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Merging in the Shadow of the Law: Why Judicial Efficiency Analysis Matters

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ABSTRACT: This article examines current judicial interpretation of Section 7 of the Clayton Act through the lens of negotiation theory. The research exposes a gap between how courts state they are analyzing efficiency claims in Section 7 Clayton Act enforcement actions and what they are actually doing. During periods of lax antitrust enforcement, this pattern is not readily visible, since almost all proposed merger and acquisition ("M&A") deals are approved. With a shift to more aggressive antitrust policy, however, it is critical that merger review include appropriate weighting of transaction-generated efficiencies. Although only a small number of Section 7 cases are litigated each year, corporate negotiators assess thousands of potential M&A deals annually. For decades, scholars have applied microeconomic models to analyze antitrust policy. This article applies analytical frameworks from the negotiation literature to demonstrate how in an environment of increased enforcement, current judicial efficiency analysis would discourage corporate negotiators from pursuing efficient deals, thereby hurting the competitiveness of U.S. companies and markets.

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INTRODUCTION

A significant gap exists between how courts say that they are implementing Section 7 of the Clayton Act and what detailed case analysis reveals they are in fact doing. The purpose of the Clayton Act is to prevent mergers and acquisitions that may substantially lessen competition or tend to create a monopoly.[1] The courts and the federal agencies responsible for enforcing the Clayton Act, however, have also expressly recognized the potential for mergers and acquisitions ("M&A") to contribute ***positively*** to competition through merger-specific efficiencies.[2] These strategic synergies and cost savings – available only through the proposed merger - enable merging parties to combine to form stronger, more nimble organizations better positioned to challenge market leaders.

This Article examines twenty-five years worth of Section 7 Clayton Act cases in which efficiency claims were raised. The analysis reveals a disturbing pattern. Although courts claim to be balancing merger-generated efficiencies with other negative factors affecting market competition, they are not in fact doing so. Rather than engaging in any true balancing analysis, courts appear to be making an assessment of the relevant concentration in the applicable market, and then allowing that initial assessment to color their recognition of claimed efficiencies. In cases with limited concentration concerns, courts often cite efficiencies as factors contributing to market competitiveness. In cases involving highly concentrated markets, however, courts often discard similar types of efficiencies. No balancing analysis is ever performed.

Such inconsistent judicial treatment of efficiency claims has not presented a significant problem before now because antitrust enforcement has been relatively lax, with the vast majority of proposed deals proceeding without intervention. With the changing economic[3] and political climate[4], however, antitrust policy is likely to shift towards more aggressive enforcement, including increased scrutiny

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[1] Clayton Act Section 7, 15 U.S.C. §. 18 (2002).

[2] U.S. Dep't of Justice & Federal Trade Comm'n, Horizontal Merger Guidelines Sec. 4 (as amended Apr. 8, 1997), *reprinted in* 4 Trade Reg. Rep. (CCH) Sec. 13,104 [hereinafter 1997 Revisions].

[3] The recent financial crisis has contributed to far greater public support for increased regulation of market activity. See Lin Yang, *Why Government Intervention Won't Work,* Time.com, Nov. 25, 2008 *available at* *http://www.time.com/time/business/article/0,8599,1862028,00.html.*

[4] President Obama has made clear that he intends to "reinvigorate antitrust enforcement," including increased scrutiny of mergers and acquisitions. Michael Orey, *Obama Appoints Antitrust Chief,* BusinessWeek, Jan. 22, 2009 available at http://www.businessweek.com/bwdaily/dnflash/content/jan2009/db20090122_htm?campaign_id+rss_daily.

of mergers and acquisitions.[5] This impending enforcement shift, combined with the failure of courts to appropriately balance efficiencies in Section 7 cases, threatens to worsen the competitiveness of U.S. corporations and markets. M&A deals that could have contributed to increased competitiveness will be either blocked or discouraged by inconsistent judicial treatment of efficiencies.

This Article argues that if courts do not consistently balance pro-competitive efficiencies against the other anti-competitive effects of proposed M&A deals, corporations facing stricter antitrust regimes will abandon important deals that could have contributed to the competitiveness of the U.S. economy. Part I reviews how courts currently treat efficiency claims. It highlights some key differences between how courts say they are weighing efficiency claims and what an analysis of the case law reveals they are actually doing. Part II discusses why we are likely to see a shift towards more aggressive antitrust enforcement. Part III applies several frameworks from the negotiation field, including value analysis, Best Alternative to a Negotiated Agreement ("BATNA") analysis, and Zone of Possible Agreement ("ZOPA") analysis, to demonstrate how inconsistent judicial efficiency analysis discourages corporate negotiators from pursuing efficient M&A transactions. This section also outlines how court action (and inaction) can hurt the competitiveness of U.S. markets and companies. Finally, Part IV suggests guidelines for how courts could incorporate efficiencies more effectively into the initial competitive analysis.

I. CURRENT COURT TREATMENT OF EFFICIENCY CLAIMS

Courts addressing Section 7 preliminary injunction cases generally state that they are applying antitrust analysis similar to that outlined in the 1997 FTC/DOJ Joint Merger Guidelines. This analysis, which provides a framework for evaluating Section 7 Clayton Act cases, includes the balancing of pro-competitive effects of projected efficiencies against other, potentially anticompetitive effects of a proposed deal. In practice, however, a gap exists between how courts state they are treating efficiencies and the role that efficiencies actually play in court decisions. As the grid analysis in this section illustrates, no true balancing analysis is taking place.

[5] In a statement to the American Antitrust Institute during his campaign, for example, Senator Obama noted that, "[a]t home, for more than a century, there has been broad bipartisan support for vigorous antitrust enforcement, to protect competition and to foster innovation and economic growth. Regrettably, the current administration has what may be the weakest record of antitrust enforcement of any administration in the last half-century… As president, I will direct my administration to reinvigorate antitrust enforcement. It will step up review of merger activity and take effective action to stop or restructure those mergers that are likely to harm consumer welfare, while quickly clearing those that do not. " *Statement of Senator Barack Obama for the American Antitrust Institute*, Sept. 27th, 2007, available at www.antitrustinstitute.org?...?aai-%20Presidential%20campaign%20-%20Obama%209-07_092720071759.pdf

a. Background on Section 7 of the Clayton Act

Under Section 7 of the Clayton Act, mergers are prohibited if they either substantially lessen competition or tend to create a monopoly.[6] Determining whether a transaction will "substantially lessen competition" can be difficult due to the predictive nature of the analyses involved.[7] Courts, therefore, use market share measurements as a proxy for this criterion. Prosecuting agencies[8] can establish a prima facie case by demonstrating that the merged entities will control a significant portion of the relevant market,[9] thus enabling them to raise prices above normal competitive levels.[10]

Merging parties have the opportunity to rebut the market-share-based prima facie case by demonstrating that specific characteristics of the market in question (e.g., ease of entry, sophisticated, powerful buyers, etc.) make it unlikely that the merged entities' market position will have a negative impact on competition.[11] Although a technical rebuttal exists, once the Agencies have established a prima facie market concentration case, historically merging parties have had a very difficult time rebutting the presumption of a resulting negative impact upon competition.[12] Courts have only recently begun to give much weight to any of the rebuttal factors that might mitigate the adverse effects of increased concentration.[13]

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[6] Clayton Act Section 7, 15 U.S.C. §. 18 (2002).
[7] See Malcolm B. Coate, *Efficiencies in Merger Analysis: An Institutionalist View*, 13 SUP. CT. ECON. REV. 189, 225-226 (2005)(discussing the inherent difficulties in using neoclassical balancing analysis to assess the anticompetitive and pro-competitive efficiency effects of a proposed merger transaction).
[8] Section 7 enforcement actions are generally brought by either the Federal Trade Commission, the Antitrust Division of the Department of Justice, or state attorney generals. Private parties may also initiate proceedings. LAWRENCE A. SULLIVAN & WARREN S. GRIMES, THE LAW OF ANTITRUST: AN INTEGRATED HANDBOOK 574 – 575 (2nd ed. 2006).
[9] Interesting issues about how to identify appropriate product and geographic market definitions often end up determining the outcome of Section 7 cases. For example, see Federal Trade Commission v. Whole Foods Market, 502 F.Supp.2d 1, 9 (2007), (holding that the appropriate market against which to assess the impact of a Whole / Foods Wilds Oat merger was the "premium, natural, and organic supermarket" market instead of supermarkets generally). These issues, however, are well beyond the scope of this Article.
[10] Federal Trade Commission v. Cardinal Health, Inc., 12 F.Supp.2d 34, 52 (D.D.C. 1998).
[11] Id. at 54.
[12] See Thomas A. Piraino, *A New Approach to the Antitrust Analysis of Mergers*, 83 B.U.L. REV. 785, 789 (2003).
[13] Id. The first case in which defendants successfully rebutted the government's prima facie market concentration case was *United States v. General Dynamics*. United States v. General Dynamics, 415 U.S. 486 (1974) (holding uncommitted coal reserve levels rendered current market shares a poor metric of future competitive position). See William J. Kolasky & Andrew R. Dick, *The Merger Guidelines and the Integration of Efficiencies into Antitrust Review of Horizontal Mergers*, 71 ANTITRUST L.J. 207, 214 (2003).

Of all of the potential rebuttal factors, the one that has proven the most controversial is that of "efficiencies."[14] Companies can have many different motivations for engaging in M&A activity, including diversification, growth, international expansion, tax advantages, market power, and simply a desire to "empire build."[15] Sometimes, however, the driving factor is projected synergies or cost savings.[16] By integrating their operations, management may believe, for example, that they will be able to manufacture products less expensively, reduce the size and cost of their sales forces, and/or eliminate unneeded duplicative infrastructure (e.g. HR departments, legal departments, IT departments, etc.).[17] Each of these efficiencies will enable the entity to operate more effectively – to produce more products and services at a lower cost.

Depending upon the specific structure of the market in question, such merger-based efficiencies could lead to increased competition in the market, despite an increased market concentration level.[18] If, for example, the third and fourth largest companies in the market merge, the new combined entity may be better positioned to compete for business currently dominated by the top two organizations. The positive effect that the resulting merger efficiencies have on market competition can offset the negative effect on competition that may result from increased market concentration.

b. Conflicting Guidance from Historic Supreme Court Cases and Contemporary Agency Guidelines

Courts facing Section 7 efficiency claims today are caught between historic -- and outdated[19] -- Supreme Court cases and contemporary Agency antitrust policy. The

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[14] "In recent years, the courts and agencies have become increasingly willing to consider mitigating factors that may rebut the presumption of illegality for mergers in concentrated markets. Unfortunately, however, neither the courts nor the agencies have developed standards for determining, first, what mitigating factors should be deemed particularly relevant, and second, the priority or weight that should be afforded such factors. Among the most nettlesome issues has been the weight afforded the efficiencies likely to result from a merger." See Piraino, *supra* note 12, at 791-792.

[15] See PATRICK A. GAUGHAN, MERGERS, ACQUISITIONS, AND CORPORATE RESTRUCTURINGS 117-168 (2nd ed. 2007). Also see Alan A Fisher & Robert H. Lande, *Efficiency Considerations in Merger Enforcement,* 71 CAL. L. REV. 1580, 1584 (1983) (pointing out that during the 1960s economists and lawyers often thought that the goals of mergers were unrelated to efficiencies).

[16] See ROBERT F. BRUNER, M&A LESSONS THAT RISE ABOVE THE ASHES: DEALS FROM HELL 30 (2005).

[17] See PHILIP A. AREEDA, JOHN L. SOLOW, & HERBERT HOVENKAMP, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION Vol. IVA, 78-100 (2nd ed. 2006).

[18] See Coate, *supra* note 7, at 218.

[19] As Herbert Hovenkamp noted "merger law is the largest area of public antitrust enforcement activity, and an area where the law as the Supreme Court last left it is indefensible. While antitrust casebooks continue to print 1960s-vintage merger decisions

Supreme Court has not directly addressed a Section 7 Clayton Act case on the merits in over thirty years.[20] In part, this is due to the passage of the Hart-Scott-Rodino Act in 1976. The Act, and its pre-merger notification requirements, reduced the number of mergers reviewed by the court system; instead most cases are now handled at the Agency level.[21]

The historic Supreme Court cases that do exist were decided during a time period when (1) mergers were treated with greater suspicion than today,[22] (2) very few economic tools existed to aid judges in understanding the actual impact of a proposed deal,[23] and (3) the Court considered the protection of small businesses to be an additional underlying goal of antitrust policy.[24] Given this context, it is understandable that almost all of the early Supreme Court cases ended up ruling against the merger.[25]

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that have never been overruled, no one, not even federal judges and certainly not the government enforcement agencies, pay much attention to them." HERBERT HOVENKAMP, THE ANTITRUST ENTERPRISE 208 (2005). The mergers blocked during this era by the Supreme Court would likely not receive much scrutiny today. See Gregory J. Werden, *Next Steps in the Evolution of Antitrust Law: What to Expect from the Roberts Court,* 5 J. COMPETITION L. & ECON. 49, 63 (2009).

[20]See Donna E. Patterson, *Antitrust Enforcement in the Clinton Administration,* 15 SUM ANTITRUST 70, 72 (2001). Note that in 1990, the Supreme Court did rule on a Section 7 related matter in which they considered the issue of whether divestiture is a form of injunctive relief available through Section 16 of the Clayton Act. Although the underlying claim did involve a Section 7 Clayton Act issue, the Supreme Court only narrowly considered the Section 16 divestiture question. See California v. American Stores Company, 495 U.S. 271 (1990).

