussion above. The government clearly has the burden of showing that a merger tends substantially to lessen competition. But if the effect of a merger on competition is a function of the merger's effect on productive efficiency, it would be impossible for the government to show that a merger substantially lessened competition unless it showed what effect that merger had on productive efficiency. To put the matter another way, from an economic standpoint a merger reduces competition only if it reduces the sum of producer and consumer surplus, i.e., only if reductions in allocative efficiency outweigh increases in productive efficiency. *Obviously, in order to determine the effect of a merger on competition under this formulation, the party with the burden of showing effect on competition must show the merger's effect on productive efficiency.* Under this approach, the government would have the burden of proof as to the effect of the merger on both forms of efficiency.

Liebeler, *Criteria for Horizontal Mergers*, in ANTITRUST ADVISER § 3.27 (2d ed. Supp. 1984) (emphasis added). *But cf. Hospital Corporation of America*, No. 9161, slip op. at 109 (FTC Oct. 25, 1985), *aff'd*, Hospital Corp. of Am. v. FTC, 807 F.2d 1381 (7th Cir. 1986) (construing efficiencies defense at FTC, finding that respondent did not meet the standards for asserting an efficiencies defense).

28. FTC STATEMENT, *supra* note 3.

29. The FTC Statement states:

> To minimize measurement difficulties, it has been suggested that an efficiencies defense could be limited to measurable operating efficiencies, such as production or plant economies of scale. These efficiencies are also more likely to be of the kind that may eventually represent an improved state of the art available to all producers. While such evidence is appropriate for consideration by the [FTC] in the exercise of its prosecutorial discretion at the pre-complaint stage, the Commission believes that there are too many analytical ambiguities associated with the issue of efficiencies to treat it as a legally cognizable defense.

Id. at 6901-5 (footnotes omitted). In a footnote, Chairman Miller disagreed with the other members of the Commission on this point, believing that scale-type efficiencies properly should be considered as part of the FTC's merger analysis, and therefore beyond the exercise of prosecutorial discretion. *Id.* at n.22. *See infra* note 196 and accompanying text.

30. FTC STATEMENT, *supra* note 3, at 6901-5. The FTC Statement also mentions, in a

cretion at the precomplaint stage, not as a part of its substantive merger analysis in enforcement litigation.[31] However, even when employed in only this very limited capacity, the FTC will require that two additional criteria be satisfied:

> To the extent that efficiencies are considered by the Commission as a policy matter, the party or parties raising this issue must provide the Commission with substantial evidence that the resulting cost savings could not have been obtained without the merger and clearly outweigh any increase in market power.[32]

different context, "management" and "distribution" efficiencies. *Id.* Former Commissioner Clanton, who was responsible for the FTC Statement project while he was at the Commission, appears to believe that it permitted consideration of scale economies only. Clanton, *Recent Merger Developments: Coming of Age Under the Guidelines*, 53 ANTITRUST L.J. 345, 345, 357 (1984).

31. Thomas Campbell, who was director of the FTC's Bureau of Competition when the FTC Statement was issued, recently reasserted his belief that efficiencies should not be recognized as an affirmative defense in substantive merger analysis. *Proposed Amendments, supra* note 9, at 264-69 (statement of Thomas Campbell). Campbell cites three reasons: (1) efficiencies are virtually impossible to measure with the requisite degree of precision, *id.* at 7-8; (2) efficiencies, when balanced against welfare loss from market power, do not enhance economic welfare for the consumer, *id.* at 8; and (3) efficiencies, if they are real, must be measured against not only the immediate increase in market power (which is the direct result of the merger), but also future increases in market power (as a result of the more-efficient firm driving the less-efficient firm(s) out of the market) as well, which are almost impossible to estimate, *id.* at 9-10.

32. FTC STATEMENT, *supra* note 3, at 6901-5. The Commission cited respondents' failure to satisfy these two criteria in rejecting asserted efficiencies justifications in *American Medical International, Inc.*, 104 F.T.C. 1219-20 (1981), and *Hospital Corp. of Am.*, No. 9161, slip op. at 109 (FTC Oct. 25, 1985), *aff'd*, 807 F.2d 1381 (7th Cir. 1986). *See infra* notes 190-91 and accompanying text.

For a discussion of the use of efficiencies in the exercise of prosecutorial discretion at the FTC, see Stoner, Merger Enforcement at the FTC Under the New Merger Guidelines (1985) (unpublished manuscript); Pidano & Silvia, Analysis of Efficiencies in Horizontal Mergers and Joint Ventures at the FTC's Bureau of Economics (1984) (unpublished manuscript).

The Commission's decision on the General Motors-Toyota joint venture is a good illustration of how efficiencies are considered in the exercise of prosecutorial discretion. There the Commission permitted General Motors and Toyota (the world's first and third largest producers of automobiles, respectively) to manufacture jointly a new subcompact automobile subject to certain restrictions. The Commission's analysis emphasized what it considered to be three significant procompetitive benefits that would likely result from this joint venture: (1) an increased total output of small automobiles available in the United States; (2) an automobile that would be cheaper to produce than other alternatives available to General Motors; and (3) an opportunity to observe and learn the more efficient Japanese manufacturing methods. *General Motors Corp. and Toyota Motor Corp.*, 48 Fed. Reg. 57,314, 57,315 (1983). The Commission balanced against these benefits two potential anticompetitive effects of the joint venture: (1) the potential for a reduction in General Motors' incentive to produce its own small automobile; and (2) the potential for the exchange information not essential to the joint venture's operation and which is competitively sensitive. *Id.* at 57,316.

What makes the General Motors-Toyota decision interesting is the Commission's emphasis on the potential for acquiring managerial efficiencies in light of the measureability concerns expressed in the Commission's Horizontal Merger Statement. FTC STATEMENT, *supra*

C. *Proposed Amendments to the Clayton Act*

Two separate amendments to the Clayton Act that would specifically require consideration of efficiency gains in merger analysis have recently been introduced. Despite similarities, however, these proposals would require the consideration of different types of efficiencies in different contexts, and would impose different standards of proof.

Senator Strom Thurmond[33] and Congressman Hamilton Fish[34] recently introduced the Merger Modernization Act of 1986, (in con-

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note 3, at 6901-5. The Commission clearly demonstrated its willingness to accept these efficiencies despite this previously noted concern over the inability to establish positively their existence, to quantify them accurately, or to balance them in a quantitative fashion against anticompetitive concerns. *See also id.* at n.20 ("Where efficiencies flow from factors peculiar to the merged firms, such as improved quality of management, their contribution to the economy as a whole is more problematic.").

These issues are, however, not directly relevant to the examination of efficiencies in this Article. In the General Motors-Toyota decision, the Commission chose not to examine the joint venture under traditional merger or concentration analysis (although the Commission did cite the 1982 Horizontal Merger Statement in a footnote), because "the areas of competition between [General Motors and Toyota] will dwarf the area of cooperation," and coordination of output and pricing decisions was prohibited; and instead utilized a more lenient standard, a modified rule of reason analysis. *See* Memorandum to FTC Commissioners from Timothy J. Muris (Director, Bureau of Competition) Regarding Proposed General Motors-Toyota Joint Venture, File No. 821-0159, 11-13 (Dec. 16, 1983). For a discussion of the rule of reason analysis, see National Soc'y of Professional Eng'rs v. United States, 435 U.S. 679, 691 (1978) (construing Chicago Bd. of Trade v. United States, 246 U.S. 231 (1918)). Moreover, the Commission's decision on the General Motors-Toyota joint venture should be regarded as sui generis, because overriding public policy considerations (the need for the U.S. automobile industry to become more competitive) had largely preempted traditional antitrust analysis in that case.

The General Motors-Toyota joint venture has been thoroughly discussed in several recent law review articles (many of which severely criticize the Commission's decision), and further analysis of it is beyond the scope of this Article. *See generally Symposium: Perspectives on the General Motors-Toyota Joint Venture*, 31 WAYNE L. REV. 1163 (1985) (discussion includes an economic assessment, competition analysis, efficiencies justification, and a definitional test for joint ventures); Clanton, *Horizontal Agreements, The Rule of Reason, and the General Motors-Toyota Joint Venture*, 30 WAYNE L. REV. 1239 (1984) (analysis of rules applied in joint venture analysis); Note, *The GM-Toyota Joint Venture: Legal Cooperation or Illegal Combination in the World Automobile Industry?*, 19 TEX. INT'L L.J. 699 (1984) (implications of the General Motors-Toyota joint venture on the automobile industry); Note, *International Joint Ventures in the United States: The GM-Toyota Deal*, 22 COLUM. J. TRANSNAT'L L. 505 (1984) (analysis of General Motors-Toyota joint venture and potential ramifications); *Antitrust Law—Proposed Consent Agreement Between General Motors Corporation and Toyota Motor Corporation*, 25 HARV. INT'L L.J. 421 (1984) (brief commentary).

33. On March 7, 1986, Senator Thurmond (R-S.C.) introduced "The Merger Modernization Act of 1986" on behalf of the Reagan administration. S. 2160, 99th Cong., 2d Sess., __ CONG. REC. __ (1986).

34. On February 26, 1986, Congressman Fish (R-N.Y.) introduced "The Merger Modernization Act of 1986," on behalf of the Reagan administration. H.R. 4247, 99th Cong., 2d Sess., __ CONG. REC. __ (1986).

junction with the Reagan administration's proposed plenary overhaul of the antitrust laws,)[35] which amends section 7 of the Clayton Act.[36] The Act is intended to make efficiencies one of the primary considerations in statutory merger analysis in both public and private cases.[37] It identifies specific factors to be considered in assessing the probable competitive effect of the acquisition,[38] including

35. The administration's antitrust package proposes far reaching changes in antitrust law of which statutory treatment of efficiencies is only a very small part. The legislative package would: (1) delete the incipiency standard from the Clayton Act and require that, for a merger to be judged illegal under the Clayton Act, the plaintiff must show a "significant probability" that the proposed transaction will be anticompetitive; (2) grant a five year exemption from the antitrust laws for mergers and acquisitions in industries that have been seriously injured by imports; (3) eliminate treble damage awards in cases other than those involving illegal overcharges or underpayments, provide for an award of attorneys' fees and costs to prevailing defendants, and provide for a reduction of amounts that antitrust plaintiffs have received in settlement; (4) authorize courts to dismiss private suits against foreign entities where the alleged activity has only minimal or unintended effects on American consumers; and (5) permit corporate directors to serve on the boards of competing companies except in certain de minimis instances. Although the package has generated a mixed reaction, there has been near unanimity on the need to recognize efficiencies in merger analysis. *Compare* Millstein & Kessler, *Compromise Struck on Antitrust Remedies Reform*, Legal Times of Wash., May 26, 1986, at 22, *with* Pearlstein, *Busting The Trustbusters, Inc.*, *id.*, April 1986, at 35.

36. The principal focus of The Merger Modernization Act of 1986 is on the incipiency standard contained in section 7, 15 U.S.C. § 18 (1983). Section 7 prohibits acquisitions that "may" substantially lessen competition or "tend to create a monopoly" in any product line or market. *See supra* note 12. Until the late 1970's, large firms which desired to merge were often blocked by virtue of size alone. *See, e.g.*, United States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963) (merger resulted in the bank's gaining control of 30% of commercial banking in Philadelphia); United States v. Von's Grocery Co., 384 U.S. 270 (1966) (merger concentrated 7.5% of Los Angeles' retail grocery market). *See supra* note 1.

The Reagan administration believes that section 7 is now outdated because it was enacted when economic understanding was less sophisticated and "social concerns," such as the elimination of jobs or harm to competing, but smaller, firms, dominated antitrust policy. The administration contends that section 7 has in the past either discouraged or altogether barred procompetitive acquisitions. *See Reagan Administration's Package to Congress For Revision of Federal Antitrust Laws*, Antitrust & Trade Reg. Rep. (BNA), at S-6 (Special Supp. Feb. 20, 1986) [hereinafter *Administration Analysis*].

Pursuant to the administration's proposal, courts will have to find "a significant probability" that the acquisition will permit the merged firms to engage in anticompetitive behavior. *Id.* at S-9. In addition, the measure of illegality is changed from "lessen competition" or "create a monopoly" to "substantially increase the ability to exercise market power." *Id.*

37. "For the first time, judges, business, and lawyers will be able to look to the law and know that it recognizes the importance of efficiencies." *Proposed Amendments*, *supra* note 9, at 19 (statement of Malcolm Baldrige, Secretary of Commerce).

38. These factors, which incorporate both the quantitative and qualitative considerations under the 1984 Merger Guidelines, are: (1) the number and size distribution of firms and the effect of the acquisition thereon; (2) ease or difficulty of entry by foreign or domestic firms; (3) the ability of smaller firms in the market to increase production in response to an attempt to exercise market power; (4) the nature of the product and terms of sale; (5) conduct of firms in the market; (6) efficiencies deriving from the acquisition; and (7) any other evi-

"efficiencies deriving from the acquisition"; however, efficiencies will be considered only when the other five factors indicate that the acquisition would result in a significant risk of market power.[39] Although the statutory language does not set forth the type of efficiencies to be considered, the administration's Analysis accompanying the proposal specifies efficiencies derived from "economies of scale, better integration of production facilities, plant specialization, lower transportation costs, and similar savings relating to specific manufacturing, servicing, or distribution operations of the merging firms,"[40] along with "other efficiencies [that] can be sufficiently demonstrated to be achievable."[41] The proposal, however, appears to exclude from consideration those efficiencies that could be achieved by the firms without merging.[42] The Analysis further suggests that once a significant anticompetitive effect is established, the proponent of these efficiencies (presumably, the merging firms) has the burden of affirmatively establishing their existence;[43] but the Analysis states that "[i]t should not be the burden of firms to establish an affirmative case for the existence of efficiencies when the analysis [of the other five factors] does not indicate that the merger otherwise would result" in anticompetitive effects.[44]

In anticipation of the Reagan administration's legislative efforts to overhaul the antitrust laws (and perhaps in an attempt to defeat such efforts), Senator Howard Metzenbaum earlier introduced the Antitrust Improvement Act of 1986,[45] which, among other things,

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dence indicating whether the acquisition will or will not substantially increase the ability, unilaterally or collectively, to exercise market power. DOJ 1984 GUIDELINES, *supra* note 2, § 3.5, ¶ 4493, at 6879-17.

39. *Administration Analysis, supra* note 36, at S-10.

40. *Id.* This adopts nearly verbatim the principal types of efficiencies recognized in the 1984 Guidelines. *See supra* note 25 and accompanying text.

41. *Administration Analysis, supra* note 36, at S-10. This presumably includes the other additional efficiencies set forth in the 1984 Guidelines that the Antitrust Division concluded "may be difficult to demonstrate." *See supra* note 25 and accompanying text.

In his Congressional testimony on S. 2160, Secretary Baldrige referred specifically to economies "in production, in distribution, in research and development, *or in any other level of corporate activity.*" *Proposed Amendments,* supra note 9, at 18 (statement of Malcolm Baldrige, Secretary of Commerce) (emphasis added). Assistant Attorney General Douglas H. Ginsburg, testifying on behalf of Attorney General Edwin Meese III, identified "joint operating efficiencies, economies of scale, economies of scope, and financial economies." *Id.* at 26 (statement of Edwin Meese III, Attorney General).

42. "Where it is necessary to consider efficiencies, however, the courts should also consider whether similar efficiencies could be achieved by the firms without merging." *Administration Analysis, supra* note 36, at S-10.

43. *Id. Compare with supra* note 27 and accompanying text *and infra* note 206.

44. *Administration Analysis, supra* note 36, at S-10.

45. On January 27, 1986, Senator Howard M. Metzenbaum (D-Ohio) introduced the

attempts to restrict the consideration of efficiencies in the exercise of prosecutorial discretion by the antitrust enforcement agencies. Unlike the Reagan administration proposal, the Metzenbaum proposal would amend section 7A of the Clayton Act, the Hart-Scott-Rodino Act,[46] which mandates a premerger review and enforcement mechanism by the Commission and the Antitrust Division.[47] Metzenbaum's proposal requires that a firm[48] claiming that efficiencies[49] will be created by an acquisition submit certain information[50] demonstrating such efficiencies. This information is to be considered by the Antitrust Division or the Commission, in some unspecified manner, in deciding whether to challenge the acquisition.[51] The proposal, however, limits consideration to operational efficiencies.[52] Where the enforcement agency decides on the basis of such cost efficiencies not to initiate an enforcement action, the Metzenbaum proposal would require the relevant enforcement agency to certify that the firms have demonstrated by clear and convincing evidence that:

> (1) costs of operation are likely to be substantially reduced directly as a result of the proposed acquisition or joint venture,
> (2) the cost reduction is likely to lead to reduced prices, and promote competition, and
> (3) there is no reasonable alternative method for achieving such

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Antitrust Improvement Act of 1986. S. 2022, 99th Cong., 2d Sess., __ CONG. REC. __ (1986), [hereinafter Metzenbaum proposal or Metzenbaum bill]. This legislation makes many changes, other than its treatment of efficiencies, that are intended to strengthen enforcement of the antitrust laws.

