

EFFICIENCIES ANALYSIS IN MERGERS

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Debra A. Valentine
O'Melveny & Myers, LLP
Washington, D.C.

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- I. Should Merger Review Include an Analysis of Efficiencies?
 - A. Yes. Mergers have the potential to generate significant efficiencies. Admittedly, the literature on the extent to which mergers are successful is not overwhelming. But those mergers that succeed usually do so because they have achieved efficiencies – that is, a better utilization of existing assets. Competition law should take account of that.
- II. If Efficiencies Are Part of Merger Review, How Should They Fit into the Analysis?
 - A. There are effectively three ways of incorporating efficiencies into merger analysis:
 1. As part of the competitive effects analysis.
 2. As a defense, once an agency determines that anticompetitive effects are likely.
 3. As part of the public interest test.
 - B. By integrating efficiency analysis into the competitive effects analysis, the focus remains on the proper antitrust inquiry – the merger’s likely effect on competition in the relevant market.
 1. Moreover, by asking whether efficiencies affect the merged firm’s ability and incentives so as to deter the likely exercise of market power post-merger -- and by assessing the efficiencies’ likely effect on the relevant market -- the focus remains on consumer welfare.

2. Efficiencies could counteract a merger's potential to harm consumers if cost reductions enhance the merged firm's incentive to reduce price or increase output. Two high cost competitors could become a more effective low cost firm (Bergen-Brunswick-AmeriSource). Innovations or quality improvements that the two firms could not achieve separately may make the merged firm a more competitive force and improve overall competition in the market as well.
 3. Incorporating efficiencies into the competitive effects analysis somewhat minimizes the apples and oranges problem of weighing efficiencies against potential reductions in competition. It is more analogous to the balancing of pro- and anti-competitive effects that occurs in other areas of competition law, such as the analysis of joint ventures.
 4. And by integrating efficiencies into the competitive effects analysis, less pressure is placed on the pass through issue – whether the efficiencies will be passed on to consumers – because if the market remains competitive, it is likely that the efficiencies will be passed on.
- C. If efficiencies are treated as an affirmative defense, they become relevant only after the agency has determined that an anticompetitive effect is likely.
1. This approach has the benefit of leaving the difficult issue of efficiencies to the end of the analysis. But one need not reach efficiency issues in routine, unproblematic cases in any event; and if they are assessed as part of the competitive effects analysis, one can integrate them toward the end of the balancing process.

2. Parties are less likely to put forward efficiencies in this context, because they effectively would be conceding that an anticompetitive effect is likely.
3. Arguably, if efficiencies are truly a defense or a trump, they need not be passed through to consumers and could well contribute to total but not consumer welfare.
4. Treating efficiencies as an affirmative defense creates more of a problem of weighing apples against oranges – how should agencies or courts weigh efficiencies against anticompetitive effects?
5. In the U.S., creating an affirmative defense is difficult from the litigation procedure perspective – technically, the government should be proving that a merger is likely to lessen competition. With an affirmative defense, the parties would be proving that efficiencies excuse an otherwise illegal transaction. Currently, while parties have the burden of producing evidence of efficiencies, they do not have the burden of proof in merger litigation.

D. If efficiencies are treated as part of a public interest analysis, there is a greater potential for unprincipled analysis and unbounded discretion.

1. Arguably, an agency could choose to recognize particular efficiencies (and not others) in the public interest context because it deemed certain ones, such as production efficiencies or innovation efficiencies, as particularly meritorious.

2. Agencies could also more legitimately consider efficiencies that are not passed on to consumers – that is, embrace a total welfare standard in the public benefit context, as Australia seems to do. In the words of its Tribunal, if a merger results in “considerable” savings “in the cost of supplying a good or service, this might well constitute a substantial benefit to the public, even though the cost saving is not passed on to the consumers in the form of lower prices.”
3. Ultimately, the discretion inherent in most public interest tests and the possibility that non-competition authorities would be administering this portion of the analysis suggests that there is a strong potential for deviation from a sound, economically grounded competition analysis.

III. What Kind of Efficiencies Should be Recognized?

A. Logically, efficiencies that are specific to the proposed merger.

1. These are efficiencies that are likely to be accomplished with the merger and not likely to be accomplished without the merger (or through other more procompetitive means).
2. The relevant comparison should be to practical alternatives available to the parties, not to some ideal structural reconstruction of the marketplace.
3. Arguably, if efficiencies are recognized as a defense or as part of the public interest analysis, the agency need not logically impose a merger-specificity requirement, although it may choose to do so (so as not to credit efficiencies that could be accomplished in a less anticompetitive manner).

- B. The efficiencies must not result from anticompetitive reductions in output or service.
1. Many firms' documents talk about cost savings, but if reductions in distribution costs mean less timely service for customers, or reductions in advertising expenditures eliminate informative content about competitive alternatives, then output is not increased and consumer welfare is not enhanced.
 2. Again, this requirement could be tempered if efficiencies are viewed as cost savings relevant to some public interest criterion, but not necessarily related to consumer welfare.
 3. The efficiencies should be assessed net of costs incurred to achieve them.
- C. The efficiencies must be verifiable.
1. Parties must provide sufficient evidence for the agency to verify: a) that the efficiency likely will be achieved; b) the magnitude of the efficiency; and c) the costs of achieving the efficiency.
 2. If efficiencies are integrated into the competitive effects analysis, the parties must also show
 - a. how the efficiency will enhance the merged firm's ability and incentive to compete; and
 - b. why each efficiency is merger-specific.
 3. If an affirmative defense approach or public interest test is used, these latter two proof requirements would not logically be required, although they may be desirable.

IV. The Analysis Can be Further Refined as Agencies Become More Comfortable With It.

A. Efficiencies that are not in the relevant market might be considered, particularly insofar as undertakings or remedies are evaluated.

1. If a merger achieves efficiencies in another market that is inextricably linked with the relevant market, and particularly if a partial divestiture cannot feasibly eliminate the anticompetitive effect in the relevant market without sacrificing the efficiencies in the other market, then out-of-market efficiencies might be weighed.

2. This is easiest to accept if the merger were to raise the price of pens slightly in one market, but decrease the price of ink markedly in a related market and the same people experienced both the price increase and price decrease and net benefited from the merger.

B. Efficiencies with no short term price effects but that reliably may lead to long-term price decreases may be considered.

1. If such forward-looking analysis is undertaken, the efficiencies should be discounted because they are less proximate and more difficult to predict.