[21] See SULLIVAN & GRIMES, *supra* note 8, at 579. See also Patterson, *supra* note 20, at 72.

[22] See Craig W. Conrath & Nicholas A. Widnell, *Efficiency Claims in Merger Analysis: Hostility or Humility*?, 7 GEO. MASON L. REV. 685, 691 (1999).

[23] "With respect to Section 7 of the Clayton Act, Supreme Court jurisprudence is totally out of touch with developments in economics and agency enforcement because the Court has not considered the merits of a merger case for more than three decades." Werden, *supra* note 19, at 73-74.

[24] See SULLIVAN & GRIMES, *supra* note 8, at 557 (explaining how in *U.S. v. Von's Grocery Co*., the Supreme Court's decision to strike down a merger of two retail grocery store chains that collectively held 8.9% of the market was based on the Court's desire to protect small businesses).

[25] Brown Shoe Co. v. United States, 370 U.S. 294, 344 (1962) (holding merger of two shoe manufacturers/sellers controlling 7.2% of retail outlets in fragmented market violated Clayton Act due to trend of consolidation); United States vs. Philadelphia National Bank, 374 U.S. 321 (1963) (holding merger of two Philadelphia banks that held at least 30% of commercial banking business in four county Philadelphia metro area violated Section 7 of Clayton Act); FTC v. Proctor & Gamble Co., 386 U.S. 568 (1967) (holding "product extension merger" of diverse manufacturer of household products with leading manufacturer in household liquid bleach market violated Clayton Act); United States v. Von's Grocery Co., 384 U.S. 270 (1966) (merger involving 7.5% of grocery store market in L.A area blocked due to "anticompetitive trends" in the market).

In 1990, when reviewing Section 7 Supreme Court cases, the D.C. Circuit noted critically that, "[i]n the mid-1960s, the Supreme Court construed Section 7 to prohibit virtually any horizontal merger or acquisition. At the time, the Court envisioned an ideal market as one composed of many small competitors, each enjoying only a small market share; the more closely a given market approximated this ideal, the more competitive it was presumed to be."[26]

During this time period, the Supreme Court never directly addressed the issue of an "efficiency defense;" therefore, no specific precedent exists stating whether potential pro-competitive efficiencies should be included in the Section 7 competitive impact analysis.[27] Some of the language from these early cases, however, is fairly hostile to the concept of an efficiency defense. For example, in *Brown Shoe Company vs. United States,* the Court stated, "…we cannot fail to recognize Congress' desire to promote competition, through the protection of viable, small, locally owned business. 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."[28]

A year later in *United States v. Philadelphia National Bank,* the Court noted, "We are clear, however, that a merger the effect of which "may be substantially to lessen competition" is not saved because, on some ultimate reckoning of social or economic debits and credits, it may be deemed beneficial… Congress determined to preserve our traditionally competitive economy. It, therefore, proscribed anticompetitive mergers, the benign and the malignant alike, fully aware, we must assume, that some price might have to be paid."[29]

Finally, in 1967 in *Federal Trade Commission v. Proctor & Gamble, Co*., the Court most directly stated, "Possible economies cannot be used as a defense to illegality. Congress was aware that some mergers which lessen competition may also result in economies but it struck the balance in favor of protecting competition."[30] Although this language comes very close to rejecting the efficiency defense outright, scholars have identified various reasons for why a narrow interpretation of this statement is appropriate.[31]

[26] United States v. Baker Hughes, 908 F.2d 981, at 989 (D.C. Cir. 1990).
[27] See Timothy Muris, *The Efficiency Defense Under Section 7 of the Clayton Act*, 30 CASE W. RES. L. REV. 381, 416 (1980).
[28] Brown Shoe Co. v. United States, 370 U.S. 294, 344 (1962).
[29]United States vs. Philadelphia National Bank, 374 U.S. 321, 371 (1963). Note that some commentators believe that this language referenced other benefits that the transaction would bring to the community and not specific corporate efficiencies. See Muris, *supra* note 27, at 409.
[30] FTC v. Proctor & Gamble Co., 386 U.S. 568, 580 (1967).
[31] See Kolasky & Dick, *supra* note 13, at 211. For various reasons why one should not interpret the Court in *Proctor & Gamble* as explicitly rejecting the efficiency defense, see Muris, *supra* note 27, at 412.

At times, Supreme Court dicta from these older cases goes even a step further, implying that not only should efficiencies not be recognized as a positive merger benefit, but also revealing that they were actually considered to be a ***negative consideration***.[32] Supreme Court judges feared that merger-generated efficiencies would give the new combined organization an unfair advantage against smaller, existing businesses.[33] It is unlikely that the Supreme Court of this earlier era would have validated the type of efficiencies claims being made today.

In stark contrast to this hostile view of mergers and efficiencies, recent Agency actions and guidelines explicitly recognize the potential positive, pro-competitive impact of merger-generated efficiencies. The Federal Trade Commission and the Antitrust Division of the Department of Justice hold concurrent jurisdiction for prosecuting Section 7 Clayton Act claims.[34] Over the years, their publicly released Guidelines have slowly acknowledged and incorporated efficiencies into the analysis of the competitive effects of horizontal mergers.

Courts assessing Section 7 efficiency claims today face an interesting situation. Although the early Supreme Court cases were clearly hostile to efficiency claims, recent Agency guidelines and actions have been more supportive. Unfortunately, the legislative history of Section 7 does not clarify whether, or to what extent, Congress expected courts to consider potential efficiencies in Section 7 Clayton Act cases.[35] The discussions that took place prior to the 1950 amendments to Section 7 focused on the negative competitive impacts of increased market

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[32] "The treatment of efficiencies in the United States began with a notable misstep. In 1962 in Brown Shoe Co. v. United States, the U.S. Supreme Court, in the first merger case it considered after the Clayton Act was thoroughly revised in 1950 to augment governmental power to challenge mergers, concluded that efficiencies realized in mergers could weigh against the legality of a merger." Robert Pitofsky, *Efficiency Considerations and Merger Enforcement: Comparison of U.S. and EU Approaches,* 30 FORDHAM INT'L L.J. 1413, 1416 (2007).

[33] In 1969, Oliver Williamson noted that, "[a]s things stand now, we observe the regrettable condition in which a company proposing a merger, an apparent effect of which is to realize economies, consciously suppresses the economies aspect lest it be used affirmatively by the government to attack the merger." Oliver E. Williamson, *Allocative Efficiency and the Limits of Antitrust*, 59 AM. ECON. REV. 113. In *Brown Shoe Company vs. United States,* the first Supreme Court Section 7 case heard under the new amended Clayton Act, the government actually argued that the merger was anticompetitive because it would allow the company to LOWER prices due to efficiencies gained through vertical integration. In a strange twist, the defendants actually denied that the merger would generate any efficiencies. See Muris, *supra* note 27, at 403-404.

[34] See SULLIVAN & GRIMES, *supra* note 8, at 574-575.

[35] See Robert Pitofsky, *Proposals for Revised United States Merger Enforcement in a Global Economy*, 81 GEO. L.J. 195 at 211-212 (1992). Some commentators have noted that at that time, legislators did not perceive a conflict between promoting efficiency and protecting consumers via antitrust policy. See Fisher & Lande, *supra* note 15, at 1587-1588. See also Robert M. Vernail, *One Step Forward, One Step Back: How the Pass-On Requirement for Efficiencies Benefits in FTC v. Staples Undermines the Revisions to the Horizontal Merger Guidelines Efficiencies Section,* 7 GEO. MASON L. REV. 133, 138 (1998)

concentration levels; they did not squarely address the issue of whether, or how, efficiencies resulting from a merger should be considered in the analysis.[36]

c. How the Courts SAY They Are Treating Efficiency Claims

Although it is not binding authority, lower courts generally say that they are applying antitrust analysis consistent with the 1997 DOJ/FTC Horizontal Merger Guidelines framework when analyzing Section 7 cases and efficiency claims.[37] The 1997 FTC/DOJ Horizontal Merger Guidelines state that,

> [t]he Agency will not challenge a merger if cognizable efficiencies are of a character and magnitude such that the merger is not likely to be anticompetitive in any relevant market. To make the requisite determination, the Agency considers whether cognizable efficiencies likely would be sufficient to reverse the merger's potential to harm consumers in the relevant market (e.g., by preventing price increases in that market).[38]

The Guidelines expressly outline that a balancing approach be taken, with potential pro-competitive efficiencies balanced against other potential anticompetitive impacts of the merger.[39] This is clearly a difficult task, as both the "pro-

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[36] Id. In the legislative history, there was a Committee report that noted that the statute was not meant to prevent two small companies from merging to compete more effectively with a larger rival. Id. at 212 (noting that if Congress had analyzed this example, they would have recognized it as a narrow application of the Efficiency Defense). "The legislative history of Section 7 of the Clayton Act does not expressly address efficiencies or whether efficiencies could be evaluated in a Section 7 action. Neither the Supreme Court nor any lower court nor the Federal Trade Commission has ever interpreted the legislative history as expressly requiring or absolutely foreclosing a consideration of efficiencies in a merger analysis under Section 7." *Anticipating the 21st Century, supra* note 68, at Chapter 2, pg. 4.

[37] "Thus, an analysis of the likely competitive effects of a merger requires determinations of (1) the relevant product market, (2) the relevant geographic market, and (3) the transaction's probably effect on competition in those markets … Under the Federal Trade Commission and U.S. Department of Justice Horizontal Merger Guidelines, a market with a post merger HHI above 1800 is considered "highly concentrated," and mergers that increase the HHI in such a market by more than 100 points "are presumed … likely to create or enhance market power or facilitate its exercise." Although the Merger Guidelines are not binding on the Court, they provide a "useful illustration of the application of HHI."" Federal Trade Commission v. CCC Holdings, 2009 WL 723031, 7 (D.D.C. 2009). "The Merger Guidelines recognize that "mergers have the potential to generate significant efficiencies by permitting a better utilization of existing assets, enabling the combined firm to achieve lower costs in producing a given quantity and quality than either firm could have achieved without the proposed transaction." Although the Supreme Court has not sanctioned the efficiencies defense in Section 7 cases, "the trend among lower courts is to recognize the defense."" Id. at 39.

[38] 1997 Merger Guidelines, *supra* note 2, at Section 4.0.

[39] "The greater the potential adverse competitive effect of a merger – as indicated by the increase in the HHI and post-merger HHI from Section 1, the analysis of potential adverse

competitive" and "anticompetitive" projected impacts are projections.[40] Furthermore, the impacts – both positive and adverse – are generally based on economic models of predicted behavior, rather than allegations of specific, illegal behavior such as price-fixing.[41] The Guidelines also state that efficiencies are most likely to impact decisions in situations where the anticompetitive effects are not that great.[42]

The lower courts typically use market concentration figures, as calculated by the Herfindahl-Hirschman Index ("HHI"), as a starting point to determine whether a merger raises potential anticompetitive issues. The HHI of a market is calculated by taking the sum of the squares of all of the competitors' market shares in the industry.[43] The 1997 Horizontal Merger Guidelines broadly divide markets into three basic categories: un-concentrated (HHI below 1000), moderately concentrated (HHI between 1000 and 1800), and highly concentrated (HHI above 1800).[44]

For each category, the Guidelines outline basic assumptions about the impact that potential mergers will have on market dynamics. For example, in moderately concentrated industries, mergers that raise the HHI by more than 100 points will "potentially raise significant competitive concerns;" in highly concentrated industries, mergers that raise HHI by more than 100 points are presumed "likely to create or enhance market power or facilitate its exercise."[45] Against this rather

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competitive effects from Section 2, and the timeliness, likelihood, and sufficiency of entry from Section 3 – the greater must be cognizable efficiencies in order for the Agency to conclude that the merger will not have an anticompetitive effect in the relevant market. When the potential adverse competitive effect of a merger is likely to be particularly large, extraordinarily great cognizable efficiencies would be necessary to prevent the merger from being anticompetitive." Id.

[40] "The evaluation of the likely competitive effects of a proposed merger or acquisition is one of the more complicated tasks facing antitrust regulators because almost all of the analysis is, by necessity, forward-looking." A.E. Rodriguez & M.B. Coate, *Merger Pitfalls in Practice: Three Case Studies*, 20 U. PA. J. INT'L ECON. L. 793, 798 (1999).

[41] In recent years, both the FTC and DOJ have increasingly relied on "unilateral effects theories" to block M&A deals. The basic idea is that dominant firms with large market shares can affect market price unilaterally, without needing to explicitly or tacitly collude with other competitors. See Piraino, *supra* note 12, at 804.

[42] "In the Agency's experience, efficiencies are most likely to make a difference in merger analysis when the likely adverse competitive effects, absent the efficiencies, are not great. Efficiencies almost never justify a merger to monopoly or near-monopoly." FTC/DOJ, 1997 Guidelines, *supra* note 2, at Section 4.0.

[43] FTC/DOJ, 1997 Guidelines, *supra* note 2. For example if 10 firms exist, each with 10% market share, the HHI for the market will be 1000 ($10^2+10^2+10^2+10^2+10^2+10^2+10^2+10^2+10^2+10^2$). In contrast, if one firm has 91% of the market and the other nine firms each have 1% market share, the HHI will be 8,290 (8,281 (91^2) + 9 for the other 9 firms that have 1% share each). A market dominated by a monopoly would have an HHI of 10,000 (100*100).

[44] Id.

[45] Id. at Section 1.51.

concrete and specific measurement, Courts attempt to balance other factors such as ease of entry, buyer concentration, and potential efficiencies to assess whether the overall impact of the merger will be anticompetitive.