46. Pub. L. No. 94-435 § 201, 90 Stat. 1390, codified as amended at 15 U.S.C. § 18a (1983).

47. The Hart-Scott-Rodino premerger review program is intended to give "the government antitrust agencies a fair and reasonable opportunity to detect and investigate large mergers of questionable legality before . . . the assets, technology, and management of the merging firms are hopelessly and irreversibly scrambled together . . . ." H.R. REP. NO. 1373, 94th Cong., 2d Sess. 3, *reprinted in* 1976 U.S. CODE CONG. & ADMIN. NEWS 2637. *See generally* A.B.A. Antitrust Section, *Mergers and Acquisitions, Joint Ventures, and Interlocking Directorates*, in ANTITRUST LAW DEVELOPMENTS 214-18 (2d ed. 1984).

48. More specifically, the bill applies to "persons" subject to Section 7A(a) of Hart-Scott-Rodino. Metzenbaum bill, *supra* note 45, § 5(a).

49. More specifically, the bill specifies "cost reductions." *Id.*, § 5.

50. The Metzenbaum bill would require the FTC and the Antitrust Division to promulgate rules, within 180 days after its enactment, specifying the information that must be filed. *Id.*

51. According to the proposed statute, "[t]he Federal Trade Commission and the Attorney General shall take into account such information . . . ." *Id.*, § 5(a).

52. "Such information shall be limited to specific reductions in the cost of production, distribution, transportation, or, in exceptional cases, other factors directly related to firm operations." *Id.* Like the administration's proposal, the bill excludes cost reductions that can be achieved by some reasonable alternative method other than the proposed transaction. *See supra* note 42 and accompanying text.

cost reductions other than the proposed acquisition or joint venture.[53]

This certification may be offered in evidence in a subsequent public or private antitrust action for determining whether the transaction is anticompetitive.[54] However, notwithstanding its detailed approach, the Metzenbaum proposal does not specify the role that efficiencies are to play in private litigation. Contexts not covered include where the asserted efficiencies are not dispositive in the exercise of prosecutorial discretion under section 7A,[55] where the transaction is exempt from premerger review,[56] or where the efficiencies claim is rejected by the reviewing agency but the agency does not prevail in a subsequent enforcement action.

II. TREATMENT OF EFFICIENCIES BY THE COURTS

The lower courts have generally read four early Supreme Court decisions—*Brown Shoe v. United States,*[57] *United States v. Philadelphia National Bank,*[58] *United States v. Phillipsburg National Bank,*[59] and *FTC v. Procter & Gamble*[60]—as disfavoring efficiency justifica-

53. H.R. 4247, 99th Cong. 2d Sess. § 5(b)(1)-(3) (1986).

54. "In the event such a certification is made, it may be offered by any party to any action under the antitrust laws or the Federal Trade Commission Act alleging that the acquisition or joint venture violates such laws and shall be relevant in determining whether the acquisition or joint venture may substantially lessen competition." *Id.*

55. The Metzenbaum bill would require certification of the existence of such efficiencies only where the reviewing enforcement agency "declines to initiate an action [on a transaction] on the grounds that the [transaction] is likely to promote competition through reducing costs." Metzenbaum bill, *supra* note 45, § 5(b). In most cases, the existence of efficiencies is only one of several qualitative factors suggesting that the transaction should not be challenged. Arguably, the Metzenbaum bill would apply only where efficiencies are the single dispositive consideration, an extremely rare situation. The only example available is the General Motors-Toyota joint venture. *See supra* note 32. *See also* Clanton, *supra* note 32, at 1265 ("[I]n the GM matter, the Commission seems to be giving virtually dispositive weight to the claimed efficiencies.") *See also id.* at 1263 (Commission's emphasis on efficiencies factors "played a major, if not determinative, role in the decision to approve the [GM-Toyota] venture."). If this reading of the bill is correct, there is a failure to take into consideration the antitrust enforcement agencies' tendency to ignore efficiencies as the publicly asserted basis for their decisions to forego an enforcement action. *See supra* note 8 and accompanying text.

56. The Hart-Scott-Rodino Act contains numerous statutory exemptions to the premerger filing and notification requirements. In addition, many transactions also fall outside its jurisdictional reach. 15 U.S.C. § 18a (1983). *See* A.B.A. Antitrust Section, *supra* note 47, at 214-17 (summarizes exemptions and jurisdictional requirements). The Metzenbaum bill would not apply in private merger litigation involving such exempt transactions. Metzenbaum bill, *supra* note 45, § 5(a).

57. 370 U.S. 294 (1962).

58. 374 U.S. 321 (1963).

59. 399 U.S. 350 (1970).

60. 386 U.S. 568 (1967).

tions in merger cases.[61] However, as the FTC correctly concluded in a recent decision, *American Medical International,* a careful reading reveals that discussions of the efficiencies justification in those decisions are dicta only and that reliance upon them by the lower courts is misplaced.[62] For instance, the defendant in *Brown Shoe*

61. The following decisions have also been interpreted as opposed to the efficiencies defense: RSR Corp. v. FTC, 602 F.2d 1317, 1325 (9th Cir. 1979), *cert denied,* 445 U.S. 927 (1980) (anticompetitive effects which are felt due to a merger are not offset by the increased ability to compete in another market); Int. Tel. & Tel. Co. v. General Tel. & Elec. Corp., 518 F.2d 913, 936 (9th Cir. 1975) (courts are not "required to balance the evil of anticompetitive effect against a concomitant gain in efficiency resulting from economies of scale."); Calnetics Corp. v. Volkswagen of America, Inc., 348 F. Supp. 606, 621 (C.D. Cal. 1972), *supp. op.* Calnetics Corp. v. Volkswagon of America, Inc., 353 F. Supp. 1219 (C.D. Cal 1973), *rev'd and remanded on other grounds,* 532 F.2d 674 (9th Cir. 1976), *cert. denied,* 429 U.S. 940 (1976) (acquisitions, however beneficial in making an entity a more vigorous competitor, are not saved from illegality under section 7); Mississippi River Corp. v. FTC, 454 F.2d 1083, 1089 (8th Cir. 1972) ("honest intentions, business purposes and economic benefits are not a defense to violations of an antimerger law"); Crown Zellerbach Corp. v. FTC, 296 F.2d 800, 825 (9th Cir. 1961), *cert. denied,* 370 U.S. 937 (1962) (it is plain from the Clayton Act and its legislative history that concern with the accomplishment of economies through merger was not a part of congressional thought, and, regardless of these consequences, mergers which create a monopoly should be prohibited); American Crystal Sugar Co. v. Cuban-American Sugar Co., 152 F. Supp. 387, 399-400 (S.D.N.Y. 1957), *aff'd,* 259 F.2d 524 (2d Cir. 1958) ("the acquisition by one corporation of all or part of the stock of another corporation . . . is within the reach of § 7 of the Clayton Act" as long as the likelihood of a resulting restraint on commerce is apparent); United States v. Aluminum Co. of Am., 148 F.2d 416, 431 (2d Cir. 1945) (any corporation which stimulates demand and opens new uses for products and in doing so acts to control the market to the exclusion of others cannot escape the charge of monopoly); Aluminum Co. of Am. v. FTC, 284 F. 401, 408 (3d Cir. 1922), *adhered to,* 299 F. 361 (3rd Cir. 1924), *cert. denied,* 261 U.S. 616 (1923) (although motive of the acquisiton was to increase production of aluminum and maintain reasonable prices during the time of war, court looked only at the effect of the acquisiton in creating a monopoly); United Nuclear Corp. v. Combustion Eng'g Inc., 302 F. Supp. 539, 554-55 (E.D. Pa. 1969) ("It is simply not legally possible to permit a clear violation of the Clayton Act in one line of commerce in order to strengthen competition in another line of commerce."); United States v. Mfr. Hanover Trust Co., 240 F. Supp. 867, 942-43 (S.D.N.Y. 1965) ("It is of no moment that a short-run by-product may have greater efficiency and lower costs, . . . the long-run advantage to the community depends upon the removal of restraints upon competition."); United States v. Kennecott Copper Corp., 231 F. Supp. 95, 102 (S.D.N.Y. 1964), *aff'd,* 381 U.S. 414 (1965) (although economic forces may lead to amalgamation for efficient operations, Congress has said mergers are undesirable from a social standpoint, and the courts must enforce the law as Congress wrote it); United States v. Bethlehem Steel Corp., 168 F. Supp. 576, 617 (S.D.N.Y. 1958) (advantages of size must be rejected in favor of a competitive system).

62. 104 F.T.C. 177, 215 (1984). *Accord, Hospital Corporation of America,* No. 9161 (FTC Oct. 25, 1985), *aff'd,* 807 F.2d 1381 (7th Cir. 1986). *See infra* text accompanying notes 183-84. Care must be exercised when determining the type of efficiencies claim being asserted. For instance, the most commonly quoted statement on the efficiencies issue in *Philadelphia National Bank*—that an anticompetitive merger "is not saved because, on some ultimate reckoning of social or economic debits or credits, it may be deemed beneficial"—refers to balancing competitive effects across *different* markets. *Philadelphia National Bank,* 374 U.S. at 371. This is quite different from an efficiencies defense asserted where the procompetitive and anticompetitive effects of the acquisition in the *same* market are balanced.

did not argue economic efficiency as a defense, but instead attempted to establish that no efficiencies would be produced as a result of the acquisition.[63] In *Philadelphia National Bank*, the

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See also United Nuclear Corp., 302 F. Supp. at 555 ("It is simply not legally possible to permit a clear violation of the Clayton Act in one line of commerce in order to strengthen competition in another line of commerce."); United States v. Lever Bros. Co., 216 F. Supp. 887, 898-99 (S.D.N.Y. 1963). *See generally* C.A. HILLS, *supra* note 3, § 3.28.

63. In *Brown Shoe* the Justice Department challenged the merger of two shoe manufacturers-retailers, G.R. Kinney and Brown Shoe. The district court concluded that the lower prices resulting from the acquisition would drive independent retailers out of the market. *See Brown Shoe*, 179 F. Supp. at 738. On appeal, the Justice Department argued that the merger would produce lower costs, lower prices, and better quality goods. Brown Shoe claimed that no such economic efficiencies would result. The Supreme Court affirmed the district court's finding of liability, stating:

> A . . . significant aspect of this merger is that it creates a large national chain which is integrated with a manufacturing operation. The retail outlets of integrated companies, by eliminating wholesalers and by increasing the volume of purchases from the manufacturing division of the enterprise, can market their own brands at prices below those of competing independent retailers. Of course, some of the results of large integrated or chain operations are beneficial to consumers. Their expansion is not rendered unlawful by the mere fact that small independent stores may be adversely affected. It is competition, not competitors, which the Act protects. But we cannot fail to recognize Congress' desire to promote competition through the protection of viable, small, locally owned businesses. Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets. It resolved these competing considerations in favor of decentralization. We must give effect to that decision.

Brown Shoe, 370 U.S. at 344. *See* L. SULLIVAN, HANDBOOK OF THE LAW OF ANTITRUST 630, 631 (1977); Muris, *The Efficiency Defense Under Section 7 of the Clayton Act*, 30 CASE W. RES. L. REV. 381, 407 (1980) (the Court, in *Brown Shoe*, did not concern itself with the efficiencies defense since the Brown Shoe Co. did not assert it. Thus the "Court . . . was not presented with, nor did it specifically address, the issue of efficiency as a justification."). *Accord*, Williamson, *Allocative Efficiency and the Limits of Antitrust*, 59 AM. ECON. REV. 105, 113 (1969) (*Brown Shoe* has led companies who have considered a merger to "consciously [suppress] the economics aspect" since it may be used successfully by the government to challenge the merger); Note, *Economies of Scale: Weighing Operating Efficiency When Enforcing Antitrust Law*, 49 FORDHAM L. REV. 771, 799 n.162 (1981) [hereinafter Laudati] (*Brown Shoe* is representative of those decisions which hold that a section 7 violation can be established with proof that, due to the merger, the merged firm will be more efficient than its smaller competitors).

The government asserted a similar economic efficiencies theory in *United States v. Tidewater Marine Service, Inc.*, where it was alleged that capital costs, research, and development savings would result from the acquisition. 284 F. Supp. 324 (E.D. La. 1968). The district court noted:

> [W]e do not feel that economies of size alone can be any basis for invoking the antitrust laws. Quite the contrary, for the business quest for economy and efficiency is a mainstay of competition. It is when this quest is eliminated and stagnation sets in that competition suffers. Economies of size, acquired through a merger, will justify the application of the antitrust laws only when it offers the merged firm significant competitive advantages so that a probability of a substantial lessening of competition ensues. To hold otherwise would espouse a warped view of the fundamental policy of antitrust law; mergers should not be condemned because they are beneficial to the merging parties, but because they are harmful to customers and competitors, or to competition as a whole. In this case, even if the merger were to

defendant claimed that the local community would benefit from a larger bank, a "socio-political" justification for the merger, not an economic efficiencies defense. Moreover, the Supreme Court in that case explicitly recognized that it was not entertaining an economies of scale defense.[64] The *Phillipsburg National Bank* case similarly did not focus on operating efficiencies.[65] And in *Procter & Gamble,* the defendant did not attempt to demonstrate the anticipated savings in sales, distribution, and manufacturing that would result from the acquisition as a factor to be balanced against the anticompetitive effects of the acquisition (perhaps because the Court viewed such scale economies as discouraging new entry).[66] In short, the

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> afford economies of size to the defendants to the exclusion of other firms, the anticompetitive result is clearly absent.

Id. at 341. *See also* General Foods Corp. v. FTC, 386 F.2d 936, 946 (3d Cir. 1967), *cert. denied,* 391 U.S. 919 (1968); *Heublein, Inc.*, 96 F.T.C. 385, 594-96 (1980).

In *Heublein,* the Commission cited the decision in F.T.C. v. Procter & Gamble Co., 386 U.S. 568 (1967) for the proposition that even "significant advertising advantages could violate Section 7." *Id.* at 595. The author of that opinion, former Commissioner Robert Pitofsky, recently testified in favor of a statutory efficiencies defense, asserting that "in [*Brown Shoe* and *Procter & Gamble*], efficiencies appear to have been counted against the merger—an interpretation of Section 7 that was unwise and virtually indefensible." *Proposed Amendments, supra* note 9, at 286 (statement of Robert Pitofsky).

64. In *Philadelphia National Bank,* the Supreme Court noted:

> There was evidence that Philadelphia, although it ranks fourth or fifth among the Nation's urban areas in terms of general commercial activity, ranks only ninth in terms of the size of its largest bank, and that some large business firms which have their head offices in Philadelphia must seek elsewhere to satisfy their banking needs because of the inadequate lending limits of Philadelphia's banks . . . .
>
> [The Bank] offered testimony that the merger would enable certain *economies of scale,* specifically, that it would enable the formation of a more elaborate foreign department than either bank is presently able to maintain. *But this attempted justification, which was not mentioned by the District Court in its opinion and has not been developed with any fullness before this Court, we consider abandoned.*

374 U.S. at 334 n.10 (emphasis added). Defendants had argued that the resulting bank "with its greater prestige and increased lending limit, would be better able to compete with large out-of-state (particularly New York) banks, would attract new business to Philadelphia, and in general would promote the economic development of the metropolitan area." *Id.* at 334.

65. 399 U.S. 350 (1970) (without explicitly rejecting efficiencies, the Court emphasized the product market, the geographic market, the anticompetitive effects and the convenience and needs of the community).

66. In 1957, Procter & Gamble, a large diversified manufacturer of household products, acquired the assets of Clorox Chemical Co., the leading manufacturer of household liquid bleach, and the only one selling it on a national basis. Although the Court condemned economies as an antitrust defense (citing *Brown Shoe*), the Court was examining economies as an anticompetitive, rather than procompetitive, effect. It stated:

> The acquisition may also have the tendency of raising the barriers to new entry. The major competitive weapon in the successful marketing of bleach is advertising. Clorox was limited in this area by its relatively small budget and its inability to obtain substantial discounts. By contrast, Procter's budget [approximately $80 million] was much larger; and, although it would not devote its entire budget to advertising Clorox, it could divert a large portion to meet the short-term threat of a new entrant. Procter would be able to use its volume discounts to advantage in advertis-

decisions that appear to reject the assertion of an efficiencies defense in section 7 cases do not appear to be well supported.[67]

Taking the contrary position are several lower court decisions that have directly examined efficiencies in section 7 merger analysis. In *Fruehauf Corp. v. FTC*, the Second Circuit Court of Appeals explicitly found scale economies in the manufacture of heavy duty truck wheels to be a procompetitive factor in favor of the acquisitions.[68] Similarly, the Sixth Circuit in *Marathon Oil Co. v. Mobil Corp.* recognized operating and scale efficiencies as important factors in assessing the acquisition's competitive impact.[69]

Two more recent cases, *FTC v. Bass Brothers Enterprises*[70] and

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> ing Clorox. Thus, a new entrant would be much more reluctant to face the giant Procter than it would have been to face the smaller Clorox.

Procter & Gamble, 386 U.S. at 579 (footnote omitted). *See generally* Greenfield, *supra* note 2, at 229, 249-50 (discussing the reluctance of the FTC and the courts to recognize an efficiencies defense).