As one might imagine, it can be very difficult to balance these other, more subjective, factors against specific HHI concentration figures.[46] Yet, this balancing analysis is extremely important. Not only does it help the Courts to come to a decision regarding the projected impact of any particular merger, but also it creates precedent as to how courts weigh specific efficiencies against other potential anti-competitive effects of proposed deals. This precedent is extremely important to potential acquirers as companies assess whether a particular deal will likely raise Section 7 concerns.

d. How the Courts ARE Treating Efficiency Claims

There is a significant gap between how courts state that they are treating efficiency claims and how projected synergies are actually being incorporated into courts' decision making processes. Courts do not appear to be engaging in any true balancing of the pro-competitive effects of efficiencies vs. other anticompetitive aspects of a proposed deal. Instead, case analysis demonstrates that they first make a determination regarding market concentration levels and then allow that analysis to color their assessment of the associated efficiencies.

In situations involving lower levels of market concentration, courts have recognized significant merger-generated efficiencies. In cases involving higher market concentration, however, similar types of efficiencies are discarded by the courts as non-cognizable.

Courts apply three criteria to determine whether efficiencies will be recognized: (1) verifiability – whether the efficiency claims are supported by data, (2) merger-specificity – whether the efficiencies could be achieved through other less restrictive means, and (3) consumer pass-through – whether the efficiencies will ultimately benefit consumers. Few efficiency projections satisfy all three criteria.

1. Balancing of Efficiency Claims

Craig Conrath & Nicholas Widnell observed in their 1999 article, *Efficiency Claims in Merger Analysis: Hostility or Humility*?, "[t]he difficult challenge presented by such an efficiencies defense is whether there is a coherent way to balance the potential anticompetitive effects of a merger against its potential efficiency benefits. This question has remained a perennial topic of debate among

[46] See Coate, *supra* note 7, at 225-226.

antitrust practitioners."[47] How should the courts decide whether the claimed efficiencies offset any projected anticompetitive effects of the merger?[48]

One significant problem with current judicial treatment of Section 7 efficiency claims is that the recognition of efficiencies is lopsided. In 1999, prior to his term in office, former FTC Chairman Timothy Muris observed a similar pattern with Agency decisions. "Too often, the Agencies found no cognizable efficiencies when anti-competitive effects were determined to be likely and seemed to recognize efficiency only when no adverse effects were predicted. Thus the Agencies tended to reach a conclusion on likely anticompetitive effects of a merger, a decision that influenced their conclusions regarding efficiencies."[49] In other words, the Agencies appeared to be first coming to a conclusion on anticompetitive effects – without considering efficiencies – and then allowing ***that*** decision to impact their assessment of efficiencies.

Unfortunately, the troubling Agency pattern that Timothy Muris observed in 1999 is now clearly discernable in courts' treatment of Section 7 efficiency claims as well. With the exception of some hospital mergers, courts recognize substantial efficiencies only in cases with limited projected anticompetitive effects. In cases where anticompetitive impacts are more likely, courts are shying away from any true balancing. Instead, they simply declare the claimed efficiencies in these cases to be insubstantial or unverifiable.

2. *The Grid Analysis: A Bimodal Pattern*

An analysis of all available Section 7 preliminary injunction cases over the past twenty-five years involving efficiency claims confirms this view. The twenty-three cases analyzed span a broad range of industries including tank ammunition, baby food, supermarkets, coal mining, wholesale prescription drugs, wagering software, aircraft transparencies, gasoline, fluid milk processing, food service glassware, ERP software applications, and office supplies. Seven of the twenty-three involved hospital mergers. The cases took place between 1986 and 2009. Approximately half were heard in either the D.C. District Court or the D.C. Court of Appeals; the rest were spread among many different jurisdictions.

The following grid categorizes the cases based on two factors: (1) the level of predicted market concentration created by the merger, and (2) the level of efficiencies created by the merger that was recognized by the Court. The purpose

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[47] See Conrath & Widnell, *supra* note 22, at 686.

[48] "The ultimate question is what amount of efficiency gain will offset what amount of increased market power." See Paul Rogers, *The Limited Case for an Efficiency Defense in Horizontal Mergers,* 58 TUL. L. REV. 503, 540 (1983). Conceptually, this may not seem too difficult an idea to grasp. The issues arise, however, when courts attempt to move from the realm of theoretical concepts to concrete, real market assessments.

[49] See Timothy Muris, *The Government and Merger Efficiencies: Still Hostile After All These Years*, 7 GEO. MASON L. REV. 729, 731 (1999).

of the grid is NOT to provide information about the final holding of the court, nor to discuss how the Court balanced these factors. It simply lays out the underlying factors identified by the Court.

At a minimum, one would expect to see a broad array of combinations on the grid (i.e., cases involving high market concentration and high efficiency levels, low concentration and medium efficiencies levels, medium market concentration and high efficiency levels, etc.) If there were any selection bias for the cases, it would logically tip in balance of the "close calls," as the cases most likely to proceed with litigation would be ones, for example, with high market concentration and high efficiencies levels.

The data, however, reveal a completely different picture. ***A bimodal pattern appears, in the opposite direction of what the selection bias would predict.*** With the exception of hospital mergers, recognition of high levels of efficiencies generally only occurs in cases where concentration levels are relatively low. Similarly, almost all cases that involved high concentration levels involve low recognized levels of efficiencies. The only cases not to consistently follow this pattern involve hospital mergers. In these cases, the non-profit nature of the organizations merging appears to affect courts' recognition of efficiencies.[50] In almost all other cases, courts only recognized significant efficiencies in situations where they had already determined that the merger did not substantially increase market concentration.

[50] For example, in *Federal Trade Commission v. Butterworth Health Corporation,* the court explicitly states, "Of critical importance in the Court's evaluation of the evidence, as detailed above, are the following considerations. First, nonprofit hospitals operate differently in highly-concentrated markets than do profit-maximizing firms. Second, the boards of these two hospitals are comprised of prominent community and business leaders whose employees depend on these facilities for services, and who have demonstrated their genuine commitment to serve the greater Grand Rapids community through their governance of the hospitals… Fifth, substantial cost-savings and efficiencies would be realized as a result of the merger." Federal Trade Commission v. Butterworth Health Corporation, 121 F. Supp. 1285, 1302 (W.D. Mich. 1996), *aff'd* 121 F. 3d 708 (6th Cir. 1997).

Table 1. Court Recognition of Efficiencies

EFFICIENCIES \ CONCENTRATION	HIGH	MEDIUM	LOW
HIGH	1. Butterworth*		2. Country Lake 3. Carilion Health* 4. Long Island*
MEDIUM		5. Arch Coal 6. Foster Western	7. Tenet Health*
LOW	8. Swedish Match 9. Cardinal Health 10. Univ. Health* 11. Alliant Tech. 12. Heinz 13. PPG 14. Libbey 15. United Tote 16. CCC 17. Rockford* 18. Staples 19. Franklin	20. Am Stores 21. Illinois Cereal	22. Mercy Health* 23. Oracle

*Hospital Merger. See next page for full citations of all cases.

Full Citations for Cases Appearing in Table 1.

1. *Federal Trade Commission v. Butterworth Health Corporation*, 121 F. Supp. 1285, (W.D. Mich. 1996), *aff'd* 121 F. 3d 708 (6th Cir. 1997).
2. *United States v. Country Lake Foods, Inc.*, 754 F.Supp. 669 (Minn. 1990).
3. *United States v. Carilion Health System*, 707 F.Supp. 840 (W.D Vir. 1989), *affd* 892 F.2d 1042 (4th Cir. 1990) Unpublished opinion.
4. *US v. Long Island Jewish Medical Center*, 983 F. Supp. 121 (E.D. NY 1997).
5. *Federal Trade Commission v. Arch Coal*, 329 F. Supp.2d 109 (D.C. 2004).
6. *Federal Trade Commission v. Foster Western Refining, Inc.* 2007 WL 1793441 (D.N.M.)
7. *Federal Trade Commission v. Tenet Health Care Corporation*, 186 F.3d 1045 (8th Cir. 1999).
8. *Federal Trade Commission v. Swedish Match*, 131 F.Supp 2d 151, (D.D.C. 2000).
9. *Federal Trade Commission v. Cardinal Health, Inc.*, 12 F.Supp.2d 34 (D.D.C. 1998).
10. *Federal Trade Commission v. University Health Inc.*, 938 F.2d 1206 (11th Cir. 1991).
11. *Federal Trade Commission v. Alliant Techsystems*, 808 F.Supp. 9 (D.D.C. 1992).
12. *Federal Trade Commission v. H.J. Heinz Co.*, 246 F. 3d 708 (D.C. Cir. 2001).
13. *Federal Trade Commission v. PPG, Industries*, 798 F.2d 1500, 1508 (D.C. Cir. 1986).
14. *Federal Trade Commission v. Libbey, Inc.*, 211 F.Supp.2d 34 (D.D.C. 2002).
15. *United States v. United Tote, Inc.*, 768 F.Supp. 1064, (Del. 1991).
16. *Federal Trade Commission v. CCC Holdings, Inc.*, 605 F.Supp.2d 26 (D.C. 2009).
17. *United States v. Rockford Memorial Corporation*, 717 F. Supp. 1251 (N.D. Ill. 1989), *aff'd*, 898 F. 2d 1278 (7th Cir. 1990).
18. *Federal Trade Commission v. Staples, Inc.*, 970 F.Supp. 1066, (D.D.C. 1997).
19. *United States v. Franklin Electric Co.*, 130 F.Supp.2d 1025 (W.D.Wis. 2000).
20. *State of California v. American Stores Company et al.*, 697 F. Supp. 1125 (C.D. Cal. 1988), *aff'd in part and rev'd in part on other grounds*, 872 F.2d 837 (9th Cir. 1989), *rev'd on other grounds*, 495 U.S. 271 (1990).
21. *Federal Trade Commission v. Illinois Cereal Mills*, 691 F.Supp. 1131 (N.D.Ill. 1988), *aff'd* 868 F.2d 901 (7th Cir. 1989).
22. *United States v. Mercy Health Services*, 902 F. Supp. 968 (N.D. Iowa 1995); *dismissed as moot* 107 F.3d 632 (8th Cir. 1997).
23. *United States v. Oracle Corporation*, 331 F.Supp.2d 1098 (N.D. Cal. 2004).

Although courts have recognized significant efficiencies related to production economies of scale,[51] operational efficiencies (i.e., spreading administrative costs

[51] United States v. Country Lake Foods, 754 F.Supp. 669, 680 (Minn. 1990).

over a broader organization),[52] capital avoidance,[53] and improved quality of services,[54] they have only done so in situations where the associated merger did not create market concentration concerns. In cases where mergers did create market concentration issues, similar types of efficiencies were almost always discredited.[55] Appendix I, at the end of this Article, contains a detailed analysis of the data supporting the market concentration and efficiency levels identified in the grid.

Courts' current treatment of efficiencies in Section 7 cases is troubling. Efficiencies are not being judged according to their individual merits, but rather in relationship to the other perceived anticompetitive effects of the merger. This means that identical sets of predicted efficiencies could be treated very differently in two different mergers.

It would be theoretically sound to find that a set of projected efficiencies justifies a merger in one context, but not in another due to the other anticompetitive effects of the deal, ***as long as this determination took place during the balancing portion of the analysis***. Unfortunately this is not what is currently occurring in the courts. Different merger contexts appear to be influencing whether the courts ***recognize*** the efficiencies in the first place. In situations without significant anticompetitive risks, courts are recognizing projected efficiencies as valid. In situations with competitive concerns, similar efficiencies are being characterized as unverifiable.

2. *Recognition of Efficiency Projections*

Courts use three main criteria to disregard efficiencies: verifiability, merger specificity, and ultimate consumer pass through. Although the 1992 Guidelines eliminated the more onerous "clear and convincing" evidentiary standard,[56] merging companies must still "substantiate" claims so they can be "verified."[57]

[52] United States v. Long Island Jewish Medical Center, 983 F.Supp. 121, 148 (E.D.NY 1997).
[53] Id. at 148-149.
[54] United States v. Carilion Health System, 707 F.Supp. 840, 849 (W.D.Vir. 1989), *affd* 892 F.2d 1042 (4th Cir. 1990) Unpublished opinion.
[55] Federal Trade Commission v. H.J. Heinz Co., 246 F.3d 708, 720 - 724 (D.C. Cir. 2001). See also Federal Trade Commission v. CCC Holdings, 2009 WL 723031, 39-42 (D.D.C. 2009).
[56] U.S. Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines* (1992), *reprinted in* 4 Trade Reg. Rep. (CCH), Sec. 13,104 (*1992 Guidelines*).
[57] Specifically, the 1997 Guidelines state "…the merging firms must substantiate efficiency claims so that the Agency can verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved (and any costs of doing so), how each would enhance the merged firm's ability and incentive to compete, and why each would be merger-specific. Efficiency claims will not be considered if they are vague or speculative or otherwise cannot be verified by reasonable means." See 1997 Guidelines, *supra* note 2, at Section 4.0.