67. Consideration of economic efficiencies in section 7 analysis is consistent with the increased importance that the Supreme Court has given to economic analysis in recent antitrust decisions. For instance, Justice White wrote in *Broadcast Music Inc. v. Columbia Broadcasting System*:

> [O]ur inquiry must focus on whether the effect and, here because it tends to show effect, . . . the purpose of the practice are to threaten the proper operation of our predominantly free-market economy — that is, whether the practice facially appears to be one that would always or almost always tend to restrict competition and decrease output, and in what portion of the market, or instead one designed to 'increase economic efficiency and render markets more, rather than less, competitive.'

441 U.S. at 19-20 (1979) (citing and quoting *United States Gypsum Co.*, 438 U.S. at 436 n.13, 441 n.16). *See supra* note 4. The Supreme Court in Northern Pacific R'y v. United States, 356 U.S. 1, 4 (1958), identified economic efficiency as one of the principal goals of antitrust, and in *United States Gypsum Co.*, 438 U.S. at 441 n.16, characterized economic efficiency as procompetitive. *See also Sylvania*, 433 U.S. at 49 (under rule-of-reason analysis fact-finder should "[weigh] all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition.").

In the section 7 context, the Supreme Court has focused on economic evidence in assessing the legality of acquisitions. *See, e.g.*, United States v. General Dynamics Corp., 415 U.S. 486; United States v. Marine Bancorporation, 418 U.S. 602 (1974). *See generally* Kauper, *The 1982 Horizontal Merger Guidelines: Of Collusion, Efficiency, and Failure*, 71 CALIF. L. REV. 497, 508 n.26, 526 (1983) (noting the courts' increasing reliance on economic efficiency).

68. 603 F.2d 345, 360 (2d Cir. 1979) (the court notes that "Fruehauf had a pro-competitive effect on the market through its collaborative efforts to develop new types of heavy duty wheels by virtue of its ability to draw new entrants into production of conventional wheels by offering to deliver its patronage."). *Cf.* United States v. Wilson Sporting Goods Co., 288 F. Supp. 543, 566-67 (N.D. Ill. 1968) (recognizing scale economies as relevant, but finding the proposed merger to be anticompetitive).

69. 669 F.2d 378, 382 (6th Cir.), *aff'g* 530 F. Supp. 315 (N.D. Ohio 1981), *cert. denied*, 455 U.S. 982 (1982) (the court allocated a separate part of its opinion to "benefits" arising from the proposed merger, noting operating efficiencies and advantages of scale).

70. 1 Trade Cas. (CCH) ¶ 66,041 (N.D. Ohio 1984). This case also illustrates the reliance that some courts have placed on the FTC and Department of Justice Merger Guidelines

United States v. LTV Corp.,[71] illustrate the current use of efficiencies in merger analysis. In *Bass Brothers*, the Commission sought preliminary injunctions against two acquisitions in the carbon black industry: Sid Richardson Carbon's acquisition of Ashland's domestic carbon black operations and Columbian Enterprises' acquisition of Continental Carbon Company. Both Sid Richardson and Columbian claimed that efficiencies would result from the acquisitions. Sid Richardson planned to integrate fully Ashland's operations into its own, saving an estimated $6.5 million in overhead costs by, among other things, eliminating separate sales and research operations. Other savings to be achieved through the merger included $1.1 million resulting from the installation of energy conservation equipment and $1.6 million resulting from changes in reactor operations. Columbian anticipated a $5 million savings in fixed overhead costs by closing two domestic plants and additional unspecified savings by eliminating duplication in sales forces, research and development staffs, and administrative departments. The trial court rejected both efficiencies claims, finding no reliable evidence that firms in the industry incurred significantly different costs of produc-

in assessing the legality of an acquisition under section 7. Other decisions, however, do not even cite the Guidelines, and instead employ different merger analysis. *See, e.g.*, FTC v. Warner Communications, Inc., 742 F.2d 1156, 1162-63 (9th Cir. 1984) ("Factors to consider when determining the impact on competition include the market shares of the merging firms, industry trends towards concentration, the degree of concentration within the industry, prior mergers by the firms in question and the barriers to entry in the industry . . . . This list of factors is not exhaustive.")

Other courts specifically reject mandatory reliance on the Guidelines. *See, e.g.*, Monfort of Colorado, Inc. v. Cargill, Inc., 761 F.2d 570, 579 (10th Cir. 1985), *rev'd*, 107 S. Ct. 484 (1986) (Court of Appeals rejected the use of the Guidelines, asserting that "these guidelines are more useful for setting prosecutorial policy than delineating judicial standards.") *See, e.g.*, United States v. Atlantic Richfield Co., 297 F. Supp. 1061, 1073 (S.D.N.Y. 1969), *aff'd sub nom.* Bartlett v. United States, 401 U.S. 986 (1971) (the Guidelines "are in no way binding on the Department in a particular case and . . . of course, the Guidelines are in no way binding on the courts.")

But at least one court has held that the Antitrust Division cannot disavow its merger Guidelines in a federal court enforcement action. *See Waste Management, Inc.*, 743 F.2d at 983 ("If the Department of Justice [in its Merger Guidelines] routinely considers ease of entry as relevant to determining the competitive impact of a merger, it may not argue to a court addressing the same issue that ease of entry is irrelevant."). Nothing, however, mandates the use of the Guidelines in private merger litigation. *See generally* A.B.A. ANTITRUST SECTION, MONOGRAPH NO. 1- MERGERS AND THE PRIVATE ANTITRUST SUIT 26 (1977) (indicates that the Guidelines are "merely rules of thumb to guide analysis and to give some predictability to the likelihood of [an] enforcement action"); Schwartz, *The Merger Guidelines: Guide to Government Discretion and Private Counseling or Propaganda for Revision of the Antitrust Laws?*, 71 CALIF. L. REV. 575, 577 (1983) (purpose of Guidelines is to educate the public about regulatory process, to control the exercise of prosecutorial discretion, and to provide legal guidance for courts).

71. 2 Trade Cas. (CCH) ¶ 66,133, at 66,334 (D.D.C. 1984).

tion or that these firms suffered costs of production or that these firms suffered cost disadvantages;[72] that none of the companies was failing and the financial losses that they had recently suffered "were not unusual;"[73] that no serious efforts were made to find buyers other than industry competitors;[74] that the only new technology in the industry related to production cost savings, and nearly all companies were adopting, or considering, similar cost-reduction technologies;[75] and that these efficiencies were "largely available through feasible means other than merger."[76] The trial court held that "[d]efendants' claims of efficiencies yielded by their acquisitions do not amount to public equities outweighing the public interest in effective antitrust enforcement."[77]

In *LTV Corp.*, the Justice Department consented to the merger of two competitors in the steel industry, LTV and Republic Steel. The companies claimed that extensive efficiencies would result from production integration and consolidation, producing savings estimated at $343 million per year or approximately $27 per ton of steel.[78] The Justice Department concluded, among other things, that existing financial difficulties facing Republic and the possibility that the merged company might realize some of these efficiencies suggested that the merger would not threaten competition.[79] Re-

72. *Bass Brothers*, 1 Trade Cas. (CCH) ¶ 66,041, at 68,617.

73. *Id.* at 68,616-19.

74. *Id.* at 68,617-18.

75. *Id.* at 68,611-13.

76. *Id.* at 68,619.

77. *Id.* at 68,622.

78. *LTV Corp.*, 2 Trade Cas. (CCH) ¶ 66,133, at 66,341. *See also LTV-Republic Steel Merger—Justice Clearance*, 5 Trade Reg. Rep. (CCH) ¶ 50,465 at 56,126 n.* (1984) (explaining why the merger of LTV Corp. and Republic Steel Corp., initially opposed by the Department of Justice, should not be challenged).

79. *Id.* at 56,125. In approving the consent decree, Assistant Attorney General McGrath stated:

> No one can be certain whether this merger will have a substantially positive impact on the domestic steel industry. Obviously, the industry needs considerable cost-cutting, modernization, and restructuring to compete successfully in today's market. However, it is far from clear that mergers are the answer. *It can by no means be assumed, without a careful case-by-case analysis, that every merger will produce net efficiencies or that efficiencies cannot be achieved without merger.* Recent years have witnessed numerous examples of mergers between troubled competitors entered into for hoped-for efficiencies that never materialized. Indeed, there are relatively few good examples of success stories in such circumstances. However, since the LTV-Republic merger, as restructured, does not raise substantial competitive problems and since there is at least a chance that the merger may permit these companies to compete more effectively, the end result may well be a competitive plus.

Id. at 56,127 (emphasis added). *Compare* United States v. Bethlehem Steel Corp., 1958 Trade Cas. (CCH) ¶ 69,189 at 74,681-83 (S.D.N.Y. 1958) (defendants "urge earnestly" that viewing the consent decree under the provisions of the Antitrust Procedures and Penalties Act,[80] the trial court concluded that, notwithstanding the parties' inability to quantify definitively the anticipated cost savings from these operating efficiencies, the merger was in the public interest:

> [A] basic United States industry—steel—continues to find itself in a weakened and deteriorating condition. The present plight and future prospects of LTV and Republic are no exception to this pattern. The purpose of the present merger is to achieve savings in cost through increased efficiencies which will enable the surviving company to compete more effectively both here and in the export market. We cannot predict that these efforts will succeed, but we can say with some certainty, that without an opportunity to improve their acute financial predicament, their future will indeed be bleak.[81]

III. TREATMENT OF EFFICIENCIES IN THE LEGAL AND ECONOMICS LITERATURE

Legal and economics commentators generally favor recognition of efficiencies in section 7 cases, but disagree over the type of efficiencies that should be considered and how they should be considered.[82] The discussion below surveys the principal legal and economics literature with regard to two specific issues: (1) under

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the beneficial aspects of the challenged merger be considered). *See* Greenfield, *supra* note 2, at 248 (noting that efficiencies "may have helped save the Republic-LTV merger.")

80. 15 U.S.C. § 16(b)-(h) (1982) (known as the "Tunney Act").

81. *LTV Corp.*, 2 Trade Cas. (CCH) ¶ 66,133, at 66,343 (1984). Several other recent decisions make at least passing reference to efficiencies in merger analysis. *See* Christian Schmidt Brewing Co. v. G. Heileman Brewing Co., 1 Trade Cas. (CCH) ¶ 66,374, at 64,841 (6th Cir. 1985) ("We are obliged to acknowledge that this antitrust injury would not be sufficient were the injury merely to result from increased efficiency . . . ." As a result of other anticompetitive injuries, the court gave Stroh and Schmidt standing to seek declaratory and injunctive relief.); Stroh Brewing Co. v. Malmgren, 1 Trade Cas. (CCH) — ¶ 64,670, at 73,644 (W.D. Wis. 1982) (In denying Schlitz's motion for a preliminary injunction, the court "considered the following factors which show that competition may not be lessened by the proposed merger and may, in fact, be increased: geographical sales patterns, different brands and grades of beer, excess plant capacity, *economies of scale*, national advertising and product differentiation, inability to fix prices, industry structure and history.") (emphasis added)). *Cf.* United States v. American Cyanamid Co., 2 Trade Cas. (CCH) ¶ 65,656, at 69,363 (2d Cir. 1983) (court noted that vertical integration may foster efficiency and enhance competition).

82. The analysis that follows focuses on the legal and economics literature adopting the efficiencies defense in the section 7 context. For a thorough bibliography of sources that examine issues relating to efficiencies in the merger context, see A.B.A. ANTITRUST SECTION, MERGER LAW BIBLIOGRAPHY 1950-1980 137-42 (1982); A.B.A. ANTITRUST SECTION, MONOGRAPH NO. 7, MERGER STANDARDS UNDER U.S. ANTITRUST LAWS 191-95 (1981). For a discussion of efficiencies in contexts other than section 7, raising issues beyond

what conditions should efficiencies resulting from an acquisition be considered in assessing the competitive impact of that acquisition under section 7; and (2) what types of efficiencies should be considered? Unfortunately, this discussion reveals a mass of contradictory theories on the application of efficiencies in merger analysis, providing very little guidance for the antitrust lawyer.

A. *Areeda and Turner's Partial Efficiencies Defense*

Areeda and Turner conclude that a theoretical case for an efficiencies defense is especially strong in cases where market demand is declining, stable, or expanding very slowly.[83] They believe that the efficiencies defense should not be available where market demand is growing substantially, except where entry into the market is easy.[84] They argue that the defense should be limited to cases where diseconomies of scale cause both of the merging firms to suffer from substantial cost disadvantages of five percent or more.[85] They maintain that to permit an efficiencies defense based on "relatively trivial economies" would encourage its being asserted frivo-

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the scope of this Article, see Clanton, *supra* note 32. *See also infra* notes 159-163 and accompanying text.

Several important commentators have rejected the efficiencies justification. *See* R. BORK, THE ANTITRUST PARADOX 124-29 (1978) (the problem of accurately measuring projected cost savings precludes use as a matter of proof, although productive efficiency should be factored into overall merger evaluation); R. POSNER, ANTITRUST LAW 112 (1976) (notes the difficulty of measuring actual costs of proposed merger against monopoly costs to determine projected efficiencies); Brodley, *Potential Competition Mergers: A Structural Synthesis*, 87 YALE L.J. 1, 83-85 (1977) (economic efficiencies are factored into his own proposed merger rules but not treated separately); Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 HARV. L. REV. 226, 318-21 (1960) (notes congressional preference for "noneconomic advantages of deconcentrated market and the unlikely possibility that mergers yield striking cost reductions."). *See infra* note 121.

As Judge Bork has pointed out, the dispute regarding acceptance of an efficiencies defense reflects the conflict between protection of consumer welfare and protection of small business as the principal goal of antitrust. R. BORK, *supra*, at 201-04. An efficiencies defense would be appropriate if consumer welfare was the sole goal of antitrust; however, if small business is to be protected, industrial efficiency must sometimes yield to small business concerns, given that small businesses are often less efficient than their larger competitors. *See id*; *see also supra* notes 4-5 and accompanying text.

On the basis of an empirical study of three-quarters of all acquisitions over the period 1950 through 1976, economists F.M. Scherer and David Ravenscraft have concluded that mergers on average are not efficiency-enhancing, although some have resulted in efficiency gains. *See* D. RAVENSCRAFT & F.M. SCHERER, THE PROFITABILITY OF MERGERS (FTC Working Paper No. 136, 1986). For a summary of these conclusions, see *Proposed Amendments*, *supra* note 9, at 81-85 (statement of F.M. Scherer).

83. P. AREEDA & D. TURNER, 4 ANTITRUST LAW ¶ 946e, at 168 (1968) [hereinafter AREEDA & TURNER].

84. *Id.* at 147.

85. *Id.*

lously, and "[i]t is doubtful, to say the least, that the efficiency gains from such an approach would be worth the administrative costs, given the fact that alleged gains often will not be present."[86]

With regard to the type of efficiencies to be considered, Areeda and Turner would limit the efficiencies defense to economies in: (1) plant size;[87] (2) plant specialization (where there is product complementarity and where diseconomies extend to approximately 70% of the firm's output); and subject to certain qualifications, possible economies in (3) distribution;[88] (4) research and development;[89] and (5) promotion.[90] Areeda and Turner reject an efficiencies defense based on: (1) plant specialization economies lacking product complementarity, or where diseconomies affect only a small portion of output; or economies in (2) capital cost, (3) procurement, (4) overhead, or (5) the combination of complementary resources.[91] Areeda and Turner would allow aggregation only of those specific economies permitted above; other claims, such as procurement and overhead economies, would be excluded.[92] Once these economies are firmly established, however, Areeda and Turner believe that the economies defense should be absolute, re-

86. *Id.* at 168.

87. Areeda and Turner add that direct and specific proof should be required to establish the existence of potential size economies. *Id.* at 172. Size diseconomies should not be based on proof of losses, abnormally low profits, or declining market shares. *Id.* at 174.

88. Areeda and Turner propose that distribution diseconomies should be considered only upon a showing that (1) there are significant scale economies in distribution (e.g., warehousing, retailing); (2) there are economies in integration or in "quasi-integration" by contract with distributive outlets; (3) efficient distribution and integration requires use of outlets handling only one manufacturer's product line; and (4) the merging firms are compelled to sell widely in local markets where their sales are too small for efficient distribution. *Id.* at 181.

89. Areeda and Turner contend that proof problems of research and development economies "are truly formidable." *Id.* at 189. Although relative efficiency can theoretically be determined by comparing the value of research and development "output" with the cost of producing that output, there are numerous practical problems in calculating the value of that output and its cost. *Id.* However, Areeda and Turner observe:

> The task would not always be hopeless. Some cases will be relatively clear, such as those in which effective research requires extremely expensive facilities which small firms plainly cannot afford because purchase would involve too high a percentage of the firm's resources in light of the risks, or those in which firms below a certain size appear to engage in no significant R & D at all.

Id. at 190.

90. *Id.* at 147-48. Areeda and Turner summarize the prerequisites for a promotional economies defense: (1) substantial scale economies must exist; (2) due to such scale economies the merging firms must operate at a substantial competitive disadvantage in the market; and (3) there must be no effective alternatives to horizontal merger to overcome that disadvantage. *Id.* at 186.

91. *Id.* at 175.

92. *Id.* at 196.

gardless of the merging firm's aggregate market share.[93]

B. *Williamson's Naive Tradeoff Analysis*

Williamson's "naive tradeoff model" concludes that a merger yielding non-trivial real economies must produce substantial market power and result in relatively large price increases for the net allocative effects to be negative.[94] Rather than develop a set of rules relating to the circumstances under which the economies defense should be considered,[95] Williamson sets down rough guidelines for the application of economies:[96]

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93. *Id.* at 197. Areeda and Turner reject the notion that such economies should constitute a defense only when the merging firm's market share does not exceed some specified figure or, quantitatively, potential cost savings outweigh aggregate market share (i.e., "the higher the [market] share, the larger the cost saving required to make out the defense"). *Id.*

94. *See* Williamson, *Economies as an Antitrust Defense: The Welfare Tradeoffs*, 58 AM. ECON. REV. 18 (1968) [hereinafter Williamson I]; Williamson, *supra* note 63; Williamson, *Economies as an Antitrust Defense Revisited*, 125 U. PA. L. REV. 699 (1977) [hereinafter Williamson II].

The central inquiry is this: how much must costs decrease to offset a given increase in market power and ensure that prices do not increase? Williamson's most minimal non-trivial economy is two percent. Williamson II, *supra*, at 709. But Thomas Campbell, former director of the FTC's Bureau of Competition, refers to calculations suggesting that efficiencies must cut costs fifty percent, where the elasticity of demand is two, before the price will fall. Campbell, *The New Merger Guidelines: A Federal Trade Commission Perspective*, 51 ANTITRUST L.J. 295, 301 (1982). Campbell identifies the general types of efficiencies that are eligible for the defense:

> The second point is about the *kind* of efficiencies: They must represent a general lowering of the cost curve, and not merely the fact that one manager believes he can run a business better than another. The reason is that only a general lowering of the cost curve, an improvement in technology, some device that has a patent (which eventually will run out), only that sort of improvement will eventually redound to the benefit of the economy in general. The others would merely be an increased rent to the corporation involved.

Id. (emphasis in original). The focus, therefore, is on efficiencies that produce a downward shift in marginal costs, either short-term or long-term.

Williamson concludes, under the naive tradeoff model, that if a reduction in average costs on the order of five to ten percent is available through merger, the merger must give rise to price increases in excess of twenty percent (where the elasticity of demand is two) and in excess of forty percent (where the elasticity of demand is one-half) for the net allocative effects to be negative. *See generally* A. FISHER, F. JOHNSON & R. LANDE, *supra* note 4; Daskin, Efficiency, Market Shares, and Mergers (1985) (unpublished manuscript).

95. Williamson's partial equilibrium analysis admittedly fails to account for certain possibly undetected economic effects. Consequently, Williamson posits several qualifications to his tradeoff rule. These "qualifications," which are actually additional factors that should be considered in determining the net allocative effect of an acquisition, include inference and enforcement expense, timing, incipiency, weighting, income distribution, extra-economic political objectives, technological progress, and the effects of monopoly power on managerial discretion. Williamson I, *supra* note 94, at 24. The impact of these qualifications on analysis under the naive tradeoff model is examined in Williamson's principal literature. *See* Williamson I, *supra* note 94, at 24-32; Williamson II, *supra* note 94, at 710-713.

96. Williamson suggests that his naive tradeoff model would support a change in the

> I do not think it feasible or rewarding for the courts to entertain explicitly an economies defense involving a full-blown trade-off assessment. The courts may nevertheless find it instructive to permit arguments pertaining to technological and transactional economies to be brought before them. For one thing, permitting such arguments assures that economies will not be regarded perversely as anticompetitive. Additionally, an economies defense may help put the relevant issues in perspective. If the government argues that a merger has an anticompetitive purpose or effect, when, in fact, the evidence of either is extremely thin and speculative, permitting the defense to demonstrate that nontrivial economies exist presumably will make the court more reluctant to accept the government's contentions. On the other hand, when economies cannot be shown to exist or appear to be negligible, courts will perceive little social loss in holding for the government. . . .
>
> That a quantitative assessment is too ambitious, however, does not imply that no assessment whatsoever should be attempted. On the contrary, in circumstances in which trial evidence discloses that purported anticompetitive effects are small or negligible, the introduction and qualitative evaluation of economies is apt to have merit. Not only is a better understanding of the economic incentives that underlie the merger likely to result, but—especially if the economies are at all substantial—the possibility that economies will be regarded inadvertently as anticompetitive will be forestalled.[97]

In addition to general technological and transaction economies, Williamson makes specific reference to economies of specialization,[98] as well as plant scale, distribution, integration, technological, and management economies.[99] He concludes, however, that "the cost savings attributable to merger frequently are not of a production function kind but instead have transactional origins."[100]

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treatment of efficiencies under the Merger Guidelines (at the time, the 1968 Guidelines) as follows:

> With respect to vertical and horizontal mergers, for example, Merger Guidelines could be rewritten to acknowledge a band of uncertainty within which an economies defense would be available: above a specified set of market share values, a merger would be disallowed; below a second set of values, a merger would be permitted; within the range between, an economies defense, subject to an appropriate set of threshold stipulations, would be entertained.

Williamson, *supra* note 63, at 114 (footnote and emphasis omitted).

97. Williamson II, *supra* note 94, at 728, 731.

98. *Id.* at 724.

99. *See* Williamson I, *supra* note 94, at 18 n.2.

100. *See* Williamson II, *supra* note 94, at 723. Williamson states:

> It is my contention that mergers for conventional scale-economy reasons are much less common than mergers for transactional-economy reasons. In situations in which autonomous market contracting actually or prospectively incurs non-trivial transaction costs, nonmarket or market assisted modes warrant active consideration. Put another way, administrative modes of organization—firms—and

With regard to issues of proof, Williamson believes that difficulties inherent in the measurement of such economies can be overcome. "These [difficulties] can be mitigated at the outset by requiring that claims of economies pass threshold specifications before such will even be entertained."[101] He describes these proof thresholds as follows:

> Operationally it may be essential to express the value of the threshold as a function of the ease with which economies can be established. Economies that have a highly speculative aspect should be required to reach a higher minimum level than those which are more objectively specified. (Thus if economies in both production and distribution expenses are claimed, and if the former are better specified than the latter, distribution economies would have to reach a higher threshold than would production economies to be admissible.) Since the ease with which exaggerated claims are detected varies directly with the degree of distortion attempted, and since evidence of distortion seriously debilitates a defense, adjusting the threshold in this way will tend to protect . . . against grievously inflated efficiency claims.[102]

Williamson concludes that the defendant should bear the burden of establishing the existence of such economies by clear and convincing evidence.[103]

C. *Muris' Presumptive Model*

Muris employs the Williamson tradeoff analysis to conclude that a merger should be presumed to be procompetitive where the evidence demonstrates the existence of nontrivial economies.[104] Under this rule, there is no need to compare the benefits of the merger with the cost of increased market power.[105] Where savings

> autonomous contracting modes of organization—markets—are alternative ways of executing transactions. Unfortunately, this proposition, which is both familiar and acceptable as an abstract matter, has had only a limited impact on economic analyis of the firm and even less of an impact on antitrust enforcement. This is especially true with respect to merger policy. Mergers, I submit, should be regarded positively when internal organization yields transactional economies that bring about a desired contractual result, provided that the resulting combination does not give rise, directly or indirectly, to market power effects that outweigh the transactional benefits.

Id. at 723-24 (footnote and emphasis omitted).

101. Williamson, *supra* note 63, at 113 (footnote omitted).

102. Williamson I, *supra* note 94, at 24.

103. *Id. See also* Williamson II, *supra* note 94, at 703.

104. Muris, *supra* note 63, at 393, 417, 422. Muris defines "nontrivial" economies to be in the magnitude of only one to two percent. *Id.* at 420. *See supra* note 94.

105. Muris, *supra* note 63, at 420.

cannot be measured[106] (as in the case of nontechnical efficiencies) or cannot be measured reliably (as in the case of some technical efficiencies), Muris concludes:

> Discussing efficiency within litigation will still be relevant if a defendant shows that the merger will probably result in nontrivial economies, even when it cannot show their precise magnitude. To explore this point, it will be helpful to divide the proof of efficiency into two components: existence and magnitude. Merely showing the existence of the efficiency may constitute sufficient justification. If the defendant shows that the merger will increase efficiency and if the cost savings can be projected over a substantial part of the production process, the merger may then be justified, particularly where proof of possible market power is weak. Moreover, this approach is perfectly consistent with the Clayton Act, which is concerned with probabilities, not certainties.[107]

Where this presumption is rebutted, Muris believes that courts should require more extensive proof of the resulting efficiencies or engage in a rough balancing of the claimed economies against the increased market power.[108]

With regard to the type of efficiencies to be considered, Muris concludes that the defense should encompass only real (as distinguished from pecuniary)[109] cost savings, which encompasses both technical and nontechnical efficiencies. Technical efficiencies, which are usually easier to demonstrate than nontechnical efficiencies,[110] include economies of scale; nontechnical efficiencies include transaction costs, capital costs, and management costs.[111] He concedes that entertaining claimed economies at trial will complicate section 7 cases:

> None of this is meant to deny the fact that the efficiency defense will complicate trials. Some efficiencies will not be sufficiently demonstrable, and some proceedings will devolve into a mass of conflicting, confusing testimony . . . .
>
> [But i]f merger law is to be based upon sound economic theory, efficiency must be explicitly considered. Although an efficiency justification will somewhat complicate merger

106. Muris cites the use of engineering and statistical studies as two acceptable methods of measuring the magnitude of cost savings resulting from efficiencies. *Id.*

107. *Id.* at 422-23 (footnote omitted).

108. *Id.* at 426.

109. "Pecuniary economies, such as cost savings from tax advantages, merely transfer wealth without reducing the resources spent to produce the product in question." *Id.* at 417 n.155 (citation omitted).

110. *Id.* at 419.

111. *Id.* at 418-419.

proceedings and economies cannot always be demonstrated, the justification will increase the number of beneficial mergers that withstand judicial scrutiny. Further, antitrust jurisprudence and its relation to economics would seem to require efficiency evidence.[112]

D. *Fisher and Lande's Implicit Incorporation Model*

Fisher and Lande reject adoption of the Williamson tradeoff analysis on a case-by-case basis and instead propose implicitly incorporating efficiencies "[b]y raising the market-share thresholds of presumptive illegality to account for potential efficiency gains."[113] They believe that the empirical evidence on efficiencies resulting from mergers is conflicting and difficult to interpret.[114] Conceding that existing studies tend to show that acquired firms benefit substantially from mergers, they nevertheless conclude that "[a]ny net gains from corporate acquisition can reflect so many different factors that it is a leap of faith to attribute these gains to increased efficiencies."[115] Fisher and Lande contend that the Williamson naive tradeoff model, "as a first approximation," accurately depicts the net welfare effect of such mergers.[116] However, they maintain

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112. *Id.* at 424, 431 (footnote omitted). Muris suggests that the availability of post-acquisition evidence of cost savings will reduce difficulties of proof. *Id.* at 425 n.185. *See infra* note 219 and accompanying text.

113. Fisher & Lande, *Efficiency Considerations in Merger Enforcement*, 71 CALIF. L. REV. 1582, 1669 (1983). The same authors recently reexamined, inter alia, the tradeoff analysis between cost savings resulting from efficiencies and the increase in market power. *See* A. FISHER, F. JOHNSON & R. LANDE, *supra* note 4.

114. Fisher and Lande examine a wide range of empirical data: cost data based on survivor analysis, statistical techniques and engineering studies; firm profitability studies; and direct evidence of economic efficiencies from actual mergers such as comparisons of accounting data for merging firms with data for a control group of nonmerging companies, econometric studies evaluating changes in stock market valuation due to a merger, and case studies of individual mergers. Fisher & Lande, *supra* note 113, at 1606-24. Based on these studies, Fisher and Lande conclude:

> [T]here appears to be substantial support for the inductive generalizations that many individual mergers create substantial efficiencies, that many others are notable failures, and that the record of prediction has been very poor in individual cases. The record certainly is too poor to give us any confidence that we can predict the level of cost saving on a case-by-case basis sufficiently accurately to make this prediction a major basis of public policy.

Id. at 1624 (footnote omitted).

115. *Id.* at 1693.

116. Fisher and Lande credit Williamson with near universal acceptance of what has become known as Williamsonian merger analysis: merger efficiencies are desirable and should to some extent offset potential market-power effects. *Id.* at 1583. They contend that Williamson's work has caused the policy debate to shift from questioning the existence and desirability of efficiencies to the consideration of the best way to factor anticipated efficiencies into merger enforcement. *Id.* at 1584. *See also id.* at 1650.

that a complete analysis must go beyond consideration of marginal cost, demand elasticity, and market power to include other factors, such as wealth transfers, possible changes in product quality, the timing and dispersion of the market power and efficiency effects, political impact, technological progress, and the costs of rent-seeking behavior by firms with market power.[117] But Fisher and Lande recognize that this creates severe theoretical difficulties on an individual case basis.[118] "[T]he net effect of these various qualifications is that small differences in the elasticity of demand, specifications of the demand relationship, expected rise in price-cost margins, or anticipated costs savings from expected efficiencies can change the tradeoff dramatically in individual cases."[119]

Furthermore, Fisher and Lande conclude that practical problems associated with tradeoff analysis can be equally severe. Efficiencies cannot be conclusively established by "clear and convincing evidence" since many of the most significant efficiencies are incapable of prediction or measurement prior to the merger. Proof of efficiencies requires numerous cost calculations and quality comparisons that would in all likelihood be prohibitively complicated, lengthy, expensive, and controversial.[120] Fisher and Lande conclude that because efficiencies considerations defy explicit proof,[121]

117. Fisher and Lande admit that most of these additional factors are points that Williamson himself originally included as qualifications to his naive tradeoff model. *See id.* at 1630-44.

118. *See id.* at 1650-51 (discussing in detail the theoretical difficulties with quantifying the welfare tradeoff analysis).

119. *Id.* at 1644.

120. *Id.* at 1653-54. Fisher and Lande believe that the "clear and convincing" standard of proof mandated by the 1982 and 1984 DOJ Guidelines will have an extremely limiting effect on the outcome of merger litigation or the exercise of prosecutorial discretion because "one rarely could call premerger predictions of efficiencies 'clear and convincing' evidence." *Id.* at 1654 (footnote omitted).

121. This difficulty of proof was instrumental in Bork's rejection of the efficiencies defense:

> Passably accurate measurement of the actual situation [including an estimate of efficiencies and deadweight loss] is not even a theoretical possibility; much less is there any hope of arriving at a correct estimate of the hypothetical situation. Consider two of the factors that would have to be known: the demand curve over all possible relevant ranges of output and the marginal cost curve over those same ranges. Only by knowing where marginal cost and demand intersect could one know whether there was a restriction of output and what its size was. *Nobody knows these curves.* Even the companies involved do not . . . .
>
> There is a good reason why firms do not know these things, and it is the same reason why *they cannot be known through an antitrust trial.* The demand curve is not known because it changes continually and because the company is not constantly plotting it by running its prices up and down. The attempt to do so might make a minor contribution to science, but quite a research grant would be required,

the party with the burden of proof would most likely not prevail.[122]

Fisher and Lande also believe that use of a tradeoff analysis on an individual case-by-case approach would greatly increase business uncertainty, thereby increasing the firms' costs of finding desirable mergers and, in some cases, even deterring firms from attempting potentially desirable mergers.[123] Furthermore, adoption of tradeoff analysis on a case-by-case basis fails to recognize the limited ability of the courts and the antitrust enforcement agencies to assess efficiencies accurately,[124] thus risking "judicial ad hocery, and erosion of confidence in the judicial system, and increased costs of business uncertainty and antitrust enforcement."[125] They estimate that a case-by-case efficiencies defense would increase uncertainty, enforcement, and litigation costs by thirty to one hundred percent,[126] but would fail to reduce those costs associated with barring desirable mergers or from allowing undesirable mergers.[127] Consequently, Fisher and Lande reject not only the full efficiencies defense[128] advocated by Muris, but also the Areeda and Turner partial efficiencies defense.[129] They maintain that implicit incorpora-

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> since the losses incurred in an attempt by a major company might make serious inroads on the resources of even the Ford Foundation.

Id. at 1657-58 (quoting R. BORK, *supra* note 82, at 125-26) (emphasis added by Fisher & Lande).

122. *Id.* at 1655-56.

123. *Id.* at 1655.

124. Fisher and Lande believe that tradeoff analysis "[m]ay be beyond the limits of reliable adjudication." *Id.* at 1657. They believe that courts are best suited to adjudicate problems of an "either-or" variety, i.e., which side is correct, whereas an efficiencies defense requires an interrelated and multivariate inquiry, balancing market power, efficiencies and quality changes. They conclude:

> Given the nature of the multivariate problem, lawyers usually cannot meaningfully isolate one factor from another. Nor can judges rely on traditional step-by-step reasoning. Judges therefore are unlikely to render opinions that will guide future business and legal decisions.

Id. (footnote omitted).

125. *Id.* at 1656.