This verification requirement has proven extremely challenging for companies to meet.[58]

By definition, efficiency claims, are based on future predictions, which makes it is easy for courts to discount them as too vague and speculative.[59] Information asymmetries contribute to the problem. Merging entities have sole possession of documents and information relating to projected efficiencies.[60] Courts understandably hesitate to give much weight to evidence produced, given concerns that corporations will selectively disclose information to support their efficiency claims, while ignoring data that might dampen their assertions.[61] Courts also tend to be critical of corporate efficiency projections that change over time, generally growing the closer the organization gets to a hearing or trial.[62] More credibility is attached to internal corporate documents that pre-date the merger agreement or letter of intent.[63]

Although it might seem reasonable to discount corporate projections that tend to fluctuate over time, the fact that a merging entity can better identify an increasing number of potential efficiencies with greater accuracy over time actually makes sense given the increased access to competitive information that is allowed the

[58] "Here, however, the appellees have failed to introduce sufficient evidence to demonstrate that their transaction would yield any efficiencies, and the district court's factual finding to the contrary is clearly erroneous." Federal Trade Commission v. University Health Inc., 938 F.2d 1206, 1222 (11th Cir. 1991). "Based on the review of the recent court cases (and abstracting from the hospital mergers), it would appear that the efficiency defense faces an impossibly high burden which as a practical matter, virtually precludes the operationalization of the efficiency defense." Coate, *supra* note 7, at 230-231.

[59] "Without significantly more evidence to substantiate the savings purported in this case, and without greater clarity on the state of antitrust law in this circuit, the defendants are unable to rebut the presumption here with an efficiencies defense." FTC v. Swedish Match, 131 F.Supp 2d 151, 172 (D.D.C. 2000). Some commentators argue that the same standard of proof should be applied to efficiencies that is applied currently to assertions that a transaction will be anticompetitive. Malcolm B. Coate & A.E. Rodriguez, *Pitfalls in Merger Analysis: The Dirty Dozen,* 30 N.M.L.REV. 227, 234 (2000).

[60] See Oliver E. Williamson, *Economies as an Antitrust Defense Revisited,* 125 U. PA. L. REV. 699, 703 (1977) (discussing how an "information-impactedness" condition provides the merging entities with a strategic advantage in determining what information to disclose). See also Mark N. Berry, *Efficiencies and Horizontal Mergers: In Search of a Defense,* 33 SAN DIEGO L. REV. 515, 542 (1996).

[61] See Rogers, *supra* note 48, at 518-519. See Arthur L. Scinta, *Early Experience with the New Efficiency Guidelines,* 11 SUM ANTITRUST 17, 20 (1997).

[62] "The court is initially suspicious of the defendants' savings schedule because of the relatively little attention placed on savings by the defendants in planning for and agreeing upon the merger. The formal study of efficiencies was hastily commenced well after the announcement of the merger." United States v. Rockford Memorial Corporation, 717 F. Supp. 1251, 1289 (N.D. Ill. 1989), *aff'd*, 898 F. 2d 1278 (7th Cir. 1990). See also Federal Trade Commission v. Staples, Inc., 970 F.Supp. 1066, 1089 (D.D.C. 1997).

[63] See Deborah A. Garza, *The New Efficiencies Guidelines: The Same Old Wine in a More Transparent Bottle*, 11 SUM ANTITRUST 6, 8 (1997).

closer one gets to the close of a transaction.[64] This pattern is typical and should be a source of reassurance that the transaction is proceeding normally, rather than a cause of distrust.

A second issue that arises when companies attempt to substantiate projected efficiencies relates to classification. Which types of efficiencies should count? Originally, both the Agencies and courts articulated a very narrow interpretation of efficiencies, one that focused mainly on manufacturing economies of scale.[65] In reality, however, a broad range of efficiencies can contribute to a company's ability to compete in the marketplace.[66]

In 1995 under the leadership of FTC Chairman Pitofksy,[67] the Federal Trade Commission launched an in-depth investigation focusing on the impact of increasing innovation and globalization on the U.S. economy. [68] The resulting report, *Anticipating 21st Century, Competition Policy in the New High-Tech Global Marketplace,* acknowledged the stiff competition that U.S. businesses were increasingly facing from foreign firms.[69] During two months of hearings, witnesses suggested various ways that the FTC could adjust its competition policy to avoid hamstringing U.S. firms' ability to compete in the new, innovation-based,

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[64] "To avoid setting a prohibitive burden, staff must understand the limitations HSR regulations place on the parties. In setting its bid for the target, the firm only has access to a limited amount of information. Once the bid is accepted, the firm obtains a little more access, as it can undertake "due diligence" to ensure the target's information on which it based its bid was accurate. Thus, it appears appropriate for the staff to expect efficiency analysis with a similar degree of specificity. Analyses formally submitted to the Board of Directors to justify the bid should be given great weight." Coate, *supra* note 7, at 195. See also SULLIVAN & GRIMES, *supra* note 8, at 584 (discussing limitations that exist on sharing confidential business information before a merger deal closes). Some commentators believe that the level of detail requested to verify efficiencies can create a "Catch 22" for merging entities. "The necessary level of detail also requires antitrust counsel avoid the Catch 22" of ensuring that the information is gathered by the merging parties to support the efficiency claims, but without constituting a premature exchange of competitive information prohibited under antitrust law." Scinta, *supra* note 61, at 20.

[65] For example, in *FTC v Cardinal Health,* the court stated that, "[e]fficiencies are cost savings generated by the increased economies of scale which result from mergers." Federal Trade Commission v. Cardinal Health, Inc., 12 F.Supp.2d 34, 61 (D.D.C. 1998). This traditional, narrow definition of efficiencies misses many of the potential ways that a merger can position an organization to be a more aggressive, better competitor (e.g., through R&D synergies).

[66] For example, Malcolm Coate points out that, "Other efficiencies will enable the creation of new markets as the reorganization generated by the merger allows the post-merger firm to serve a customer need previously precluded by high transaction costs. If these efficiencies are relevant, numerical balancing of effects becomes very difficult." Coate, *supra* note 7, at 226-227.

[67] Id. at 226.

[68] See *Anticipating the 21st Century: Competition Policy in the New High-Tech Global Marketplace,* A Report by the Federal Trade Commission Staff, Executive Summary, pg. 1 (May 1996).

[69] Id., Overview, pg. 2 & Executive Summary, pg. 1.

global economy.[70] At the top of the suggestion list were proposals to significantly adjust the Agency's treatment of merger-related efficiency claims.[71]

The 1996 FTC Task Force Report acknowledged specifically that marketplace changes were demanding new skills and capabilities. "Competition has begun to focus on the dimensions of innovation, such as speed of developing, producing, and marketing improved products and the ease of responding to shifts in customer demand and supplier capabilities."[72] Mergers can contribute to the competitiveness of American companies, not only by reducing manufacturing costs, but also through improving R&D, product development, marketing efforts, customer service capabilities, and other core competencies. These are factors that distinguished companies in the global marketplaces of 1996, and they will continue to do so in years to come. These efficiencies should also be "counted" in merger analysis.[73] As they are often difficult to verify, unfortunately, many of the efficiencies with the greatest potential to impact an organization's competitive position (e.g., complimentary R&D or product design capabilities) are not recognized by the courts.[74]

In addition to being "verifiable," efficiencies weighed in a Section 7 competitive analysis must also be "merger specific." The 1997 Guidelines state that "[t]he

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[70] Id., Executive Summary, pg. 1.

[71] Id., Chapter 2, pg. 11-14. "[A]ntitrust must take special care to weed out actions that harm competition while not discouraging others that are procompetitive. For mergers, this means antitrust must give more attention to efficiencies claims than it may have previously done." Id., Chapter 1, pg. 35.

[72] *Anticipating the 21st Century, supra* note 68, at Chapter 1, pg. 18.

[73] "When considering the likelihood that a transaction will create efficiencies that may affect post-merger competitive dynamics, the FTC should not foreclose examination of a potentially wide range of efficiencies (both product and process), from economies of scale and plant specialization to distributional, promotional, transactional, managerial, and innovation efficiencies that may differ from traditional efficiency claims." Id. at Chapter 2, pg. 32.

[74] Courts generally only recognize a narrow range of efficiencies, typically in cases where the underlying merger did not present much of an anticompetitive threat. See Garza, *supra* note 63, at 6. "Moreover, efficiencies that cannot be easily quantified are downplayed, even though these savings might really affect the marketplace. Attempts to quantify these qualitative savings simply set them up for formal rejection." Coate, *supra* note 7, at 231. "In the absence of reliable and significant evidence that the merger will permit innovation that otherwise could not be accomplished, the district court had no basis to conclude that the FTC's showing was rebutted by an innovation defense." Federal Trade Commission v. H.J. Heinz Co., 246 F.3d 708, 723 (D.C. Cir. 2001). "As to qualitative benefits to consumers, the defendants proclaim that the merger of SAH and RMH will provide the Rockford community with a first class regional tertiary referral center that will eventually rival tertiary referral centers in Madison, Chicago, Milwaukee and Rochester. The defendants promise that the number, depth, and quality of services at the hospital will improve… The court finds the defendants' intention to create a state-of-the-art tertiary referral center and all its corresponding benefits in quality and community development as irrelevant for the present Sec. 7 inquiry." United States v. Rockford Memorial Corporation, 717 F. Supp. 1251, 1288-1289 (N.D. Ill. 1989), *aff'd*, 898 F. 2d 1278 (7th Cir. 1990).

Agency will only consider those efficiencies likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects…"[75] Cost savings and other benefits won't be credited to a merger if there are other, less anticompetitive ways to achieve the same outcome.[76]

Although this may seem like a fairly straightforward and logical criterion, issues arise when courts attempt to assess this criterion. What "other" methods should be considered? What if the company could merge with a different, smaller organization, but that entity is unlikely to be receptive to a deal? What if a R&D joint venture were possible between three organizations in the field, but it would put an organization's critical trade secrets at risk?[77] Should these alternatives be considered?

Fortunately, the 1997 Guidelines clarified that only those alternatives that are operationally practical, instead of simply theoretical possible, should be considered.[78] Still, many commentators feel that the criterion ends up being used excessively to discredit efficiency claims.[79] In particular, courts often point to the fact that companies could achieve similar efficiencies through internal growth as a reason to take projected efficiencies out of the competitive analysis.[80] Although it

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[75] 1997 Merger Guidelines, *supra* note 2, at Section 4.0.

[76] "Finally the district court found that a merger of PPG and Swedlow might lead to the development of more sophisticated materials and/or transparencies… the gains to be derived from technological cooperation are not exclusive to a PPG-Swedlow marriage; cooperation with other market participants could yield similar results without causing the same market concentration." FTC v. PPG, Industries, 798 F.2d 1500, 1508 (D.C. Cir. 1986). See William J. Kolasky, *Convergence or Divergence? Antitrust at the Crossroads*, 16 FALL ANTITRUST 82, 86 (2001).

[77] Note that licensing contracts and joint ventures can sometimes provide less restrictive mechanisms for capturing efficiencies. See Pitofsky, *supra* note 35, at 243-244.

[78] "Only alternatives that are practical in the business situation faced by the merging firms will be considered in making this determination; the Agency will not insist upon a less restrictive alternative that is merely theoretical." 1997 Merger Guidelines, *supra* note 2.

[79] "Requiring defendants to prove that efficiencies will be merger-specific poses several problems. The requirement allows judges, juries, and antitrust regulators to second-guess defendants' business judgment and substitute speculation on hypothetical "less restrictive" alternatives." Piraino, *supra* note 12, at 798. "[M]erger parties usually cannot prove that their merger is likely to produce net efficiencies that could not otherwise be achieved." See Eleanor M. Fox., *The Efficiency Paradox*, at 78 in HOW THE CHICAGO SCHOOL OVERSHOT THE MARK edited by Robert Pitofsky, 2008.

[80] "Weighing the evidence before it, this Court finds that the Defendants have sufficiently proved that significant efficiencies would likely result from the proposed mergers… However, this Courts finds that evidence presented by the FTC strongly suggests that much of the savings anticipated from the mergers could also be achieved through continued competition in the wholesale industry. While it must be conceded that the mergers would likely yield cost savings more immediately, the history of the industry over the past ten years demonstrates the power of competition to lower cost structures and garner efficiencies as well." Federal Trade Commission v. Cardinal Health, Inc., 12 F.Supp.2d 34, 63 (D.D.C. 1998).

is true that many companies could eventually "grow" their way into cost savings (e.g., by spreading fixed costs such as manufacturing investments over a larger revenue base), internal, organic growth is typically a multi-year process that significantly delays an organization's ability to adjust its cost base to compete more aggressively. It often does not permit an organization to gain the same level of competitive advantage that a merger could provide.[81]

The final criterion that projected efficiencies must satisfy in order to be included in Section 7 competitive analysis is referred to as "consumer pass through."[82] Any efficiencies generated from the merger transaction must directly benefit consumers. They cannot simply contribute to an increased profit margin for the corporation. The benefit is most simplistically articulated as a price decrease, although other impacts such as improved quality or variety of products available to consumers also would fulfill this requirement.[83]

Interestingly, the 1997 Guidelines do not mention explicitly a consumer pass through requirement.[84] They do, however, acknowledge that efficiencies have the potential to decrease prices or increase product quality or variety;[85] thus an immediate price decrease is not always expected.[86] The courts, in contrast, often apply a consumer pass through test to efficiency claims;[87] the criterion is so difficult to prove that Robert Pitofsky, a former FTC Commissioner, labeled it a

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[81] See Berry, *supra* note 60, at 548.
[82] See Vernail, *supra* note 35, at 134.
[83] "…substantial economic benefits accrue even when firms do not lower their prices after a merger. Firms may, for example, use cost savings to fund increased spending on research and development, information technology, upgrades to plant and equipment, and other productivity improvements. Such investments benefit consumers, workers, investors, and local communities, and they promote the long-run economic welfare of our entire society." See Piraino, *supra* note 12, at 800.
[84] See also Deborah A. Garza, *U.S. Enforcement in Transition. Is the Past Prologue? A Comparative Analysis of the Clinton Antitrust Program and Suggestions of Changes to Come*, 15 SUM ANTITRUST 64, 65 (2001).
[85] "Efficiencies generated through merger can enhance the merged firm's ability and incentive to compete, which may result in lower prices, improved quality, or new products." 1997 Merger Guidelines, *supra* note 2, at Section 4.0.
[86] "Efficiencies also may result in benefits in the form of new or improved products, and efficiencies may result in benefits even when price is not immediately and directly affected." Id.
[87] "Because of these difficulties, we hold that a defendant who seeks to overcome a presumption that a proposed acquisition would substantially lessen competition must demonstrate that the intended acquisition would result in significant economies and that these economies ultimately would benefit competition, and, hence, consumers." Federal Trade Commission v. University Health Inc., 938 F.2d 1206, 1223 (11th Cir. 1991). "The Court's finding is guided, in part, by the reality that even if the merger resulted in efficiency gains, there are no guarantees that these savings would be passed on to the consuming public." United States v. United Tote, Inc., 768 F.Supp. 1064, 1084-1085 (Del. 1991). "The savings that will be passed on to the consumers in the form of lower prices in this case is at best speculative." FTC v. Swedish Match, 131 F.Supp 2d 151, 172 (D.D.C. 2000).