126. *Id.* at 1676. Fisher and Lande conclude that this would easily amount to an increase in litigation costs of $100 million or more per year. *Id.*

127. *Id.* at 1695.

128. "A complete efficiencies defense would allow the litigation of a merger's anticipated efficiencies in the enforcement proceeding. However, such a defense probably should be confined to consideration of productive efficiency gains, as opposed to redistributive profits or mere tax savings." *Id.* at 1660 n.261 (citing P. AREEDA & D. TURNER, *supra* note 83, at 956-59).

129. A partial efficiencies defense would be limited to a consideration of the most significant or concrete factors. *Id.* at 1660. Fisher and Lande conclude that "the partial efficiencies defense would still suffer from the inherent difficulties of a case-by-case approach. *Id.* at 1663. These difficulties include unpredictability, the balancing of market power, efficiencies, and quality changes, and litigation complexity and expense. Fisher and Lande fear that

tion of efficiencies has several advantages over an individual case-by-case tradeoff analysis.[130]

> An implicit approach to the incorporation of efficiencies would provide a simple alternative to the complexity and the measurement problems of a case-by-case evaluation. By raising the market-share thresholds of presumptive illegality to account for potential efficiencies gains, this approach would permit the realization of some, but not all, of the efficiencies likely to result from mergers. Although it would surely miss many important potential efficiency gains, it would have the advantages of simplifying litigation and increasing certainty and predictability. There are two aspects to an implicit approach. First, it would set the Merger Guidelines at a level that would permit mergers likely to yield efficiencies but not likely to lessen competition substantially. Second, it would balance market-power and efficiency effects implicitly. Under this approach, the Merger Guidelines should be more permissive than they would be if they considered only market-power effects.[131]

Although Fisher and Lande fail to set forth any specific numerical thresholds of presumptive legality, they conclude that the DOJ 1982 Guidelines:

> are consistent with our recommendation to raise the Guidelines' thresholds for challenging mergers, largely for efficiency reasons. The numerical levels are reasonable and close to standards in recent court decisions, and they fairly balance the competing congressional concerns with wealth transfers, efficiency, and incipiency. The [1982] Guidelines, however, are less clear on whether the enforcement agencies actually will consider efficiencies in individual cases. The evidentiary requirements in both statements are so restrictive that if the agencies follow them as written, the Government will continue to drop merger investigations for efficiency reasons only in very rare instances. Departures from the strict written standards, however, especially with a change in the composition of the Federal Trade Commission,

courts might not be able to limit such an efficiencies defense to the "most provable" types of evidence, given the necessarily fine (and, under appellate review, perhaps arbitrary) distinction that the trial court must make between relatively provable and relatively speculative efficiencies. They also argue that "a partial efficiencies defense might not even immunize a significant number of efficiency-producing mergers." *Id.* at 1663.

130. Given Fisher and Lande's rejection of tradeoff analysis on an individual case basis, there is little need to focus on the type of efficiencies that would be eligible for consideration in a specific transaction. However, they do identify specific efficiencies underlying their general analysis, including operating efficiencies (such as economies of scale, resource allocation, technological complementarities, specialization in product line, reduction in transportation costs, and various transaction-cost economies); management efficiencies (resulting from infusion of superior management, and coordination of research and development synergies or distribution facilities); and organizational efficiencies. *Id.* at 1599-1604.

131. *Id.* at 1669 (footnotes omitted).

could lead to a full efficiencies defense being forced on the Commission, the Justice Department, and the courts, with the resulting social costs of vastly greater business uncertainty, litigation, and enforcement expenses, and no reason to expect any net compensating gains.[132]

E. *Liebeler's Full Tradeoff Analysis*

Liebeler urges adoption of the Williamson welfare tradeoff analysis on a case-by-case basis.[133] Liebeler's approach, however, requires netting reductions in allocative efficiency (i.e., creation of market power) from productive and marketing efficiencies resulting from the transaction:[134]

> The fact that horizontal mergers may 'increase economic efficiency and render markets more rather than less competitive,' *Broadcast Music Inc. v. CBS*, . . . is a factor that should be counted in favor of those mergers that appear to have that effect. From an economic standpoint, permitting the creation of productive and marketing efficiencies is at least as important as (most probably much more important than) preventing firms from increasing their ability to restrict output and, thereby, to reduce allocative efficiency.
>
> From an economic standpoint, horizontal merger policy should be concerned with these two different forms of economic

132. *Id.* at 1695-96. It is unclear whether Fisher and Lande are advocating a consideration of efficiencies beyond the presumptive legality thresholds already established in the DOJ 1982 Guidelines and, if so, what form that "extra" consideration would take. Any consideration beyond a strictly mathematical application of these presumptive legality thresholds would be subject to the same criticisms made by Fisher and Lande against the case-by-case tradeoff analysis.

133. Liebeler, *supra* note 27; Liebeler, *Market Power and Competitive Superiority in Concentrated Industries*, 25 UCLA L. REV. 1231, 1260-63 (1978) [hereinafter Liebeler, *Market Power*].

134. Section 7 of the Clayton Act proscribes acquisitions which substantially lessen competition. 15 U.S.C. § 18 (1983). *See supra* note 12. Liebeler argues that from an economic standpoint competition cannot be lessened by a merger unless it operates to reduce the sum of producer and consumer surplus below the level that would have existed absent the merger. Liebeler, *supra* note 27, at 336. *Accord*, R. BORK, *supra* note 82, at 61. Determining the impact of a particular acquisition on the sum of producer and consumer surplus requires a consideration of both allocative and productive efficiency.

> "Competition" is not something separate and apart from productive efficiency, to be traded off against it or not. The Justice Department cannot, in short, tell what the effect of a merger on competition will be unless it takes into account the productive efficiencies that might be created by that merger.
>
> [The Supreme Court's opinion in *Broadcast Music Inc.*] makes it clear that an increase in efficiency makes a market more rather than less competitive, that the effect of a transaction on efficiency is one way in which the effect of that transaction on competition is to be determined. This is quite different from the approach taken by the [DOJ 1982] Guidelines in which the effect of a transaction on competition is seen as an issue completely separate from its effect on efficiency.

Liebeler, *supra* note 27, at 336.

> efficiency. Both of these forms of efficiency are different facets of the competition that [section] 7 of the Clayton Act was designed to preserve. A horizontal merger should be illegal if its only effect is to increase the ability of firms to restrict output (reduce allocative efficiency). It should be legal if its only effect is to increase productive efficiency. *The legality of a merger producing both effects should turn on its net effect.*[135]

Liebeler recognizes the inherent difficulty in employing tradeoff analysis in specific cases,[136] but maintains that assessing the existence and magnitude of productive efficiencies is no more difficult than measuring the effects of the merger on allocative efficiency.[137]

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135. *Id.* at 333-34 (citing *Broadcast Music Inc.*, 441 U.S. at 20) (emphasis added). Liebeler strongly criticizes the 1982 Guidelines for failing to recognize that increases in efficiency have a positive effect on competition. *Id.* at 333. He claims that a slightly modified version of the Williamson benefit-cost analysis is the correct theoretical structure for making such a tradeoff analysis. *Id.* at 334. *See also* Liebeler, *Market Power*, *supra* note 133, at 1260. "The [DOJ 1982] Guidelines make no attempt at such a trade-off. Their casual treatment of the efficiency issue is a serious if not fatal defect in their approach to assessing the legality of horizontal mergers." Liebeler, *supra* note 27, at 334.

136. Liebeler asserts that this measurement problem is the principal reason why the Justice Department failed to give efficiency creation a more prominent role in evaluating horizontal mergers under the 1982 Guidelines, "not because it is opposed to the creation of efficiencies." Liebeler, *supra* note 27, at 334. He believes that this proof issue even undercuts the role that the Justice Department ascribes to efficiencies in the exercise of prosecutorial discretion:

> It is not surprising that the Justice Department does not emphasize the efficiencies issue more than it does; the possibility of efficiency creation in horizontal merger cases makes it more difficult for the Department to win cases. In addition, there is no support whatever for the assertion made in the Guidelines that "[i]n the overwhelming majority of cases, the Guidelines will allow firms to achieve available efficiencies through mergers without interference from the Department." [1982] Guidelines at § V(A). The Department is not willing to consider efficiencies in specific cases because it is difficult to 'prove' either their existence or their magnitude. If that is so, we are entitled to ask how the authors of the Guidelines know that 'available efficiencies' can be achieved within the limits established by the Guidelines.

Id. at 335.

137. Liebeler criticizes the Justice Department for sidestepping the difficulties inherent in measuring the effect on market power by presuming competitively adverse effects when market concentration levels reach certain numerical levels. *Id.* at 334. He believes that concentration is not a good proxy for the measurement of market power:

> Even though the Justice Department continues to rely so heavily on concentration, there is no reason for the courts to do so. More importantly, there is no reason for lawyers faced with the problem of defending a merger that exceeds the concentration levels approved by the [1982] Guidelines to acquiesce either in those levels or in the idea that concentration is a good measure of the level of competition in an industry or of the effect of a merger. The argument against reliance on concentration figures should be pushed by those lawyers, no matter what position the [1982] Guidelines may take.

Id. at 335. *See supra* note 1 (discussing concentration-collusion hypothesis).

One former Antitrust Division official, Donald F. Turner, has concluded that some efficiencies, such as production scale economies, are more readily determinable than other non-efficiencies factors, such as ease of entry or product homogeneity. Turner, *Observations on*

He believes that requiring strict proof of the existence and magnitude of productive efficiencies while, at the same time, presuming the existence of adverse allocative efficiency effects on the basis of concentration levels is grossly inconsistent. "From the standpoint of consumer welfare, it is impossible to distinguish these two types of efficiency. If we are to have an antitrust policy based on demonstrable economic effect, it seems clear that they should be treated in similar ways."[138]

Liebeler attempts to solve this proof issue by shifting the burden of proof on the efficiencies issue from the defendant, as an affirmative defense, to the plaintiff, as a part of its required showing of a substantial lessening of competition. He observes that:

> The [plaintiff] clearly has the burden of showing that a merger tends substantially to lessen competition. But if the effect of a merger on competition is a function of the merger's effect on productive efficiency, it would be impossible for the [plaintiff] to show that a merger substantially lessened competition unless it showed what effect that merger had on productive efficiency. To put the matter another way, from an economic standpoint a merger reduces competition only if it reduces the sum of producer and consumer surplus, i.e., only if reductions in allocative efficiency outweigh increases in productive efficiency. Obviously, in order to determine the effect of a merger on competition under this formulation, *the party with the burden of showing effect on competition must show the merger's effect on productive efficiency.* Under this approach, the [plaintiff] would have the burden of proof as to the effect of the merger on both forms of efficiency.[139]

A recent Note by Laudati also supports the use of a Williamson-like balancing methodology on a case-by-case basis.[140] This position is no doubt influenced by Laudati's belief that cost economies can be measured with sufficient accuracy to warrant their inclusion in a quantitative tradeoff analysis.[141] She does not explain the conditions under which an efficiencies defense should be available. She does, however, suggest that the defense should encompass any

the New Merger Guidelines and the 1968 Merger Guidelines, 51 ANTITRUST L.J. 307, 314-15 (1982).

138. Liebeler, *supra* note 27, at 337.

139. *Id.* (emphasis added). Liebeler notes that this view is clearly at odds with the treatment of efficiencies under the 1982 Guidelines. However, the 1984 Guidelines can be read to have made a significant procedural change in this regard. *See supra* note 27. Liebeler apparently agrees with this assessment. *See* Liebeler, *supra* note 27, at 337 ("In the New [1984] Guidelines, the Department of Justice takes a position much more in line with the views expressed above.").

140. *See* Laudati, *supra* note 63, at 800, 801. *See also id.* at 794 n.130.

141. *Id.* at 800. *See also id.* at 780-84. *But see id.* at 779.

"real"[142] scale economy.[143]

F. *Rogers' Qualitative Tradeoff Approach*

Because of the practical obstacles inherent in establishing the existence and magnitude of efficiencies, Rogers urges adoption of a qualitative approach to the Williamson tradeoff analysis. This approach is similar to the balancing of competitive effects under a standard rule-of-reason analysis.[144] However, as a practical matter, it can be employed only in those cases involving marginal anticompetitive effects.[145]

Rogers' approach adopts a three-part methodology. First, the merger defendants must demonstrate that other firms in the market have cost advantages not achieved by the premerger firms.[146] These relational diseconomies should be quantified whenever possible.[147] Second, the impact of the merger on both the merged firms and the

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142. "Real" economies confer real resource savings, improving the ability of the merged firm to compete and, through dispersal, increasing competition in the market. *See id.* at 776. *See infra* note 149. "Pecuniary" efficiencies result only in money savings for the firm. *See supra* note 109.

143. Laudati, *supra* note 63, at 776. Laudati would have the defense cover a wide variety of such economies:

> Real economies usually relate directly to a production or distribution process, and may be product-specific, plant-specific, or firm specific. Product-specific, plant-specific, and firm-specific economies focus on various types of business behavior. Product-specific economies are associated with the volume of any single product made and sold. Examples of product-specific real economies are savings in machine running time, operator attendance time, and machine set-up time that result from production of large quantities of a specific product. A less quantifiable product-specific scale economy is the experience and learning gained by management and workers after producing a large volume of a specific product. Plant specific real economies are the decline of production and distribution unit costs as plant capacity and production increase. Costs decline partially because of the ability to specialize factors of production. Examples of real plant scale economies include lower unit costs in initial investment, supervision and management, maintenance, and energy consumption. Firm-specific real economies are the decline in production and distribution unit costs as firm size increases. Examples of firm scale economies include lower unit costs resulting from specialization, massed reserves, and research and development.

Id. at 779-80 (footnotes omitted).

144. Rogers, *The Limited Case for an Efficiency Defense in Horizontal Mergers*, 58 TUL. L. REV. 503 (1983).

145. *Id.* at 544-45.

146. *Id.* at 532.

147. Quantification of cost economies is possible through the use of any of four empirical methodologies: statistical cost studies, engineering studies, profitability studies, or survivorship studies. *Id.* at 539 nn.132-36. Rogers believes that statistical cost studies and engineering studies are more precise and more suitable for purposes of tradeoff analysis because they focus on actual cost savings of technical processes achieved through the merger. However, both tend to ignore nontechnical efficiencies, such as improvements in research and development or management. *Id.* at 540.

market must be assessed. The merger defendants must show that the efficiencies resulting from the transaction outweigh the costs associated with eliminating a competitor from the market, thus demonstrating that the merger produces a new firm that is "better able to compete and that the resulting firm's competitive enhancement will produce a more competitive market."[148] This is done by establishing that the new firm has achieved (or will achieve) cost economies, and that by achieving these economies the cost advantages enjoyed by other firms in the market have been (or will be) reduced or eliminated.[149] This is essentially Williamson's welfare tradeoff analysis, although expressed in nonquantitative terms. Rogers believes that these competitive effects cannot be measured with sufficient mathematical precision to allow them to be quantitatively balanced.[150] Instead, Rogers proposes a qualitative approach, similar to a standard rule-of-reason analysis.[151] However, Rogers does

148. *Id.* at 533. *See also id.* at 527 n.89 (to prove efficiencies, the defendant must demonstrate that through the merger the market will become more competitive and that the same result could not have been achieved through internal expansion).

149. *Id.* at 533. This requires dispersion of the efficiency gains to the market. "The dispersal effect (in terms of competition) occurs when the efficiency increase enhances the competitive capabilities of the merged firm and *that* creates a more competitive relevant market." *Id.* at 521 n. 71 (emphasis in original).

150. *See id.* at 538 n.131. Even if cost economies could be precisely quantified, Rogers maintains that they still could not be properly injected into the Williamson tradeoff calculus. First, it is unlikely that present measurement techniques can supply sufficiently conclusive data to overcome the presumption of illegality created by market foreclosure evidence.

> The quantitative data is not likely to be conclusive given the problems of measurement and the likelihood of conflicting expert testimony. In the horizontal context, the uncertain quantitative proof must then be measured against direct, hard evidence of anticompetitive effect caused by the elimination of a market entrant and the concomitant increase in market share to the new firm. Simply put, the tradeoff analysis is likely to be one-sided, with the efficiency proponent unlikely to meet its burden of proof through quantitative means. The difficulties experienced in establishing a cost justification defense to price discrimination allegations under the Robinson-Patman Act should be instructive here.

Id. at 541 (footnote omitted). Second, the calculus itself may not be appropriate for use by the courts:

> A more fundamental problem, sometimes termed "bounded rationality," confronts the use of economies in the merger context. Our legal system may simply be ill-equipped to deal with sophisticated economic arguments put forth in an adversary context. Part of the problem lies with the fact that most judges and lawyers are not economists. But the main obstacle may arise from the incompatibility of economic theory with the legal system as manifested in the litigation process. The balancing of efficiency gains against competitive loss in a horizontal acquisition is illustrative. Measuring potential operational or capital benefits to the workings of the resulting firm against the effect of the elimination of one firm from the market presents a real challenge to the courts' powers of perception and comprehension. If the balance struck is an intuitive one made by a judge with a lay knowledge of economics, it might be preferable to exclude efficiency considerations altogether.