"killer qualification" ensuring that efficiencies will never make a difference in merger analysis.[88]

II. THE CHANGING LANDSCAPE: INCREASED ADMINISTRATIVE SCRUTINY OF M&A DEALS

Although intellectually troubling, the courts' inconsistent treatment of efficiency claims has not substantively impacted the level or character of M&A activity in the United States.[89] Over the past ten years, the low level of Section 7 enforcement activity has resulted in almost all mergers proceeding forward, regardless of whether they create pro-competitive efficiencies or not.[90] As the Obama administration takes office, however, stricter scrutiny of deals in concentrated markets is likely. As the pendulum swings back towards more aggressive antitrust enforcement, the importance of consistent efficiency analysis grows. Unless courts include the projected impact of merger-generated efficiencies on market dynamics, future enforcement proceedings will block pro-competitive deals.

a. The Obama Administration

The U.S. economy has had a very healthy rate of M&A activity over the last thirty years, despite the inattention paid to efficiencies in Section 7 cases. Efficiencies have not played a large role in court decisions regarding Section 7 preliminary injunctions, at least in part, because it was not necessary for them to do so.

Over the past eight years, the Administration has taken a very permissive view of mergers and acquisitions.[91] Only the most egregious transactions have been prosecuted. In this context, efficiencies are simply less relevant. If almost all mergers are approved, whether they create more competitive organizations or not,

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[88] See Pitofsky, *supra* note 35, at 208.

[89] See GAUGHAN, *supra* note 15, at 3-11 for an overview of recent M&A trends.

[90] See Jonathan B. Baker & Carl Shapiro, *Detecting and Reversing the Decline in Horizontal Merger Enforcement*, 22 SUM ANTITRUST 29 (2008)(asserting that in the past 10 years U.S. merger enforcement -- particular that led by the DOJ -- has become too lax).

[91] "Regrettably, the current administration has what may be the weakest record of antitrust enforcement of any administration in the last half century." Senator Obama, *supra* note **Error! Bookmark not defined.**, at 1. "With respect to mergers, I've already said that the statistics show that we are at a very low level of merger enforcement at the DOJ. The FTC is about where it usually is. I think that most lawyers think that the chance of getting a merger through review and cleared without challenge is vastly better today than it was ten years ago." Pitofsky, *supra* note **Error! Bookmark not defined.**, at 10. See Baker & Shapiro, *supra* note 90, at 29.

there is less need to identify the truly efficient deals.[92] Implementation of antitrust policy, however, shifts with each new administration.[93] In particular, recent Democratic administrations have taken a more aggressive stance regarding horizontal mergers.[94]

During his campaign, President Obama clearly identified that part of his agenda including "reinvigorating antitrust enforcement."[95] In a statement to the American Antitrust Institute during his campaign, Senator Obama noted that, "[a]t home, for more than a century, there has been broad bipartisan support for vigorous antitrust enforcement, to protect competition and to foster innovation and economic growth. Regrettably, the current administration has what may be the weakest record of antitrust enforcement of any administration in the last half-century… As president, I will direct my administration to reinvigorate antitrust enforcement. It will step up review of merger activity and take effective action to stop or restructure those mergers that are likely to harm consumer welfare, while quickly clearing those that do not."[96]

During the first six months of the Obama administration, signs of stricter antitrust enforcement have already emerged.[97] On May 11th, 2009, Christine Varney, the

[92] "Thus, merger efficiencies generally have been well recognized within merger law by imposing more stringent standards for proving a merger anticompetitive; there remains, however, the issue of whether, and how, antitrust law recognizes specific efficiencies in individual cases." Conrath & Widnell, *supra* note 22, at 686. Note that this is the horizontal merger enforcement policy that some Chicago School scholars consider optimal. Due to concerns about the Court's ability to properly weigh efficiencies, as well as a general disbelief in the anticompetitive impacts of most mergers, scholars such as Richard Posner would eliminate the efficiency defense and increase the concentration levels at which mergers raise antitrust concerns. See RICHARD A. POSNER, ANTITRUST LAW, 133-134 (2nd ed. 2001). This is the direction that U.S. policy has moved over the last ten years.

[93] "There remains, however, a concern that enforcement priorities shift too sharply with each new Assistant Attorney General in charge of the Antitrust Department, Chair of the FTC, and, of course, with each new administration. Although shifts in emphasis may reflect desirable flexibility and a healthy concern about new developments, serious questions may be raised about *ad hoc* case selection and sharply shifting priorities." MILTON HANDLER ET AL., TRADE REGULATION: CASES AND MATERIALS 114 (4th ed. 1997).

[94]During the Clinton Administration, both agencies were more inclined to litigate merger cases. Although the increased level of antitrust activity was at least in part due to an increased number of underlying merger transactions, the figures also reveal a more aggressive agency stance than in the prior administration. See Patterson, *supra* note 20, at 71-72. "The Clinton Administration antitrust agencies successfully brought antitrust back "on stage."" Id. at 72.

[95] Senator Obama, *supra* note **Error! Bookmark not defined.**.

[96] Id.

[97] Commentators have noted that President Obama's appointees have leanings toward behavioral economics. This could significantly impact antitrust enforcement under the new Administration. "The application of behavioral economics to merger analysis by the FTC and DOJ under Clayton Act Sec. 7 risks expanding the scope of agency review to reach transactions that were previously unassailable and imposing substantial costs without

newly appointed Assistant Attorney General for the Antitrust Division of the Department of Justice gave remarks to the Center for American Progress.[98] In her speech, she stressed the importance of vigorous antitrust policy, particularly in troubled economic times.[99] In addition to outlining how the agency intends to step up enforcement efforts, Varney officially withdrew an earlier Department of Justice report issued under the Bush administration that outlined an extremely conservative approach to enforcing Section 2 of the Sherman Act.[100] Her statements and actions made clear that the private sector should expect more aggressive antitrust enforcement in the years to come.[101]

b. The Ongoing Financial Crisis

The research for this article was conducted during the first twelve months of the financial crisis that began to affect the U.S. economy in 2008. This dramatic economic incident significantly affected public opinion regarding the ethics of corporate behavior. Current widespread fears of the "dangers" of big business, combined with public support for increased regulation, politically support more aggressive interpretation and enforcement of antitrust policy.

If the new, or for that matter any, future administration weighs the potential anticompetitive effects of M&A deals more heavily, efficiency concerns gain critical importance. Increased scrutiny of M&A deals is not necessarily harmful to our economy. Some deals have the potential to lessen competition and should be

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improving the predictive quality of agency merger review." Neil R. Stoll & Shepard Goldfein, *Obama's FTC: Merger Analysis to Become Exercise in Hindsight?*, 2009 N.Y.L.J. 3 (2009). "The Obama administration has swept away policy after policy from the Bush administration, and the top antitrust regulator, Assistant Attorney General Christine Varney, made it clear in her first speech this week that she's coming in with a very big broom." Tamara Lytle, *Obama's New Antitrust Rules Have Big, Powerful Companies Sweating,* U.S. News & World Report.com, Thursday, July 9, 2009.

[98] Christine A. Varney, *Vigorous Antitrust Enforcement in this Challenging Era, Remarks Prepared for the Center for American Progress* (May 11, 2009) *available at* www.usdoj.gov/atr/public/speeches/245711.htm.

[99] "Thurman Arnold's legacy of vigorous antitrust enforcement was thus a cornerstone of the New Deal's economic agenda and a part of that era's legacy for modern economic policy. The lessons learned from this historical example are twofold. First, there is no adequate substitute for a competitive market, particularly during times of economic distress. Second, vigorous antitrust enforcement must play a significant role in the Government's response to economic crises to ensure that markets remain competitive." Id. at 4.

[100] "For these reasons, I hereby withdraw the Section 2 Report by the Department of Justice. Thus, effective today, May 11, 2009, the Section 2 Report no longer represents the policy of the Department of Justice with regard to antitrust enforcement under Section 2 of the Sherman Act. The Report and its conclusions should not be used as guidance by courts, antitrust practitioners, and the business community." Id. at 8.

[101] "As antitrust enforcers, we cannot sit on the sidelines any longer – both in terms of enforcing the antitrust laws and contributing to sound competition policy as part of our nation's economic strategy." Id. at 5.

stopped. Others, however, that are based on substantial synergies could actually increase competition. If the Agencies begin blocking deals at lower levels of market concentration, it is imperative that both the Agencies and the courts focus on sorting out the truly efficient transactions from the rest. Failure to do so would hinder the competitiveness of U.S. companies in concentrated markets.

Many scholars believe U.S. entities to already be at a significant disadvantage competitively vis-à-vis their international peers, particularly in important areas such as R&D.[102] Although it is true that foreign companies often face aggressive antitrust regimes in their home markets,[103] limiting the ability of U.S. firms to execute value-creating transactions in concentrated markets will only hurt further American organizations' global market position.[104] As the Agencies, and particularly the courts, struggle with the difficult task of weighing efficiencies it is important that they consider the full range of efficiencies – including the most strategic synergies such as R&D, product development, IP, and marketing skills. Only by taking all of the potential sources of competitive advantage into consideration, will value-enhancing deals be recognized.

The transparency and consistency of section 7 determinations is essential for the U.S. merger and acquisition market to function most effectively.[105] Although the vast majority of mergers proceed without raising antitrust issues,[106] corporations in concentrated markets need a concrete understanding of what factors the Agencies and courts will consider and how they will weigh them. Without this, it is very

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[102] In 1999, Pitfosky observed that many believed American R&D efforts to be lagging behind other countries. Pitofsky, *supra* note 35, at 241. He also noted that in many markets such as steel, autos, and coal, U.S. companies were struggling due to the competitive positioning of other countries' markets. Id. at 227-228.

[103] See Kyle Robertson, *One Law to Control them All: International Merger Analysis in the Wake of GE/Honeywell,* 31 B.C.INT'L & COMP. L. REV. 153, 158-159 (2008).

[104] Over a decade ago, former FTC Chairman Robert Pitofsky pointed out the negative impact that U.S. antitrust policy can have on the competitiveness of US companies, if efficiencies are not properly considered. As he noted, "… few would argue that the failure of United States enforcement agencies and courts to take into account efficiency, productivity, and innovation considerations in merger analyses was the principal cause of American firms' difficulties in international trade. Nevertheless, in some market situations, consideration of such factors could result in permitting otherwise illegal mergers and could make a significant difference in the ability of firms to compete in international trade…t]he welfare of the United States – as producers, consumers, and citizens – depends on the ability of U.S. firms to compete effectively in world markets." …" Pitofsky, *supra* note 35, at 198-208. It is important that our domestic antitrust policy does not undercut this important goal. This does not mean that we need to sacrifice domestic markets in order to create a super efficient "national champion" competitor. It does mean, however, that we need to recognize the powerful pro-competitive impacts that merger-generated efficiencies can have on US firms' ability to compete – both at home and abroad.

[105] "Without clear guidance, business executives are more likely to miscalculate, avoiding transactions that could promote the productivity of the American economy and pursuing mergers that are harmful to consumers." Piraino, *supra* note 12, at 805.

[106] See Pitofsky, *supra* note 32, at 1413.

difficult for these organizations to judge whether contemplated actions will run afoul of the Clayton Act.[107]

The Agencies are aware of this issue. The Federal Trade Commission's 1996 report, *Anticipating the 21st Century – Competition Policy in the New High Tech, Global Marketplace*, noted that witnesses requested even greater transparency about why certain activities were challenged while others were not.[108] In 1997, former FTC Chairman Robert Pitofsky explicitly acknowledged this issue at a Roundtable Conference with Enforcement Officials.[109] "Finally, let me say a few words about a subject that I have not discussed, and which is rarely discussed at these meetings, and that is the question of transparency. I feel that there is a responsibility on the part of enforcement agencies like ours to let people know what we're doing and why we're doing it, and what we're not doing and why we're not doing that."[110] Administrative decisions that recognize efficiencies in one context, but deem the exact same claims unverifiable in another, undercut this important goal.

Fortunately, since former Chairman Muris's observation in 1999, the Agencies have attempted to alter this trend.[111] Evidence exists that the Agencies now evaluate efficiency considerations based on their independent merits and that such assessments do impact Agency determinations of whether to exercise prosecutorial discretion.[112] Furthermore, the Agencies have continued to acknowledge and

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[107] "The courts and agencies have developed a checklist of relevant factors to consider, but they have been unable to define when particular factors should be dispositive of a merger's legality. As a result, the courts and agencies have become more likely to miscalculate either by allowing anti-competitive mergers to proceed or by precluding transactions beneficial to consumers. This lack of clear guidance from the courts and agencies has left both practitioners and business executives confused as to the legality of particular mergers." Id. at 786.

[108] See *Anticipating the 21st Century, supra* note 68, at Exec. Sum., pg. 10.

[109] Robert Pitofksy, *supra* note **Error! Bookmark not defined.**, at 933.

[110] Id.

[111] In 2002, while serving as Chairman of the FTC, Timothy Muris stated, "I want to encourage the presentation of solid, credible efficiencies evidence. I also want to reassure antitrust counsel that such evidence will be taken seriously… I do not expect that substantial efficiencies studies will be presented in very many cases. I do hope that they occur with more frequency than current practice… Solid efficiency presentations will better enable the Commission to identify and forego challenging those mergers with bona fide efficiencies that benefit consumers. Timothy Muris, *Understanding Mergers: Strategy and Planning, Implementation, and Outcomes,* pg. 2, available at http://www.ftc.gov/speeches/muris/mergers021209.shtm.

[112] For example, in 2002, the FTC chose not to prosecute the 4-to-3 merger of AmeriSource Health Corporation and Bergen Brunswick Corporation in the drug wholesale industry. Projected efficiencies factored into this decision. "We also noted that based on our review of the efficiencies, the proposed transaction likely would give the merged firm sufficient scale to allow it to become more cost-competitive with the two leading firms and to invest in the value-added services customers desired. Further, we believed that the combined firm could initiate these improvements more rapidly than either could do individually, and that

respond to the market's need for greater transparency. With these goals in mind, in 2006 the FTC & DOJ released a new report, *Commentary on the Horizontal Merger Guidelines,* which explains current Agency frameworks and analysis and provide case examples.[113] The issue of transparency and consistency, however, has not gone away. It has simply relocated from Agency offices to the courtroom.

The Courts do not appear to be engaging in any true balancing analysis that weighs the projected anticompetitive effects of a merger with the predicted pro-competitive merger-specific efficiencies.[114] Instead, they seem to be considering the other anticompetitive effects of the merger when determining whether to recognize the merger-specific efficiencies in the first place.

Although this approach may result in the same ruling in a particular case (i.e., a preliminary injunction could be granted either because the court does not recognize the claimed efficiencies or because it recognizes the claimed efficiencies, but does not find them great enough to offset other projected anticompetitive effects), it does not provide market participants with the consistent, transparent information they need concerning which efficiencies "count." As scrutiny of M&A deals grows, this inconsistency will hinder U.S. corporations from executing value creating M&A deals in concentrated markets.

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this timing advantage would be significant enough to constitute a cognizable merger-specific efficiency." Id. at 1. See also Thomas B. Leary, *Efficiencies and Antitrust: A Story of Ongoing Evolution,* 2002 WL 31512400 (F.T.C.) at 9-10 (explaining how efficiencies considerations are incorporated into Agency review). See also Malcolm B. Coate & Andrew J. Heimert, *Economic Issues: Merger Efficiencies at the Federal Trade Commission 1997-2007* (2009), *available at http://www.ftc.gov/os/2009/02/0902mergerefficiencies.pdf.*

[113] "Today, to provide greater transparency and foster deeper understanding regarding antitrust law enforcement, the Agencies jointly issue this Commentary on the Guidelines. The Commentary continues the Agencies' ongoing efforts to increase the transparency of their decision-making processes." Federal Trade Commission & U.S. Department of Justice, *Commentary on the Horizontal Merger Guidelines,* Foreword, pg. v (2006) available at http://www.usdoj.gov/atr/public/guidelines/215247.htm. Despite Agency efforts, many observers still believe transparency to be an unresolved issue. See SULLIVAN & GRIMES, *supra* note 8, at 605.

[114] In 2003, one commentator observed that, "[f]or their part, the lower federal courts have not found it necessary to balance the potential anti-competitive effects of mergers against efficiencies. Courts have tended to reject efficiency claims in cases in which they have already concluded that a merger will be anti-competitive and to credit such claims to support their conclusion that a merger does not pose a serious competitive threat. In no case have efficiencies saved a merger that would otherwise be deemed anti-competitive." Piraino, *supra* note 12, at 795. In 2005, Malcolm Coate made a similar observation stating, "Efficiencies only appear relevant when the structural presumption is weak and so the court has to balance qualitative evidence of price effects with qualitative evidence of efficiencies." Coate, *supra* note 7, at 231.

III. THE IMPACT OF JUDICIAL TREATMENT OF EFFICIENCIES ON CORPORATE M&A NEGOTIATION DECISIONS

For over fifty years, law and economics scholars have analyzed antitrust policy using microeconomic market models and econometric tools. Law and economics, however, is not the only lens through which Section 7 Clayton Act cases can be viewed. This section of the Article applies frameworks from the negotiation field to analyze how, in a regime of stricter antitrust enforcement, judicial treatment of the efficiency defense affects individual corporate M&A negotiation decisions. When considered in aggregate, these individual corporate decisions affect the size, shape and character of U.S. M&A activity in concentrated markets. As will be discussed, courts' current application of the efficiency defense would hamstring corporations from using mergers and acquisitions as an effective tool to build more competitive organizations.

a. Sources of Value Analysis

The traditional view of negotiation that many people hold is best described as a "zero sum" haggle.[115] A simple case illustrates this point. Assume that Acme Corp. is looking for a particular piece of used industrial equipment needed for a new manufacturing facility; they discover that Beta Inc, a local company, has the equipment at a nearby plant. If the only variable under negotiation is price, every dollar or concession that Acme wins, Beta loses. If Beta agrees to lower the price by $350,000, Acme gains because Beta has agreed to give up $350,000. This interaction is described as "zero-sum" due to the two entities' collective inability to do anything more than decide how to allocate a fixed set of resources between themselves.[116]

Over the last thirty years, scholars in the negotiation field have put forth an alternative model for describing and analyzing more complex negotiations. This integrative framework[117] suggests that many negotiations that are often perceived by negotiators to be zero-sum are not in fact zero-sum.[118] Opportunities exist to use the negotiation process not only to split up a fixed set of resources, but also to

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[115] ROGER FISHER, WILLIAM URY, & BRUCE PATTON, GETTING TO YES: NEGOTIATING AGREEMENT WITHOUT GIVING IN 3-4 (2nd ed. 1991).

[116] For a discussion of how negotiators are often trapped in a "zero-sum mindset," see ROBERT H. MNOOKIN, SCOTT R. PEPPET, & ANDREW TULUMELLO, BEYOND WINNING, NEGOTIATING TO CREATE VALUE IN DEALS AND DISPUTES 168 (2000). See also LEIGH THOMPSON, THE MIND AND HEART OF THE NEGOTIATOR 113 (1998).

[117] See MAX H. BAZERMAN & MARGARET A. NEALE, NEGOTIATING RATIONALLY 67-76 (1992). See MNOOKIN, PEPPET, &TULUMELLO, *supra* note 116, at 254-271. See Bruce Patton, *Negotiation, in* THE HANDBOOK OF DISPUTE RESOLUTION 279, 279-285 (MICHAEL L. MOFFITT & ROBERT C. BORDONE, ED., 2005). See HOWARD RAIFFA WITH JOHN RICHARDSON & DAVID METCALFE, NEGOTIATION ANALYSIS: THE SCIENCE & ART OF COLLABORATIVE DECISION MAKING 195-212 (2002).

[118] See BAZERMAN & NEALE, *supra* note 117, at 16-22.

see if ways exist for negotiators collectively to identify options that might enlarge the resources jointly available to them or to split the resources in a way that increases the value to each side.

For example, in the scenario described above, in addition to getting as much money for the equipment as possible, it is possible that the executives from Beta Inc. have a few other important interests. Beta may still have a few weeks of manufacturing runs scheduled in the nearby plant, so although they would like to finalize an agreement to sell the equipment as soon as possible, they would rather not transfer ownership of the machinery until the end of the month. Beta Inc. may also be facing some type of cash crisis. Although the total amount of money that they receive for the equipment is important, it is possible that they would be willing to reduce the final sale price in order to obtain a cash advance.

Depending upon Acme Corp's situation, it may not be very costly for them to accommodate Beta Inc. on some of the things that they value. If Acme's new manufacturing facility will not begin operations for a few weeks, they may be willing to postpone the actual transfer of ownership of the equipment, if they would receive a discount on the sale price. If the two companies can jointly craft an option that addresses this concern and which each would find superior to a simple straight sale, they have created value.[119]

Similarly, it is possible that Acme's cash flow situation would allow them to forward a portion of the sales price in advance as part of the deal. If this accommodation were possible, Acme may be willing to agree to this term as part of the overall deal, particularly if Beta Inc. would compensate Acme at a rate greater than they are currently earning in their investment accounts. By exploring creative options to address each of these issues – the date on which title of the equipment transfers and an advance of funds – the two companies have created value.

Recent negotiation literature provides a useful framework for identifying opportunities to create value when negotiating deals.[120] Specifically, parties can look for creative options that (1) leverage scale economies, (2) identify shared interests, (3) take advantage of differences in resources and capabilities, relative valuations, predictions, risk preferences, and time horizons, and (4) minimize transactions costs and moral hazards.[121] These opportunities enable negotiators to

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[119] Economists analyze potential deals by determining the total "utility" that each negotiator assigns to the various options available to them. Options which increase one party's total utility without reducing the other party's total utility create value as they enlarge the total utility points that can be divided between the parties. For an applied discussion of pareto optimality, see HOWARD RAIFFA, THE ART & SCIENCE OF NEGOTIATION 135-142 (1982).
[120] See DAVID A. LAX & JAMES K. SEBENIUS, THE MANAGER AS NEGOTIATOR: BARGAINING FOR COOPERATION AND COMPETITIVE GAIN 88-112 (1986); See Michael L. Moffitt, *Disputes at Opportunities to Create Value, in* THE HANDBOOK OF DISPUTE RESOLUTION 173, 176-181 (MICHAEL L. MOFFITT & ROBERT C. BORDONE ed. 2005).
[121] Id.

maximize the potential value of a deal before it is distributed between the parties, to achieve the "win/win" to which people so often refer.

In the context of mergers and acquisitions, the value creation framework from the negotiation field provides a useful tool to analyze potential deals. If one looks at a potential acquisition or merger through a zero-sum bargaining lens, the negotiation dynamics appear quite simple. Putting aside agency and multi-party issues,[122] the critical question appears to be how much Corporation A will pay for Corporation B's stock or assets. Every dollar more that Corporation A pays, is a dollar gained for Corporation B's shareholders. Likewise, every dollar less that Corporation A pays comes out of the pockets of Corporation B's shareholders.

Although there certainly are distributional aspects of an M&A deal, there are at least two points in time when sophisticated negotiators can move the discussion out of the zero-sum realm. The first critical point in time is when the attorneys are negotiating the M&A agreement.[123] In addition to designating a particular sales price, a well-drafted document also creates value by reducing the many transaction costs and risks of the deal.[124] For example, well-crafted representations and warranties, accompanied by indemnification clauses, reduce the risk of misinformation between sellers and buyers.[125] Earn-out or contingent-pricing agreements help negotiators come to an agreement when buyers and sellers have differing forecasts regarding future performance.[126] Covenants help ensure that the two parties' incentives remain aligned during the period between the time when the

[122] These are obviously important factors that contribute to the overall negotiation dynamic. Agency issues arise when corporate officers and board members, with differing interests, are involved in the negotiation process. For an in-depth analysis of how principal/agent issues can affect negotiation dynamics, see MNOOKIN, PEPPET, & TULUMELLO, *supra* note 116, at 69-91.

[123] "[P]eople hire transactional lawyers because they add value to the deal. This conception of the lawyer's role rejects the zero sum mentality. Instead, it claims that the lawyer makes everybody better off by increasing the size of the pie… For the most part, lawyers increase the size of the pie by reducing transaction costs." STEPHEN M. BAINBRIDGE, MERGERS & ACQUISITIONS 4-5 (2003).

[124] "I suggest that the tie between legal skills and transaction value is the business lawyer's ability to create a transactional structure which reduces transaction costs and therefore results in more accurate asset pricing." Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing,* 94 YALE L.J. 239, 255 (1984) (asserting that effective business attorneys function as "transaction cost engineers," thus creating value in deals). "The returns on even a mediocre deal can be enhanced for the buyer through artful deal design." BRUNER, *supra* note 16, at 40.

[125] Gilson, *supra* note 124, at 282.

[126] "… there is a familiar remedy, commonly called an "earnout" or "contingent price" deal for this failure of homogeneous-expectations assumption. It is intended, as a prominent practitioner has put it, to "bridge the negotiating gap between a seller who thinks his business is worth more than its historical earnings justify and a purchaser who hails from Missouri."" Id. at 263. "Two studies have reported that the returns to buyers are higher when the payment is structured to be contingent on meeting future performance benchmarks." BRUNER, *supra* note 16, at 34.

merger agreement is negotiated and the transaction closes. Each of these structural agreements helps reduce risk, and thus increases the value of the deal to each side.

A second point in time when value creation occurs is much earlier in the deal making process. If the transaction is analyzed from the point in time when Corporation A initially decided that it would like to explore an acquisition, the company can create additional value by identifying the best target acquisition.