Id. at 519 (footnote omitted). *See supra* note 124 and accompanying text.

151. Rogers reads the Supreme Court's opinion in Continental TV, Inc. v. GTE Sylvania,

not provide any specific rules to employ in this qualitative balancing.[152] Third, even if substantial economies are found to have resulted from the acquisition, it must be established that these same efficiencies could not have been achieved by either internal growth by one of the merging firms[153] or through an alternative merger that would result in greater competition.[154] Rogers contends that the plaintiff, not the defendant, should bear the burden of proving both the existence of a preferable alternative merger[155] or the viability of

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Inc., 433 U.S. 36 (1977), to have employed a tradeoff analysis that is essentially "qualitative" in nature:

> The Court recognized that vertically imposed customer or territorial limitations restrict intrabrand competition but may enhance interbrand competition because of efficiency gains in product distribution. The Court, however, did not attempt to measure the efficiency gains, although on the other side, the loss to intrabrand competition was readily ascertainable. Although the Court adopted the rule of reason, it failed to provide any criteria for its application. Thus, while the qualitative procompetitive value of efficiency gains was recognized, the necessity of quantifying the gain was not addressed.

Id. at 543 (footnote omitted).

152. Rogers recognizes this:

> While these parameters are admittedly nonspecific, they are in accord with the more generalized rule of reason analysis prevalent in other antitrust contexts. That is, if the anticompetitive effect of a given restraint is substantial, the restraint is very likely to be ruled unreasonable, regardless of the procompetitive arguments put forth. Recent rule of reason pronouncements appear to focus on the finding of any substantial anticompetitive effect as the sole prerequisite to establishing unreasonableness. The efficiency tradeoff analysis would operate similarly. Dependable proof of nontrivial economies would normally fail to convince a court to permit a merger resulting in substantial market foreclosure and increasing concentration. But that observation should not obscure the viability of the defense to merger defendants where the increase in market power is of questionable section 7 concern.

Id. at 546 (footnote omitted).

153. Rogers believes that there is a bias implicit in section 7 favoring internal expansion:

> Section 7 prohibits only growth by acquisition, and the courts have frequently pointed to the possibility of internal (or de novo) market entry by an acquiring firm to support a finding of illegality. Since section 7 discourages growth and entry by acquisition, the courts generally consider internal expansion and market entry de novo a more competitive alternative. In the horizontal merger context, internal expansion probably does have a more positive effect on competition. Merger between competitors necessarily eliminates one market entrant, while a firm's internal growth, with a capital investment roughly paralleling that involved in the acquisition of a competitor, normally increases market capacity and productivity without any offsetting loss to competition.

Id. at 525-26 (footnotes omitted).

154. *Id.* at 534. Rogers cautions that inquiry into alternative mergers should be "limited to those that might match or exceed the *specific* economies claimed by the defendant." *Id.* (emphasis in original). Furthermore, the cost of the acquisition should be comparable. *Id.* "These constraints eliminate the prospect of an argued relevance for largely dissimilar acquisitions, perhaps more costly, which might produce more but different efficiencies." *Id.* (footnote omitted).

155. Rogers argues:

> It is much simpler for the complainant to establish the existence of a preferable alternative than for the defendant to show that no reasonable, preferable alternatives exist. Further, if preferences are pinpointed by the complainant, the defend-

internal expansion.[156]

With regard to the type of efficiencies that can be used to support the defense, Rogers identifies both scale economies (such as plant scale and specialization economies, and economies in distribution, procurement, promotion, capital cost, research and development, and management) and economies of integration, but favors primary reliance on scale economies.[157] In the event that no single efficiency is substantial enough to support the defense, Rogers would allow the aggregation of several different economies.[158]

G. *Cost Economies Outside of the Section 7 Context*

Several economists have studied the existence of cost economies outside of the section 7 context.[159] For example, Scherer engaged in an exhaustive study of cost economies associated with multiplant operation in twelve industries.[160] Scherer's study is similar to an

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> ant, to retain its efficiency defense, would be forced to confront the assertion that the proposed alternative would produce the same or similar economies without the concomitant lessening of competition. Alternatively, the defendant could attempt to demonstrate the nonfeasibility of the "preferable" merger as a viable substitute acquisition.
>
> From a policy perspective, requiring the efficiency proponent to show no preferable alternatives as part of its burden of persuasion in establishing the efficiency defense would seem to vitiate the defense, even though the proponent had shown the merger to be procompetitive. The statute does not require such a limited rendering of the defense where the economies outweigh the anticompetitive effects of the acquisition.

Id. at 535-36 (footnotes omitted).

156. The same considerations apply here as well:

> As with the preferable alternative merger issue, placing the burden of proof on the complainant to establish the viability and propriety of internal expansion seems justified, assuming that the defendant has successfully shown the purported acquisition to be procompetitive. To place the burden on the defendant to demonstrate the nonfeasibility or impropriety of internal expansion would again unduly limit the scope of the efficiency defense and would increase the ludicrous possibility that a merger which is demonstrably procompetitive might be enjoined under section 7 simply because it is not the most procompetitive action possible. The decisions that have pointed to the prospect of internal expansion have typically done so in the context of reviewing an anticompetitive merger. Those cases do not necessarily establish a precedent for a combination which is, through consideration of the efficiency defense, shown to be procompetitive.

Id. at 536-37 (footnotes omitted).

157. *See generally id.* at 528-32.

158. *Id.* at 532.

159. These studies are mentioned for the sole purpose of recognizing the types of cost economies that may arise in industrial organization. For further discussion, see Scherer, *Economies of Scale and Industrial Concentration*, in INDUSTRIAL CONCENTRATION: THE NEW LEARNING 16-33 (1975).

160. *See* F.M. SCHERER, THE ECONOMICS OF MULTI-PLANT OPERATION (1975). *See also* F.M. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 81-118 (1970). Scherer's study focuses on selling and promotional economies, economies in raw material procurement, vertical integration economies, transportation cost economies, econo-

earlier study by Bain, who, using engineering cost studies, examined cost economies in twenty American industries.[161] Pratten performed a study of twenty-six British industries employing a similar methodology.[162] Numerous other economists have also studied the existence and measurement of scale economies.[163]

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mies of massed reserves, capital raising economies, economies of product specialization, economies in central administration and staffing, and economies in research and development. The results of his study are summarized in Scherer, *Economies, supra* note 159, at 17. *See generally* D. RAVENSCRAFT & F.M. SCHERER, MERGERS AND MANAGERIAL PERFORMANCE (FTC Working Paper No. 137, 1986); D. RAVENSCRAFT & F.M. SCHERER, *supra* note 82.

161. *See* J.S. BAIN, BARRIERS TO NEW COMPETITION 53-113 (1956). *See also* Bain, *Economies of Scale, Concentration, and the Condition of Entry in Twenty Manufacturing Industries*, 44 AM. ECON. REV. 15-39 (March 1954). Bain does not delineate the specific types of economies examined in his study, but it appears that his analysis is limited to production and distribution economies. This is a more limited approach than Scherer's:

> The economies of large-scale plant or firm so far referred to are economies in the costs of producing goods (as at the factory in the case of manufacturing) and of distributing them, in the sense of performing certain functions of physical distribution. Such functions normally include transportation, assembly, storage, and so forth, *but do not include* sales promotion expenses like advertising and personal promotional representation. In calculating the relation of scale to production-plus-distribution expense for a firm with either one plant or multiple plants, distribution expenses will be included only to the extent that they are either directly paid or indirectly absorbed (totally or in regard to increments above a certain level) by the firm in question. The shape of the scale-cost relation in a manufacturing industry could thus be somewhat influenced by the degree of forward integration of the manufacturers into distribution, though not necessarily so. In any event, nothing further than expenses of production plus those of physical distribution has entered into the cost-scale relationship so far described, whereas advertising and related sales-promotion expenses have been neglected.

J.S. BAIN, BARRIERS, *supra*, at 64 (emphasis in original).

In another work Bain advocates amending section 7 of the Clayton Act so as to account for merger-induced efficiencies:

> The one simple rule that is obviously needed is that a merger which may substantially lessen competition should be allowed if the merging firms can demonstrate that the merger would substantially increase real efficiency in production and distribution. (Demonstration that a merger would simply increase the profitability of the merging firm should not qualify as a basis for exemption from the law.) This sort of amendment would strengthen a very significant piece of legislation, and tend to assure that its enforcement would be in accord with accepted principles of economic rationality.

J.S. BAIN, INDUSTRIAL, *supra* note 11, at 658. *See also* Bain, *Discussion, supra* note 11, at 64-66.

162. *See* C.F. PRATTEN, ECONOMIES OF SCALE IN MANUFACTURING INDUSTRY (1971); C.F. PRATTEN & R.M. DEAN, THE ECONOMIES OF LARGE-SCALE PRODUCTION IN BRITISH INDUSTRY (1965); Silberston, *Economies of Scale in Theory and Practice*, 82 ECON. J. 369-91 (1972). Pratten examines minimal operating scale in terms of production and material costs only.

163. *See, e.g.*, Haldi & Whitcomb, *Economies of Scale in Industrial Plants*, 75 J. POL. ECON. 75 (August 1967); Moore, *Economies of Scale: Some Statistical Evidence*, 73 Q. J. ECON. 232-45 (May 1959); Stigler, *The Economies of Scale*, J. LAW & ECON. 54-71 (October 1958). Literature surveys of these and other studies appear in J. JOHNSTON, STATISTICAL COST ANALYSIS (1960); C.A. SMITH, BUSINESS CONCENTRATION AND PRICE POLICY 213-

IV. COST EFFICIENCIES IN *AMERICAN MEDICAL INTERNATIONAL*

The FTC's opinion in *American Medical International*[164] is the most recent[165] exposition on efficiencies by either of the antitrust enforcement agencies. On its facts and holding, the *American Medical International* decision is quite unremarkable;[166] instead, what is striking is how the Commission seized that case to abandon its position under the 1982 Horizontal Merger Statement and embrace efficiencies as a full-fledged defense in horizontal merger litigation.

In 1979, American Medical International (AMI), the nation's third largest proprietary hospital chain, acquired French Hospital in San Luis Obispo, California. French was one of five acute care facilities located in San Luis Obispo, three of which were owned by AMI through prior acquisitions. In 1981, prior to the announcement of the 1982 Horizontal Merger Statement, the Commission charged[167] that the acquisition violated section 7 of the Clayton Act and section 2 of the Sherman Act,[168] and requested that AMI be compelled to divest French and obtain prior approval from the Commission for future hospital acquisitions.

In conjunction with its claim that the acquisition was impliedly immune[169] from antitrust scrutiny by operation of the National

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38 (1955); McGee, *Efficiency and Economies of Size*, in INDUSTRIAL CONCENTRATION: THE NEW LEARNING 55-97 (1975); Walters, *Production and Cost Functions: An Econometric Survey*, 31 ECONOMETRICA 1-66 (Jan.- Apr. 1963).

164. 104 F.T.C. 177 (1984).

165. The Federal Trade Commission did examine efficiencies more recently in *Hospital Corporation of America*, Docket No. 9161 (F.T.C. Oct. 25, 1985), *aff'd*, 807 F.2d 1381 (7th Cir. 1986), but in that case relied primarily on *American Medical International* and provided no additional substantive analysis of the efficiencies doctrine.

166. *See infra* notes 209-213 and accompanying text.

167. 104 F.T.C. 1, 1-5 (original FTC complaint). For more detail regarding the specific allegations in the complaint, see the Commission's summary on appeal. *American Medical International*, 104 F.T.C. at 177 n.1.

168. Section 2 of the Sherman Act provides:

> Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding one million dollars if a corporation, or, if any other person, one hundred thousand dollars, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

15 U.S.C. § 2 (1982).

169. AMI contended that the National Health Planning and Resources Development Act, Pub. L. No. 93-641, 88 Stat. 2225 (1975), 42 U.S.C. §§ 300k-300s (1983), conflicted with the antitrust laws in that its effectiveness was dependant on voluntary cooperation among providers that might be proscribed by the antitrust laws. Because of this conflict, AMI argued that an implied repeal of the antitrust laws was mandated, and that its acquisition of

Health Planning and Resources Development Act,[170] AMI argued that its planned consolidation of French with another of its nearby hospitals would produce substantial cost savings. These cost savings would come in several forms: operating cost savings;[171] one-time capital cost savings;[172] additional unit cost savings from economies of scale;[173] savings from the elimination of duplication of equipment;[174] and savings in the form of service quality enhancement.[175] AMI's efficiencies claims primarily relied on a study prepared by one of its subsidiaries which outlined the proposed consolidation of the two facilities, and a later study prepared specifically for trial that quantified the expected cost savings.[176] Administrative Law Judge Barnes rejected AMI's claimed efficiencies, concluding that AMI had actually taken few steps towards consolidation and that AMI's cost savings study was unreliable. Judge Barnes further cited the difficulties inherent in accurately quantifying these savings and in balancing them against the anticipated increase in market power resulting from the acquisition.[177]

French should be immune from antitrust scrutiny. For a discussion of precedent examining the implied immunity argument in the health care context, see Bolze & Pennak, *Reconciliation of the Sherman Act With Federal Health-Planning Legislation: Implied Antitrust Immunity in the Health Care Field*, 29 ANTITRUST BULL. 225 (1984).

170. 42 U.S.C. §§ 300k-300s (1983).

171. AMI projected a 5% cost savings resulting from consolidation. AMI Reply Brief on Appeal at 18, *American Medical International, Inc.*, 104 F.T.C. 177 [hereinafter Reply Brief]. In estimating these anticipated operating expense savings, AMI assumed that the hospital at which a particular medical service was consolidated would provide the service at the lower unit cost presently being achieved by either of the hospitals. AMI Brief on Appeal at 34, *American Medical International, Inc.*, 104 F.T.C. 177 [hereinafter Appeal Brief].

172. AMI contended that without consolidating, AMI's other hospital would need to be physically expanded to alleviate current space constraints, costing approximately $21 million. However, consolidation of the two hospitals at a cost of approximately $9 million would alleviate the need for expansion and thus result in a capital cost savings of approximately $12 million. *See* Reply Brief, *supra* note 171, at 35.

173. AMI claimed that unit costs would decline because consolidation would result in combined patient volumes for particular services that were larger than those experienced at either hospital individually. Since AMI estimated its operating cost savings at experienced unit costs, *see supra* note 171, additional operating cost savings would result from lower unit costs. *See* Appeal Brief, *supra* note 171, at 35.

174. AMI argued that because of consolidation there would be no need for two separate departments to purchase identical medical equipment when the consolidated patient volume only justified one. *See id.* at 35, 37.

175. *See id.* at 38. AMI maintained that the acquisition would enhance quality of patient care "by facilitating higher volumes in each of the consolidated specialty areas" and by "reliev[ing] scheduling problems which presently exist in each of the hospital's operating rooms." *See* Reply Brief, *supra* note 171, at 21. *See also id.* at 21 n.32. AMI made no attempt to quantify these quality-enhancing efficiencies. *See id.* at 21 n.31.

176. Appeal Brief, *supra* note 171, at 32.

177. *See American Medical International, Inc.*, 104 F.T.C. at 213-14. The Commission

Interestingly, it was the FTC Complaint counsel, not AMI, who initially raised the application of efficiencies as a substantive merger defense on appeal. AMI had previously argued efficiencies only in the context of its implied immunity argument. On appeal, AMI contended that precedent purportedly rejecting the efficiencies defense was inapposite since no case had involved the hospital industry, an area where Congress sought to encourage the achievement of efficiencies through joint planning action.[178] Complaint counsel, for its part, did not limit its discussion of efficiencies to the context of AMI's implied immunity contention; instead, it attacked AMI's claim under the FTC's 1982 Horizontal Merger Statement, arguing that AMI did not satisfy the criteria for recognizing efficiencies at the prosecutorial discretion stage.[179] However, in a footnote Complaint counsel noted Chairman Miller's position, as asserted in the 1982 Horizontal Merger Statement, that scale-type efficiencies should be recognized as a legally-cognizable defense in merger analysis,[180] and that Competition Bureau Director Muris now urged the Commission to use this case to adopt Chairman Miller's position.[181] Accordingly, Complaint counsel argued that AMI failed to satisfy its burden of establishing by substantial and reliable evidence that: (1) measurable efficiencies would be achieved; (2) the cost savings were true efficiencies and did not merely reflect the lower quality or

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ultimately upheld Judge Barnes' initial decision finding liability under section 7 and ordering AMI to divest French. For a thorough analysis of this initial decision, including Judge Barnes' examination of AMI's efficiencies claims, see Miles, *Hospital Mergers and the Antitrust Laws: An Overview*, 29 ANTITRUST BULL. 253, 278-87 (1984).

178. Appeal Brief, *supra* note 171, at 34 n.41. AMI's approach to the efficiencies argument can be best described as schizophrenic. In its Appeal Brief, AMI argued that the efficiencies defense did not apply, but then cited various legal authorities (law review articles and texts authored by Williamson, Muris, and Areeda and Turner, discussed at *supra* notes 83-112) that have examined efficiencies in the section 7 context. *See* Appeal Brief, *supra* note 171, at 35 n.45. AMI apparently did this with the expectation that the applicable standard under which its efficiencies argument would be judged would be that set forth in the Commission's 1982 Horizontal Merger Statement. Of course that Statement precluded consideration of efficiencies outside of the prosecutorial discretion context and thus barred their consideration in this case.

AMI adhered to this schizophrenic approach in its Reply Brief as well. *Compare* Reply Brief, *supra* note 171, at 18 n.26 *with* Appeal Brief, *supra* note 171, at n.27. Notwithstanding Complaint counsel's emphasis in its Staff Answering Brief on the efficiencies standard under the Commission's 1982 Horizontal Merger Statement, AMI did not anticipate that the Commission would abandon the 1982 Horizontal Merger Statement and announce a more lenient efficiencies standard. Note that this case was argued and briefed before the release of the 1984 Merger Guidelines by the Antitrust Division on June 14, 1984.

179. *See* FTC Staff Answering Brief at 58, American Medical International, Inc., 104 F.T.C. 177 [hereinafter Answering Brief].

180. *See supra* note 29, *infra* note 196 and accompanying text.

181. Answering Brief, *supra* note 179, at 58 n.81.

quantity of health care services produced at lower costs; (3) the efficiencies could not have been achieved as quickly absent the merger; and (4) the cost savings clearly outweighed the adverse consequences resulting from an increase in market power.[182]

The goal that the Commission set for itself in *American Medical International* is obvious. Although it rejected AMI's implied immunity argument and could have easily avoided considering efficiencies in the antitrust context altogether since the issue of efficiencies was properly raised only in the context of this implied immunity argument, the Commission instead entertained efficiencies as a full-fledged antitrust defense, albeit in dicta only. The Commission dismissed Supreme Court precedent—*Brown Shoe, Philadelphia National Bank, Phillipsburg National Bank,* and *Procter & Gamble*[183]—finding that the Supreme Court did not in fact entertain an efficiencies defense in those cases,[184] and concluded that lower courts' reliance on language contained in these opinions for rejecting an efficiencies defense was misplaced.[185] Instead, the Commission found that language appearing in several more recent cases, such as *Continental TV v. GTE Sylvania,*[186] *United States v. General Dynamics Corp.,*[187] and *United States v. Marine Bancorporation,*[188] mandated consideration of efficiencies in antitrust analysis in general, and in horizontal merger analysis in particular.[189]

Examining the evidence of efficiencies introduced by AMI, the Commission concluded that AMI did not satisfy "any of the criteria set forth by any of the authorities"[190] for assertion of an efficiencies defense. The Commission also enumerated what it deemed to be the relevant criteria for invoking efficiencies as a defense as follows: the proponent of the efficiencies must establish by substantial evidence that (1) substantial cost savings will result from the acquisition; (2) these efficiencies are already enjoyed by one or more firms in the industry; (3) these efficiencies could not be achieved within a comparable period of time through a merger threatening less com-

182. *See id.* at 59.

183. *See supra* notes 57-66 and accompanying text.

184. *See American Medical International, Inc.,* 104 F.T.C. at 217.

185. *Id.* at 215.

186. 433 U.S. 36 (1977). There, the Court stated that the rule of reason analysis requires the fact-finder to "weigh *all of the circumstances* of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition." *Id.* at 49.

187. 415 U.S. 486 (1974).

188. 418 U.S. 602 (1974).

189. *See American Medical International, Inc.,* 104 F.T.C. at 217.

190. *See id.* at 219.

petitive harm; (4) the cost savings will inure to the benefit of consumers (i.e., market forces oblige the firm to pass cost savings efficiencies on to consumers); and (5) these efficiencies outweigh any increase in market power that may result from the acquisition.[191] Interestingly, the Commission did not cite its 1982 Horizontal Merger Statement to support this,[192] nor Chairman Miller's dissenting view in that Statement,[193] nor the efficiencies discussion in either AMI's or Complaint counsel's briefs.[194]

American Medical International is significant because, in many respects, it can be read as a revised statement by the Commission of its position on efficiencies, intended to reflect current economic thinking on the proper role of efficiencies in merger analysis.[195] Certainly, efficiencies now will be considered beyond the prosecutorial discretion stage and as a legally-cognizable defense. This represents a victory for Chairman Miller.[196] It equally represents victory for Bureau Director Muris, whose article was relied

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191. *See id.* at 219-20. AMI implicitly attempted, albeit unsuccessfully, to shift the burden of establishing the non-existence of some of the claimed efficiencies. Regarding its claim that quality-enhancement efficiencies would result from the acquisition, AMI argued:

> Complaint counsel labels several of these programs 'non-quality efficiencies' and asserts that the resulting cost savings 'are at best of little magnitude.' Complaint counsel presents no support for this claim, nor does he explain what he means by 'non-quality efficiencies.' . . . [C]omplaint counsel's assertion that the cost savings from such programs are 'of little magnitude' is unsupported by any record evidence.

Reply Brief, *supra* note 169, at 21-22 n.32 (citations omitted). *See supra* note 27 and accompanying text.

192. However, the opinion did cite to the Antitrust Division's new 1984 Merger Guidelines. *See infra* notes 204-206 and accompanying text.

193. Miller would have required that the Commission consider scale economies only. DOJ 1984 GUIDELINES, *supra* note 2, § 3.5, at 6901-5 n.2.

194. *See supra* notes 169-82 and accompanying text.

195. This is underscored in *Hospital Corporation of America*, where the Commission relied heavily on its treatment of efficiencies in the *American Medical International* decision. *See Hospital Corp. of Am.*, *supra* note 165, at 109. Note that both opinions for the Commission were authored by Commissioner Calvani.

196. *Accord*, Clanton, *supra* note 30, at 345 ("[T]he FTC also has departed from its 1982 Policy Statement and *unanimously* accepted an efficiencies defense in its recent *AMI* opinion.") (footnote omitted) (emphasis in original). One recent commentary states that the Commission's Bureau of Economics and Bureau of Competition had considered cost savings in merger litigation even before the Commission's decision in *American Medical International*. *See* Fisher, *supra* note 4, at 2 n.5.

Commissioners Pertschuk and Bailey, who disagreed with Chairman Miller on this point, wrote separate opinions in *American Medical International*. Oddly, they made no mention whatsoever of the Commission's departure from its treatment of efficiencies in its 1982 Horizontal Merger Statement. *See* 104 F.T.C. at 227-37. Commissioner Bailey similarly failed to make any mention of this policy departure in her separate opinion in *Hospital Corporation of America*. Commissioner Pertschuk had left the Commission prior to the *Hospital Corporation of America* decision.

upon by the Commission in the opinion for at least one important point: *American Medical International* indicates that the Commission will consider all types of efficiencies, not just scale economies as Chairman Miller urged.[197] Notwithstanding this, the Commission appears in some respects to have announced a much more qualified defense than Muris suggested. Although several of the Commission's requirements are implicit in the Muris efficiencies model (for example, that substantial cost savings result from the acquisition and that the cost savings inure to the benefit of consumers),[198] others are not (such as the requirement that these efficiencies already be enjoyed by one or more firms in the industry and that they cannot be achievable through a less anticompetitive acquisition).[199] Moreover, the Commission imposes a case-by-case analysis of these efficiencies (in that the efficiencies "clearly outweigh any increase in market power" that may result from the acquisition),[200] a remnant of the Commission's 1982 Horizontal Merger Statement[201] and also, of course, a departure from the Muris efficiencies model.[202]

Viewing *American Medical International* strictly as a policy pronouncement as it must be, since its discussion of efficiencies was not required for adjudication of the appeal,[203] the opinion has several major shortcomings. First, it contains no explanation for its departure from the treatment of efficiencies in the Commission's 1982 Horizontal Merger Statement, and it does not indicate whether any

197. Of course, it may be that Chairman Miller subscribed to Muris' view (that all types of efficiencies should be considered) but, for political reasons, moderated his position, hoping that the Commission would adopt it in its 1982 Horizontal Merger Statement. The Commission did not.

198. *See supra* notes 104, 109 and accompanying text.

199. *See American Medical International, Inc.*, 104 F.T.C. at 219.

200. *Id.* at 220. One commentator has recently suggested that the case-by-case analysis of efficiencies by the antitrust enforcement agencies is not necessarily inconsistent with rejection of an efficiencies defense in any context where the courts are called on to engage in merger analysis. *See* Note, *Antitrust Implications of a Joint Venture: Is An Efficiencies Justification Justifiable?*, 31 WAYNE L. REV. 1219, 1227-28 (1985). As a general matter, these agencies, which are staffed by industrial economists, are more competent than judges, who for the most part are not economists, to assess the economic consequences of a particular acquisition. *See id. Compare with supra* notes 124, 149 and accompanying text.

201. See *supra* note 32 and accompanying text.

202. *See supra* notes 105-08 and accompanying text. *See also* Reply Brief, *supra* note 171, at 18 n.27.

203. The Commission found that "AMI's acquisiton of French Hospital has and will substantially lessen competition or tend to create a monopoly of general accute care health services . . . in violation of Section 7 of the Clayton Act and Section 5 of the Federal Trade Commission Act." 104 F.T.C. at 220. In coming to this conclusion, however, the Commission did not need to consider the efficiencies defense in any context other than as a cost reduction and an element of the implied immunity argument.

portion of the Statement's treatment of efficiencies still survives. The important differences between the treatment of efficiencies in the two are obvious: the Statement's consideration of measurable operating efficiencies only, as opposed to all efficiencies in *American Medical International*, including many that defy quantification (e.g., quality service enhancement), and the Statement's consideration of efficiencies as a matter of prosecutorial discretion only, as opposed to *American Medical International's* full-fledged merger defense. These differences raise many questions that antitrust lawyers will confront when formulating an efficiencies defense in an FTC case. For instance, must all the requirements announced in *American Medical International* be met for recognition of efficiencies at the prosecutional discretion stage? The consideration of efficiencies at that stage should arguably impose less stringent requirements. Second, although the opinion approves of the treatment of efficiencies by the 1984 Guidelines (which neither of the parties cited in their briefs), it does not attempt to harmonize those requirements with the requirements imposed in the opinion.[204] Although the influence of the 1984 Guidelines is apparent (to such a degree that the opinion perhaps may be regarded as the Commission's response to the Antitrust Division's revision of its 1982 Merger Guidelines),[205] important differences may still exist. For example, the Antitrust Division no longer regards efficiencies strictly as a "defense," whereas the Commission still does.[206] Third, although by setting forth these

204. *See American Medical International Inc.*, 104 F.T.C. at 219. Note that the Antitrust Division's 1984 Merger Guidelines were issued on June 14, 1984, less than three weeks before the Commission issued the *American Medical International* opinion on July 2, 1984.

205. The Commission's reliance on the 1984, and not the 1982, DOJ Guidelines is clear. For instance, the 1982 Merger Guidelines permitted consideration of efficiencies "only in resolving otherwise close cases," *see supra* note 23 and accompanying text, whereas the 1984 Guidelines, like the policy announced by the Commission in *American Medical International*, mandates their consideration in all cases. *But see supra* note 26 and accompanying text (standards under 1982 and 1984 Guidelines are similar in practice).

This is not a semantical difference only. As a practical matter, the consideration of efficiencies in "all" cases may only make a difference in the "close case;" arguably, then, there may be little difference between the approach of the 1982 Guidelines and the current practice under the 1984 Guidelines and *American Medical International*. However, the current approach will certainly create differences in merger litigation as it is more relaxed and certainly mandates broader relevancy and broader admissibility standards for evidence of such efficiencies.

206. *See supra* note 27 and accompanying text. Arguably, this could be considered a semantic difference only since these authorities require the proponent of the efficiencies claims to establish their existence by "substantial evidence" (in *American Medical International*) and by "clear and convincing evidence" (in the 1984 Merger Guidelines). *Compare American Medical International, Inc.*, 104 F.T.C. at 219, *with* DOJ 1984 MERGER GUIDELINES, *supra* note 2. Of course, the opinion in *American Medical International* provides no

requirements the Commission identifies the task for the antitrust lawyer arguing an efficiencies defense, the opinion offers little guidance how that task can be accomplished. For instance, must all claimed efficiencies be quantified? Quantification of quality enhancement will be extremely difficult.[207] Also, given the fact that section 7 analysis is largely prospective in nature (and in most cases the cost savings will result from expected efficiencies, not efficiencies already realized), should a "risk factor" be included that reflects the "probability" that the cost savings will actually be achieved? Also, should the procompetitive value ascribed to these cost savings be discounted to reflect the time that will be needed to actually achieve them and to enhance consumer welfare, either by lowering prices or generating higher quality?[208] This short-coming—lack of guidance—is crucial, given the substantial difficulties inherent in a case-by-case analysis of efficiencies, and especially in balancing efficiencies against the anticompetitive effects resulting from an acquisition.

American Medical International was in many respects a simple merger case.[209] AMI possessed a significant share of the relevant market both before and after its acquisition of French Hospital, and market concentration under the Herfindahl-Hirschman index was extremely high.[210] Except for several interesting issues that the Commission quickly disposed of—such as AMI's implied immunity argument[211] and AMI's contention that traditional merger analysis was inapplicable because there was no price or non-price competition within the health care services market[212]—the *American Medical International* opinion confronted no novel issue.[213] In the final analysis, the Commission's treatment of efficiencies will undoubt-

guidance as to what constitutes "substantial evidence" and whether that standard differs, as a matter of law, from "clear and convincing evidence." Note, however, that the Commission in *American Medical International* chose to retain the "substantial evidence" standard from the 1982 Horizontal Merger Statement and not to adopt the "clear and convincing evidence" standard from the 1984 Merger Guidelines. This alone suggests that some difference between the two may in fact exist.

207. *Accord*, Fisher, *supra* note 4, at 37-39 & n.68.

208. *Id.* at 22, 39.

209. Miles, *Hospital Mergers and the Antitrust Laws: An Overview*, 29 ANTITRUST BULL. 253, 284 (1984).

210. *See American Medical International, Inc.*, 104 F.T.C. at 201.

211. *See id.* at 185-90. *See also supra* notes 169-70 and accompanying text.

212. *See American Medical International, Inc.*, 104 F.T.C. at 178-85.

213. The Commission's finding on another interesting issue, the appropriateness of a prior notification requirement (as opposed to a prior approval requirement) as a section 7 remedy, can be limited largely to the facts of this case and the peculiar nature of the market for hospital acquisitions. *See id.* at 221-27; *American Medical International, Inc.*, 104 F.T.C.

edly prove to be the opinion's most significant and lasting contribution to the law of merger analysis, as it was probably intended to be.

V. CONCLUSION: THE DIRECTION OF EFFICIENCIES IN THE FUTURE

A critical review of the treatment of efficiencies in the case law and the economics literature suggests one inescapable conclusion: a more explicit and detailed statement of the multivariate role of efficiencies in merger analysis is badly needed. The failure of recent pronouncements on efficiencies—the Antitrust Division's 1984 Guidelines and the FTC's 1982 Horizontal Merger Statement—to adequately address critical issues relating to the role of efficiencies in merger analysis, or to reflect the current state of the law, has resulted in continued distortion of the efficiencies doctrine. Because of the multi-jurisdictional nature of antitrust enforcement—with the FTC and Antitrust Division having dual jurisdiction over section 7,[214] and private section 7 litigation in federal courts that is not necessarily governed by the policy pronouncements of either of the two antitrust enforcement agencies[215]—there is a substantial risk that the efficiencies doctrine will evolve in unintended and perhaps even grossly inconsistent directions. The existence of a coherent, well-reasoned role for efficiencies in merger analysis requires, at the minimum, a coordinated policy between the FTC and the Antitrust Division and legislative guidelines that govern the diverse prosecutorial and adjudicative functions of the FTC, the Antitrust Division, and the federal courts.

The infirmities of a case-by-case, agency-by-agency development of the efficiencies doctrine is illustrated best by the Commission's decision in *American Medical International.* That decision's explicit departure from the Commission's 1982 Horizontal Merger Statement has already been extensively analyzed.[216] Is anything left

617 (1984) (opinion considering prior notification order in response to motion for reconsideration).

214. Section 15 of the Clayton Act empowers the Antitrust Division to enforce section 7. 15 U.S.C. § 25 (1983). Section 11 grants concurrent jurisdiction to the Federal Trade Commission. 15 U.S.C. § 21 (1983). The Commission also shares jurisdiction over section 7 by virtue of the broad reach of section 5 of the Federal Trade Commission Act. 15 U.S.C. § 45 (1983). *See, e.g.*, FTC v. PepsiCo, Inc., 477 F.2d 24, 28 n.6 (2d Cir. 1973) (every violation of section 7 is a violation of section 5). *See generally* Roll, *Dual Enforcement of the Antitrust Laws by the Department of Justice and the FTC: The Liaison Procedure*, 31 BUS. LAWYER 2075, 2076-77 (1976) (detailing substantive areas of overlapping jurisdiction).

215. *See supra* note 70. *See also* A.B.A. Antitrust Section, *supra* note 47, at 148.