When firms decide to make an acquisition, they do not usually immediately single out a particular firm to purchase. Instead, they generally engage in a lengthy and in depth scanning and evaluation process to identify potential targets and assess their value.[127] The acquirer is not simply looking to understand the intrinsic worth of potential targets. In the case of public companies this calculation would be a fairly straightforward analysis if one accepts market value as a reasonable proxy for stand-alone worth.

Instead, what companies are analyzing are potential synergies. If the two companies were to merge their operations, what synergies or efficiencies might be attained? How could they use their different resources, capabilities, relationships, and intangible assets to operate more effectively as one combined unit? Through the lens of negotiation theory, acquirers are engaging in one of the value creation phases of negotiation. They are attempting to "enlarge the pie" before they negotiate over how big of a piece each entity is going to get.

Applying the value creation framework from the negotiation literature to the mergers and acquisitions context highlights the numerous potential opportunities for M&A deals to create efficiencies.[128] Some example places where value might be created include:

1. ***Leverage Scale Economies***
    - Leverage manufacturing economies
    - Leverage existing corporate infrastructure by reducing combined staffing in general counsel's office, human resources, IT, etc.
    - Leverage purchasing economies (i.e, qualifying for discounts due to combined quantities of goods purchased)
    - Leverage promotional / marketing economies
    - Leverage necessary R&D investments such as duplicative, expensive physical hardware

2. ***Identify Shared Interests***

[127] Gilson, *supra* note 124, at 271.
[128] There is a strong body of literature recognizing the significant synergies, or efficiencies, that mergers can create. See Pitofsky, *supra* note 35, at 208. See Gregory J. Werden, *An Economic Perspective on the Analysis of Merger Efficiencies,* 11 SUM ANTITRUST 12, 12 (2001)(identifying a broad range of efficiencies generated by horizontal mergers).

- Clear, consistent, proactive communication to stakeholders (i.e., employees, customers, shareholders)
- Quick Hart-Scott-Rodino Merger Review Process

3. ***Take advantage of Differences in Resources & Capabilities***
   - Leverage each firms unique intellectual property
   - Leverage strongest brands
   - Leverage access to less expensive capital
   - Leverage specialized manufacturing facilities
   - Identify and promote strongest managers in each area
   - Leverage unique R&D skills and capabilities

4. ***Take advantage of Differences in Relative Valuations***
   - Certain resources (e.g., established distribution channels) may be worth more to acquirer than target

5. ***Take advantage of Differences in Projections***
   - Acquirer may have more optimistic view of target company market (e.g., future profitability, growth rate, etc.)

6. ***Take advantages of Differences in Risk Preferences***
   - If acquirer is larger and more diverse, acquisition may enable management to take on more risks (if target business only represents one of many initiatives in a broad portfolio)

7. ***Take advantage of Differences in Time Horizons***
   - If acquirer is a private company, acquisition may enable management to focus on long term strategic goals, rather than short term earnings per share targets[129]

8. ***Minimize Transaction Costs and Moral Hazards***
   - Reduce time period of uncertainty
   - Reduce potential litigation costs
   - Take advantage of the merged entity's ability to operate more efficiently by conducting business within the firm rather than in the marketplace[130]

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[129] Managers of public companies often feel immense pressure to hit quarterly earnings per share ("EPS") targets. See DAVID R. HERWITZ & MATTHEW J. BARRETT, ACCOUNTING FOR LAWYERS 538-539 (4th ed. 2006) (reprinting sections of Arthur Levitt's Sept. 1998 Remarks on "The Numbers Game" to NYU Center for Law and Business. Available online at http://www.sec.gov/news/speech/speecharchive/1998/spch220.txt.)

[130] Economists label this source of value "transactional efficiencies." See Williamson, *supra* note 60, at 723-724. "The New Institutional Economist (Institutionalist) would accept the neoclassical analysis and add another layer of efficiencies defined by reductions in the transaction costs associated with the market economy. To the extent mergers reduce the transaction costs of the relevant organizational structure, these efficiencies must be added into the merger analysis." Coate, *supra* note 7, at 191.

Sophisticated businesses engage in this value creation process as they look for potential acquisition targets that best match their own organization's skills, capabilities, people and resources. The process is not a one-shot evaluation, but instead an ongoing process. It is hard work to uncover potential synergies, particularly ones "real" enough that corporate officers and board members are willing to stake their futures on them. In the end, the acquirer is likely to pay a considerable premium for the company they purchase; the only rational reason to do so is the belief that this "cost," and more, can be recouped via synergies.[131] If not, the transaction destroys shareholder value.

Only over time, as the acquirer learns more detailed information about the potential target, can they best assess the feasibility of possible synergies. Of course, not all competitive information can be shared – at least not directly or at early stages of the deal.[132] Merging parties must be careful not to share directly confidential, competitive information (e.g., pricing schedules) until the deal closes, or they risk violating antitrust rules.[133] Much information can be shared; however, it takes time to identify and analyze it. For this reason, a company's identification and projection of potential synergies should become more accurate, as they gain access to more detailed information about the acquisition target. Obviously, there are no crystal balls. Projected synergies can never be 100% accurate; some underlying assumptions will always be off. But, with careful research and analysis, the estimates can be grounded in reality.

This value creation negotiation process, of companies scanning, identifying, analyzing, and discussing potential acquisition possibilities, is extremely beneficial to the competitiveness of the U.S. economy. By exploring differences in capabilities, resources, risk preferences, and other opportunities for value creation, organizations are joining forces in ways that make them more efficient and effective competitors. This is market behavior that should be encouraged, particularly as domestic companies face stronger and stronger pressure from international entities. Only be allowing our domestic companies to position themselves in as competitive a structure as possible, can they outperform their international peers.

The problem, however, is that many of the most important potential synergies, those that have the ability to create the greatest long-term value, are generally

[131] "The anticipated existence of synergistic benefits allows firms to incur the expenses of the acquisition process and still be able to afford to give target shareholders a premium for their shares. Synergy may allow the combined firm to appear to have a positive *net acquisition value* (NAV)." GAUGHAN, *supra* note 15, at 124. Note, however, that acquisition premiums cannot always be justified by obtainable synergies and instead are sometimes better explained by managerial hubris. Id. at 157-158.

[132] See SULLIVAN & GRIMES, *supra* note 8, at 584. Some companies do use consultants and "clean teams" to share confidential information pre-close that is necessary for integration planning.

[133] Id.

discounted in Section 7 merger challenges.[134] What separates good companies from great, long lasting organizations? It is generally not the 3% variable cost manufacturing efficiencies most easily recognized by the Agencies and the courts as true, verifiable efficiencies in a Section 7 challenge.[135] Instead, it is other more strategic capabilities such as R&D strength, innovation culture, product development skills, distributional relationships, developed intellectual property, customer market capabilities, data mining skills, etc.[136] These capabilities are the building blocks of competitive organizations.

The Federal Trade Commission's 1996 report, *Anticipating the 21st Century – Competition Policy in the New High Tech, Global Marketplace*, noted that in today's markets, competition is not limited to price alone; instead organizations must compete on a variety of levels including product development, variety, speed and innovation.[137] In particular, the report emphasized that innovation efficiencies can contribute significantly to competitive dynamics.[138]

As noted in the report, "[c]ompetitor collaborations are also important for staying at the forefront in markets characterized by innovation-based competition. Such combinations may allow firms to assemble complementary assets in order to produce new and improved technologies or goods or may enable the massive funding needed to pursue certain R&D."[139] Complementary technologies enable firms to generate new and improved products, thus fueling competition.[140]

Ideally, U.S. antitrust policy should recognize the strength of these valuable synergies and encourage domestic entities to leverage them to build as competitive of organizations as possible. The FTC report advises the Agencies to consider a broad range of efficiencies in merger analysis including economies of scale and plant specialization, as well as distributional, promotional, transactional, managerial, and innovation efficiencies.[141] Although the Agencies may have

[134] "Efficiencies of this kind, whether they are called innovation or managerial economies, are probably the most significant variable in determining whether companies succeed or fail – or in determining whether certain more specific merger efficiencies are achieved or not. Yet, we do not overtly take them into account when deciding merger cases." Leary, *supra* note 112, at 13.

[135] In remarks to the ABA Section of Antitrust Law in 2002, Commissioner Leary stated "…it seems clear that we do not deal in a transparent and rigorous way with the less tangible efficiencies, which nonetheless may be the most important. We do consider them internally and informally, but discount them altogether in a contested transaction because they are often difficult to quantify. We should do more to reconcile our public and our non-public practice." Id. at 14.

[136] "Economists believe that society benefits far more (real income rates grow faster) from dynamic efficiency than from allocative efficiency." SULLIVAN & GRIMES, *supra* note 8, at 16.

[137] *Anticipating the 21st Century, supra* note 68, at Executive Summary, pg. 1.

[138] Id. at Chapter 2, pg. 32.

[139] Id. at Executive Summary, pg. 1.

[140] Id. at Chapter 2, pg. 26.

[141] Id. at Chapter 2, pg. 32.

started to heed this advice,[142] the courts, unfortunately, have not. Instead they continue to generally ignore the pro-competitive impact of these important strategic synergies.

The private sector takes note of these rulings. Each time a Section 7 preliminary injunction is granted and part of the Court's decision is based on the determination that efficiencies such as those outlined above are not verifiable, a message is sent to business people across the country.[143] That message, unfortunately, states that none of these important efficiencies, these synergies that could help their companies become stronger, count.

In cases in which a merger challenge is feasible, corporate boards and executives need to be very wary of basing their decision to merge on any long-term strategic efficiencies. From a negotiation perspective, this outcome is devastating. In situations in which a merger challenge is feasible, corporate officers are not given the ability to fully engage in an important value creation phase of M&A negotiations. This is a sub-optimal outcome for the individual negotiators and for our economy.

b. BATNA and Decision Analysis

The second set of tools from the negotiation field that this article will apply to the mergers and acquisition context involve Best Alternative to a Negotiated Agreement ("BATNA") & decision analysis. A central question that all negotiators face is whether they should accept the final offer made by the other side. Is it good deal? Will the negotiations be considered a success?

Current negotiation theory suggests a variety of factors that negotiators can assess to determine the answer to this critical question.[144] Does the deal satisfy the organization's key interests? Have the negotiators explored all potential value-creating options? Is the agreement durable? One of the key questions to ask is what the organization will do if they do ***not*** come to an agreement. Of all of the

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[142] See e.g., Muris, *supra* note 111, at 1.
[143] For example, in *U.S. v. Rockford Memorial Corp.,* the Court completely discredited all of the efficiencies that would enable the merged company to provide better quality products and services. "As to qualitative benefits to consumers, the defendants proclaim that the merger of SAH and RMH will provide the Rockford community with a first class regional tertiary referral center that will eventually rival tertiary referral centers in Madison, Chicago, Milwaukee and Rochester. The defendants promise that the number, depth, and quality of services at the hospital will improve… The court finds the defendants' intention to create a state-of-the-art tertiary referral center and all its corresponding benefits in quality and community development as irrelevant for the present Sec. 7 inquiry." United States v. Rockford Memorial Corporation, 717 F. Supp. 1251, 1288-1289 (N.D. Ill. 1989), *aff'd*, 898 F. 2d 1278 (7th Cir. 1990). The role of the courts in defining antitrust policy for the private sector is very important. See Melamed, *supra* note **Error! Bookmark not defined.**, at 11.
[144] See Patton, *supra* note 117, at 285-286.

possible alternatives to this particular deal, which one is most attractive? A negotiator's best alternative to a negotiated agreement is referred to as their "BATNA."[145] It is essential that negotiators have both identified their BATNA and taken any feasible steps to improve their BATNA.[146]

Assume that in the previously described negotiation scenario, Beta has offered to sell Acme the used industrial equipment for $2.3 million. How should the Acme executives decide whether to accept the offer? There are obviously many factors that they can consider. Does the equipment meet their organization's manufacturing needs (e.g., versatility, age, speed, etc.)? Are there any established market rates for similar used machinery? Have the two companies explored all the potential ways to enhance the value of the deal (e.g., reducing the price of the equipment in exchange for a cash advance)? One of the most important questions, however, is how this deal compares to Acme's BATNA. Specifically, what will Acme do if the two companies don't come to an agreement?

Sometimes a negotiator's BATNA will be concrete. In the example described above, if Acme does not purchase Beta's equipment, they may have decided that their best alternative course of action is to purchase new equipment that costs $3.7 million. In other situations, however, one's BATNA can involve greater levels of uncertainty.[147] When an entity's BATNA involves uncertain events, many organizations use decision trees to aid in BATNA analysis, as they provide a logical way to map out and assess the likelihood and "predicted value" of different potential outcomes.[148]

BATNA & decision analysis tools provide an interesting lens through which to evaluate the impact of current efficiency defense doctrine on individual corporate M&A negotiation decisions. A corporation contemplating an acquisition that potentially raises Section 7 issues must decide whether to move forward with the negotiated deal or to proceed with their BATNA (i.e., either to take no action or explore other potential transactions).[149] In an M&A context, proceeding with the acquisition deal can involve significant uncertainty. Specifically, the corporation

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[145] See FISHER, URY & PATTON, *supra* note 115, at 99-100.

[146] Id. at 103-105. See THOMPSON, *supra* note 116, at 26.

[147] For example, settlement negotiations that involve litigation as a BATNA involve high levels of uncertainty that must be assessed. See MNOOKIN, PEPPET, & TULUMELLO, *supra* note 116, at 109-111 for a discussion of how decision trees can be used in litigation contexts to determine the expected value of a case.