216. *See supra* notes 164-213 and accompanying text.

of the Commission's position on efficiencies in the 1982 Horizontal Merger Statement? What is the effect of *American Medical International* on the fate of efficiencies at the Commission, given that its discussion of efficiencies was purely dicta? How will the required efficiencies showing differ, in terms of quality of proof or standards of proof, at the prosecutorial discretion and adjudicative stages? And given the many different postures that merger litigation can undertake[217] as well as the delay inherent in the adjudication of section 7 cases,[218] what must a defendant demonstrate at trial in order to successfully invoke the efficiencies defense? For instance, must the defendant show that efficiencies were likely to occur at time of suit, although they in fact may not have occurred by time of trial?[219] That efficiencies have been accomplished since the filing of suit, although they may or may have appeared likely to occur when suit was instituted?[220] Or perhaps notwithstanding the failure to achieve efficiencies by the time of trial, that it appears likely that substantial efficiencies will be achieved in the future? Antitrust lawyers must examine issues such as these in formulating an efficiencies defense in merger litigation, and often must deal with these same issues peripherally in making a competitive analysis of a proposed acquisition. Unfortunately, critical questions such as these remain largely unanswered. To simply extend the application of the efficiencies doctrine to the adjudicatory stage without providing any

217. Even in cases involving only the FTC, merger litigation can take many forms. These may include a preliminary injunction request prior to consummation of the transaction, adjudication at the administrative level after the transaction has been either consummated or abandoned, or review of a Commission administrative ruling at the Court of Appeals level. Antitrust Division challenges and private section 7 litigation may also entail other postures.

218. One study of merger litigation between 1950 and 1972 found that the average duration of the litigation was approximately three years, with some cases lasting over five years and others lasting less than a year and a half. Weston, *Section 7 Enforcement: Implementation of Outmoded Theories*, 49 ANTITRUST L.J. 1411, 1449 (1980). *See also* A.B.A. ANTITRUST SECTION MONOGRAPH NO. 3, EXPEDITING PRETRIALS AND TRIALS OF ANTITRUST CASES 1, n.1 (1979).

219. Although issues such as these would technically be governed by the time of suit doctrine (in conjunction with the case law relating to post-acquisition evidence), the law in those areas does not provide any clear guidance. *See* A.B.A. Antitrust Section, *supra* note 47, at 161-63. For instance, at least one decision has questioned the credibility of post-acquisition evidence that is subject to the control of the merging parties, which post-acquisition efficiencies certainly would be. *See* United States v. General Dynamics Corp., 415 U.S. 486, 504-05 (1974). But, from a public policy perspective, such efficiencies should clearly be considered. Moreover, these doctrines do not address the evidentiary value that is to be given to efficiencies not yet achieved or efficiencies actually achieved but not anticipated at the time of the acquisition.

220. A current case to follow regarding these issues is the Antitrust Division's challenge of the 1982 acquisition of the corn wet milling operations of Nabisco Brands, Inc. by Archer-Daniels-Midland Company (S.D. Iowa, Civil No. 83-51-D).

real guidelines for its application, as the Commission did in *American Medical International*, does more harm than good. In light of the dearth of ongoing section 7 litigation (both within the FTC and in private litigation), the antitrust enforcement agencies cannot realistically rely upon litigated cases for the development of a coherent set of guidelines for use in merger analysis.

An even more compelling argument in favor of a unified policy statement is the difference that persists between the Antitrust Division's 1984 Merger Guidelines and the FTC's 1982 Horizontal Merger Statement (even as "amended" by *American Medical International*)[221] on the proper role of efficiencies in merger analysis. The underlying problem is that the language in section 7 is sufficiently general and vague that the two antitrust enforcement agencies, and the courts in private section 7 litigation, can reach different, although equally valid, positions. The simple political reality is that the Antitrust Division and FTC's dual jurisdiction over enforcement of section 7, notwithstanding past efforts to eliminate it,[222] is here to stay, and antitrust lawyers must consider the policy pronouncements of both antitrust enforcement agencies when assessing the competitive impact of a proposed transaction. Even granting *American Medical International* full effect as a valid public policy pronouncement by the Commission,[223] important differences still exist between the required efficiencies showing.[224] Although the long-standing liaison agreement between the Antitrust Division and the FTC[225] has functioned in the past to prevent or settle jurisdictional disputes in individual cases, and past practice enables lawyers in many instances to predict accurately what agency will obtain

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221. *See supra* note 207 and accompanying text.

222. Dual enforcement creates unnecessary costs including the duplication of enforcement resources and the danger of inconsistent public policies. In 1981, the Reagan administration unsuccessfully proposed elimination of dual jurisdiction. *See generally* Kirkpatrick, Elman, Pitofsky & Baxter, *Debate: The Federal Trade Commission Under Attack: Should the Commission's Role Be Changed?*, 49 ANTITRUST L.J. 1481 (1980); Roll, *supra* note 214.

223. Technically speaking, the efficiencies discussion in *American Medical International* should be ignored as dicta and the Commission's 1982 Horizontal Merger Statement should be deemed controlling. *See supra* note 203. The "precedential" effect of this decision in all likelihood would not be a problem for counsel arguing a case at the prosecutorial discretion stage since, presumably, the Commission would properly limit the effect of *American Medical International*. However, this would create major uncertainty if the case were in any other legal posture.

224. *See supra* note 207 and accompanying text.

225. *See generally* Roll, *supra* note 214, at 2077-80. Under the terms of a 1948 memorandum agreement outlining the liaison procedure, the Antitrust Division and the FTC consult one another prior to initiating a formal investigation in order to determine which agency will handle the matter.

clearance to review a particular transaction,[226] these differences cannot be entirely dismissed.[227] Certainly from a public policy perspective, the legality of a transaction that may have consequences for U.S. industrial competitiveness in world markets should not turn in large measure on which particular agency obtains clearance to review the transaction.

One very damaging effect of the failure to address critical issues relating to the use of efficiencies in merger analysis is the continued distortion that the efficiencies doctrine suffers in order to meet political exigencies. Because of important commerce issues that are often involved, political pressure (subtle or otherwise)[228] from other branches of the government is often brought to the antitrust agency reviewing the transaction, as was evident in the General Motors-Toyota[229] and LTV-Republic[230] cases. To the extent personnel

226. Where both agencies express an interest in handling a particular case, the decision —which often is the result of intense negotiations between the two agencies—is generally based on relative expertise with the subject matter or industry as well as staff availability. As a practical matter, some knowledge of the enforcement activities of the two agencies will enable counsel to predict this (e.g., the Commission investigates automobile parts-related transactions and the Antitrust Division investigates transactions in the computer industry). However, many gray areas exist.

For a detailed list identifying substantive areas of expertise between the two agencies, as well as gray areas, see Roll, *supra* note 214, at 2079-80. Occasionally, despite review, but not formal clearance by one agency, the other has sued. *See* A.B.A. ANTITRUST SECTION, *supra* note 70, at 28 & n.110 (examining Nestle Alimentana's acquisition of Stouffer Corporation).

227. Of course, this is a problem principally in the context of counsel's competitive analysis of a proposed acquisition. Once clearance is granted to one of the agencies, the efficiencies arguments can be modeled to that agency's efficiencies guidelines. This problem also arises in the private section 7 litigation context to the extent that the court chooses to rely on the merger guidelines of one agency or the other.

228. This pressure can take many forms: congressional correspondence or other communications, including hearings; announcements of "interest" by other executive departments or federal agencies (although, of course, at all times professing noninvolvement and advocating impartiality); and constituent correspondence and visits. Because many upper-level bureaucrats often perceive their political, and vocational, careers to be at risk in such major decisions, this concern should not be dismissed in considering the agency decisionmaking process. For an account of the politically-charged atmosphere surrounding the Commission's review of the Champion-St. Regis transaction (although not illustrating distortion of the efficiencies doctrine), see *Champion-St. Regis Merger Hits Snag as Calvani Threatens Injunction Vote*, FTC:WATCH No. 196, 2-4 (Sept. 28, 1984). *See also Low-Key Oliver Takes Command of FTC: Arrives Without Staff "Boarding Party,"* FTC:WATCH No. 232, 2-4 (April 25, 1986).

229. *See supra* note 32. Although General Motors and Toyota requested Commission approval for their joint venture in February 1983, the matter was not sent to the full Commission for a decision until December 1983, *after* the departure of Commissioner Clanton and *after* the arrival of Commissioner Calvani, who had been a much more ardent supporter of Chairman Miller's agenda—when a 3-2 majority (which in fact was the result) appeared assured. At that time, Clanton was at best only an occasional ally of Chairman Miller and has since written critically of the Commission's decision in the General Motors-Toyota case. *See* Clanton, *supra* note 32.

within the antitrust agency decides to "yield" to such pressure, notwithstanding a compelling legal case weighing against the merger, lines of antitrust analysis that permit flexibility and provide leeway are often used to achieve the desired result. The vagueness of the parameters of the efficiencies doctrine in merger analysis and the latitude present within the doctrine itself have permitted the Antitrust Division and the FTC to use efficiencies to justify what might otherwise be objectionable transactions.[231] From a public policy perspective, there is nothing inherently wrong with allowing agency decisionmaking to reflect current political thinking. However, the cost of doing so is the damage to antitrust theory from molding doctrine to achieve the immediate politically desired result in a particular case. The resulting distortion in the efficiencies doctrine produces both intrinsic and extrinsic harm. By altering the

230. *See supra* notes 78-81 and accompanying text. Although the Antitrust Division ultimately approved the LTV-Republic transaction, in part on claimed efficiencies grounds, *see LTV-Republic Steel Merger— Justice Clearance* 5 Trade Reg. Rep. (CCH) ¶ 50,465, at 56,125 (April 9, 1984), that decision was a near complete reversal of the Antitrust Division's decision several weeks earlier to oppose the transaction. *See Department of Justice, Merger Policy - LTV Republic,* 5 Trade Reg. Rep. (CCH) ¶ 50,462, at 56,116 (March 19, 1984). In between the two decisions, then Assistant Attorney General McGrath reportedly had been subjected to pressure, both publicly and privately, from the Commerce Department and the White House to approve the transaction. *Compare* 46 Antitrust & Trade Reg. Rep. (BNA) No. 1152, 270 (Feb. 16, 1984) (McGrath reports there is little or no basis for the claimed efficiencies) *and* 46 Antitrust Trade Reg. Rep. (BNA) No. 1156, 502 (Mar. 15, 1984) (McGrath is criticized; requires factual showing of efficiency) *with* 46 Antitrust & Trade Reg. Rep. (BNA) No. 1157, 577 (Mar. 22, 1984) (McGrath conditionally approves merger, admitting that White House gave the message that Justice Department should decide this matter). Although the later decision to approve the transaction required the divestiture of two Republic steel plants, McGrath characterized the claimed efficiency gains, which he had previously rejected out-of-hand, to be "of interest." *Id.* at 577. In initially rejecting the proposed transaction, McGrath stated:

> We also considered the claim by the companies that the merger would permit substantial cost savings and that these savings are important if Jones & Laughlin and Republic are to continue as competitive factors in an increasingly difficult marketplace. The companies asserted that the merger would reduce operating expenses by more than $300 million per year. *It was clear from our study, however, that there was little or no basis for many of the claimed efficiencies.* In addition, a number of them could be realized without merging the two companies, through internal cost savings, supply contracts among the companies and perhaps even the swapping of plants and other assets among companies in the industry.

Merger Policy—LTV Republic, supra, at 56,116 (emphasis added). But several weeks later, in approving the proposed transaction, McGrath retreated from his previous position: "[W]hile we [previously] questioned many of the efficiency claims of Republic and LTV, there is reason to believe that a merged company may recognize some efficiencies." *Justice Clearance, supra,* at 56,126 (deleting footnote detailing efficiencies to be achieved).

231. Note that both General Motors-Toyota and LTV-Republic were decisions whether to exercise prosecutorial discretion by challenging the transaction. It is unlikely that blatant political pressure of this variety would ever be exerted on the Commission in its adjudicative role, although much more subtle forms of pressure are imaginable.

doctrine so as to accommodate political pressure, this practice pushes the doctrine in unintended directions[232] and invites antitrust lawyers in future cases to employ the distorted doctrine in a manner virtually indistinguishable from this "seminal" case but, nonetheless, in a manner that the agency cannot sanction.[233] This raises both the costs of making a transaction and the costs of reviewing a transaction once it is made. However, a singular statement of the efficiencies doctrine, setting forth detailed guidelines for employing efficiencies at both the prosecutorial discretion and adjudicatory stages, would eliminate the vagueness that can be used to accommodate political pressure and reduce distortion, thereby maintaining the doctrine's integrity.

Putting aside these normative issues, it is important to recognize the niche that the efficiencies doctrine occupies in antitrust law. Beginning with the Supreme Court's 1977 decision in *Continental T.V., Inc. v. GTE Sylvania, Inc.*[234] abandoning the per se rule for vertical nonprice restrictions, per se and presumptive rules of illegality have suffered a steady decline. The Court fell just short of abandoning the rule of per se illegality for resale price maintenance in *Monsanto Co. v. Spray-Rite Service*,[235] and actually did so for efficiency-enhancing horizontal agreements in *Broadcast Music, Inc. v. Columbia Broadcasting System*,[236] *NCAA v. Board of Regents*,[237] and *Northwest Wholesale Stationers v. Pacific Stationery & Printing*.[238] The Court's opinion in *Jefferson Parish Hospital District No.*

232. For instance, after General Motors-Toyota, the Commission's policy on efficiencies presumably must now be regarded as including management efficiencies of a nonquantifiable variety. *See supra* note 32.

233. Immediately after the General Motors-Toyota decision, Warner Communications, Inc. requested Commission approval for its joint venture with PolyGram Records, Inc., which essentially was the merger of each operation's prerecorded music business. The parties argued that the joint venture would yield efficiencies and procompetitive benefits. Polygram, which was strong in the classical music area, had distribution problems in the United States, and Warner was relatively weak both abroad and in the classical music area. The parties also claimed that their labels would continue to operate with creative autonomy. Despite "packaging" the proposal similar to the General Motors-Toyota joint venture, especially with regard to the claimed efficiencies, the Commission rejected the parties' contentions. *See Joint Venture Would Lessen Competition in Prerecorded Music Industry, FTC Charges*, 46 Antitrust & Trade Reg. Rep. (BNA) No. 645 (March 29, 1984); *Ninth Circuit Blocks Warner-Polygram Venture in Prerecorded Music Industry*, 46 Antitrust & Trade Reg. Rep. (BNA) 760 (April 19, 1984). The Ninth Circuit Court of Appeals later upheld the Commission. *See* FTC v. Warner Communications, Inc., 742 F.2d 1156 (9th Cir. 1984).

234. 433 U.S. 36 (1977).

235. 465 U.S. 752 (1984).

236. 441 U.S. 1 (1979).

237. 468 U.S. 85 (1984).

238. 105 S. Ct. 2613 (1985).

2 v. Hyde,[239] while technically retaining the per se rule prohibiting typing arrangements,[240] resembled more a standard rule-of-reason analysis than the application of a traditional per se rule.[241] Although the per se rule has never had a place in merger analysis under section 7, quantitative merger analysis, with its heavy reliance on market shares and market concentration, has given rise to presumptive rules of illegality.[242] However, as the Commission illustrated in the *Echlin Manufacturing*[243] decision and a number of courts in other decisions,[244] presumptive illegality, even when mandated by the "current" merger guidelines, is also losing recognition.

The efficiencies doctrine will contribute to the continuing decline of per se illegality in antitrust law in general and in merger analysis in particular. Although the imprecision of the current standards that govern application of the doctrine, and the inherent difficulty in balancing productive and allocative efficiencies, may limit the doctrine's effectiveness, the antitrust agencies and the courts will attach greater significance to demonstrable efficiencies. It is difficult to say what the equilibrium point will be between efficiencies considerations and quantitative factors in merger analysis. Following the lead that the Commission took in its *Echlin Manufacturing*[245] decision for entry barriers, a rule of per se *legality* upon a showing of tenable efficiencies is certainly not out of the question. However, it is certain that the efficiencies doctrine is just now beginning to come into its own in merger analysis.

239. 466 U.S. 2 (1984).

240. The majority asserted that "[p]er se condemnation . . . is only appropriate if the existence of forcing [the sale of a tied item] is probable." *Id.* at 15.

241. *Id.* at 25 (hospital did not force services upon unwilling patients, thus there was no basis for applying a per se rule).

242. *See, e.g.*, United States v. Philadelphia National Bank, 374 U.S. 321, 362-63 (1963). Notwithstanding the Court's later efforts in United States v. General Dynamics Corp., 415 U.S. 486 (1974), to eliminate this rule of presumptive illegality, some courts have substantially narrowed the *General Dynamics* holding so that presumptive illegality is still the rule. *See, e.g.*, *Monfort of Colorado, Inc.*, 761 F.2d at 580-81. *See also supra* note 1.

243. 3 Trade Reg. Rep. (CCH) ¶ 22,268 (F.T.C. June 28, 1985). *See supra* note 2.

244. *See* cases cited *supra* note 2.

245. Commissioner Bailey, dissenting in *Echlin*, claimed that the Commission's emphasis of entry barriers above quantitative analysis in that case "leads to a rule of *per se* legality for many mergers." *See Echlin*, 3 Trade Reg. Rep. (CCH) ¶ 22,268.