[148] For a practical explanation of how to use decision tree analysis to support negotiation choices, see Marjorie Corman Aaron, *Chapter 13: Finding Settlement with Numbers, Maps, and Trees, in* THE HANDBOOK OF DISPUTE RESOLUTION 202, 202-218 (MICHAEL L. MOFFITT & ROBERT C. BORDONE ED., 2005). See also Jeffrey M. Senger, *Decision Analysis in Negotiation,* 87 MARQ. L. REV. 723, 723-735 (2004).

[149] Many corporations that face pre-merger challenges will either abandon the deal or attempt to negotiate a settlement with the Agency. See SULLIVAN & GRIMES, *supra* note 8, at 580.

does not know whether the Agencies will take issue with the transaction, and, if so, whether the Court will issue a preliminary injunction blocking the deal.

Although the vast majority of M&A deals do not raise antitrust concerns,[150] for those that do, this uncertainty can be devastating.[151] Once a potential deal is announced, employees, customers, and shareholders are all generally anxious about the impact of the transaction. Although the merging organizations can address some of the issues raised through proactive and consistent communication, they are not in a position to take unified action such as announcing which managers will head new merged departments, issuing new pricing lists, or shutting down manufacturing facilities until the transaction has closed.[152]

The longer the waiting period extends - either due to a second request or a trial regarding a preliminary injunction - the greater risk the corporation faces of losing key employees, key customers, and general business momentum. Distraction is a significant issue. Few managers and employees can maintain full focus on their normal business goals and tasks when massive organizational change looms in the future. For this reason, most transactions are abandoned if challenged by the government.[153] Even worse, preliminary injunctions are generally considered to be "deal killers."[154]

Transparency, is therefore critical. When assessing whether to move forward with a proposed deal, corporate negotiators need as much insight as possible as to how both the Agencies and the Courts will evaluate their transaction.[155] As noted

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[150] See Leary, *supra* note 112, at 16.

[151] In order to protect and build the value of the merging organizations, the post-merger integration process must proceed as quickly as possible. Any type of uncertainly injected into the process, whether from antitrust concerns or other issues, can be devastating. "Decisions about management structure, key roles, reporting relationships, layoffs, restructuring, and other career-affecting aspects of the integration should be made, announced, and implemented as soon as possible after the deal is signed – within days if possible. Creeping changes, uncertainty, and anxiety that last for months are debilitating and immediately start to drain value from an acquisition." Ronald N. Ashkenas, Lawrence J. Demonaco, & Suzanne C. Francis, *Making the Deal Real: How GE Capital Integrates Acquisitions, in* HARVARD BUSINESS REVIEW ON MERGERS AND ACQUISITIONS 165 (2001).

[152] See SULLIVAN & GRIMES, *supra* note 8, at 584 (discussing limitations that exist on sharing confidential business information and shifting beneficial control of the acquired company before a merger deal closes).

[153] See Pitofsky, *supra* note 35, at 225.

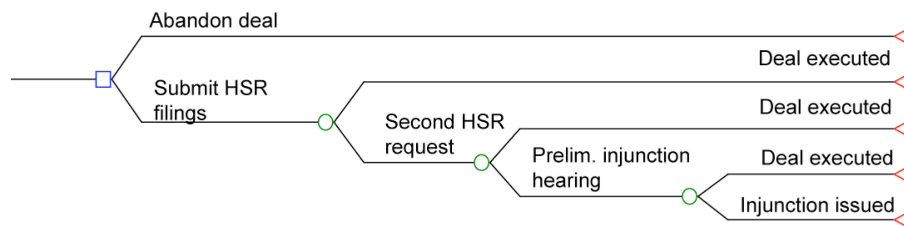
[154] See Kolasky, *supra* note **Error! Bookmark not defined.**, at 83. In *FTC v. CCC Holdings,* the Court noted that, "[t]he merging parties suggest they will abandon the merger if an injunction issues, in part because financing would be too difficult to maintain during the administrative process." Federal Trade Commission v. CCC Holdings, 2009 WL 723031, 1 (D.D.C. 2009). See also SULLIVAN & GRIMES, *supra* note 8, at 587.

[155] "Time and again, business people have said to me, "We can handle rules; we just need as much certainty as possible about *what* they are." Each case, appropriately brought, represents another opportunity to explicate the rules." Deborah Platt Majoras, *Reflections in An Election Year: Challenges in Antitrust Enforcement*, 2008 WL 699053 (F.T.C.) at 2.

above, the Agencies have taken great strides in recent years to provide more information.[156] As illustrated by the case analysis in Section I, however, courts have not.

When recognition of similar efficiencies varies depending upon the context of the case, the uncertainty facing corporate negotiators magnifies. In addition to hypothesizing as to how the Court might balance the anticompetitive and pro-competitive efficiencies of the deal, corporate negotiators also must guess whether the underlying efficiencies themselves will be recognized. When comparing the specific acquisition deal on the table against their BATNA, corporate negotiators are logically going to discount the value of the potential deal based on all of the risk factors involved. When conducting decision analysis, they are going to need to add additional tree branches (and associated probabilities) reflecting the fact that projected efficiencies may not even end up being acknowledged.

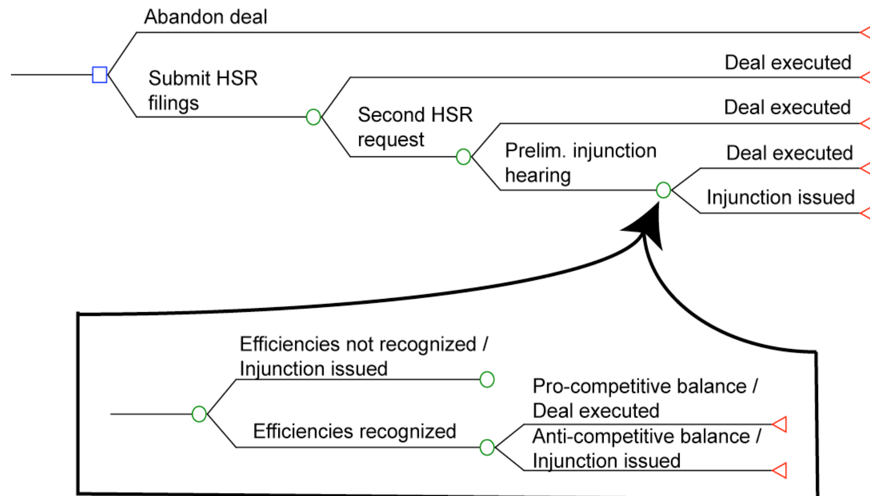
Following is a simplified decision tree mapping out the key decisions and events that a corporation would face during the HSR waiting period.



Given recent court rulings on efficiencies, this simplified tree needs additional branches. As courts have been inconsistent with their recognition of efficiencies, there is a primary issue in each case of whether the courts will even recognize the efficiencies in the first place. This risk factor creates an additional uncertainty in the stream of events that must be represented by an additional branch on the tree. Even if significant efficiencies are recognized, there is still the chance that they

[156] Id. at 5. See also William E. Kovacic, *Competition Policy in the European Union and the United States: Convergence or Divergence?*, 2008 WL 2311121 (F.T.C.) (June 2, 2008) at 15 (discussing how the U.S. has began to emulate the E.U. system in providing more transparency to the public regarding why the F.T.C. has chosen not to prosecute a particular case).

will not be deemed great enough to counter other anticompetitive effects of the proposed transaction.[157] Hence, another risk factor must be added to the diagram.



Each additional risk factor or branch of the tree reduces the value of proceeding forward with the transaction. The more opportunities that exist to derail a proposed deal, the greater the underlying value of the deal itself must be for corporate negotiators to proceed forward. The courts' inconsistent recognition of efficiencies adds uncertainty to the picture. As the tree above demonstrates, this uncertainty increases the risk of proceeding forward with the merger, thus impacting individual corporation's decisions regarding planned transactions.[158] On an aggregate basis, corporations in concentrated markets will end up abandoning more deals than they otherwise would if courts were more consistent with their recognition of efficiency claims.[159] This means that some value creating, competition-enhancing acquisitions will not take place.

[157] "[T]he revised guidelines do not explain how efficiencies are factored into the unilateral effects models commonly employed by the agencies of late. Nor do they give real guidance as to how large efficiency savings generally must be in order to be considered as an effective offset to the potential for anticompetitive effects, beyond stating that, in certain circumstances, efficiencies must be "great" and, in others, they must be "extraordinarily great."' Garza, *supra* note 63, at 6.

[158] Given the courts' hostile and inconsistent treatment of efficiencies, some antitrust attorneys actually advise their clients to forgo trying to make their best efficiency case. See Muris, *supra* note 111, at 1. This not only adds uncertainty to the decision tree, but actually makes certain branches impossible to reach.

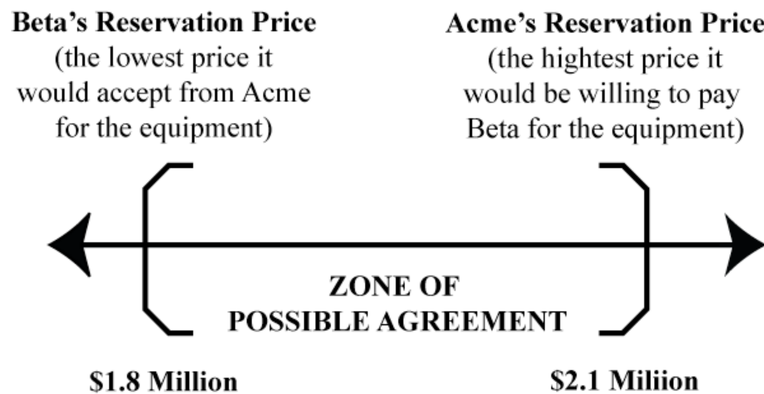
[159] Attorneys are very focused on the question of whether they can "get the deal done." See Michael L. Weiner, *Antitrust and Enhancing Efficiency,* 11 SUM. ANTITRUST 4, 4 (1997). Inconsistent treatment of efficiencies makes it more difficult to answer this question affirmatively.

c. ZOPA Analysis

A final way to conceptualize the impact of court-generated uncertainty is through the use of Zone of Possible Agreement ("ZOPA") analyses. Not all negotiations end in an agreement. Many barriers may prevent a deal, such as strategic behavior, information asymmetries, agency issues, and psychological barriers such as optimistic overconfidence, loss aversion and reactive devaluation.[160]

In some cases a deal does not occur because each party has a BATNA that is stronger than any possible offer from the other side. In such cases, there is no "Zone of Possible Agreement" or ZOPA. Graphically, one can represent the ZOPA that exists in a negotiation as the area between each party's reservation price, the price at which they are indifferent between the offer on the table and their BATNA.[161]

For example, assume in the industrial equipment scenario that Acme has determined that their BATNA is to purchase new machinery for $3.7 million. They have also decided that they are willing to pay up to $2.1 million for Beta's used equipment. This is their reservation price. They would prefer to purchase new machinery rather than pay Beta $2,100,001. However, they would rather purchase Beta's equipment for $2,099,999 than purchase the new equipment for $3.7 million. Assume that Beta has determined their reservation price to be $1.8 million. In graphical terms, the ZOPA for their negotiation is the price range between $1.8 million and $2.1 million.



[160] See Ronald L. Gilson & Robert H. Mnookin, *Symposium on Business Lawyering and Value Creation for Clients: Foreward: Business Lawyers and Value Creation for Clients*, 74 OR. L. REV. 1, 10-13 (1995). See Robert H. Mnookin & Lee Ross, *Introduction, in* BARRIERS TO CONFLICT RESOLUTION 3, 15-18 (KENNETH ARROW, ROBERT H. MNOOKIN, ET AL, ED 1995).
[161] See RAIFFA, *supra* note 119, at 45-46. See RUSSELL KOROBKIN, NEGOTIATION: THEORY AND STRATEGY 27-49 (2d ed. 2009). See Moffitt, *supra* note 120, at 175-176.

Any deal that the two companies agree to within these parameters is better for each organization than its respective BATNA. It is easiest to conceptualize a ZOPA if the negotiation focuses on only one variable such as price. When other elements are added into the mix (e.g., timing of deal, cash payment, etc.), it is more difficult to graphically illustrate the range of possible agreements that exist; conceptually, however, there is still a concrete range of options that are better than each party's BATNA – assuming that a ZOPA exists.

What light does this negotiation concept shed on the interpretation of efficiency defense doctrine? Section I of this article highlights how courts' bimodal treatment of efficiency claims robs corporations of the necessary transparency to predict reasonably whether the court will recognize the projected synergies or savings from their proposed transaction. This lack of transparency increases the uncertainty associated with proposed mergers in concentrated markets, thus causing corporate negotiators to discount the value of potential deals vis-à-vis their BATNAs (to do nothing or to continue to explore other deals). The projected "cost" of uncertainty – which can be mathematically represented through the use of decision trees – ends up impacting the ZOPA that exists between two organizations negotiating a merger or acquisition. The increased uncertainty moves the two organizations' reservation prices closer together, either reducing the size of, or potentially eliminating, the previously existing ZOPA.

For example, if Corporation A is acquiring Corporation B and there is significant uncertainty as to whether the deal will be blocked, Corporation A is not going to be willing to pay as much for Corporation B as they otherwise would. If they would be willing to pay $25 per share in a risk-free environment, they may only be wiling to pay $22 per share given the uncertainties involved. Why the reduced price? Because there are two real costs created by the uncertainty. The first cost is the risk that Corporation A will spend enormous time and energy on the proposed transaction, only to have it blocked. Even if there is only a small (e.g., 10%) chance that this occurs, the share price that Corporation A is willing to offer must reflect the risk of this cost.

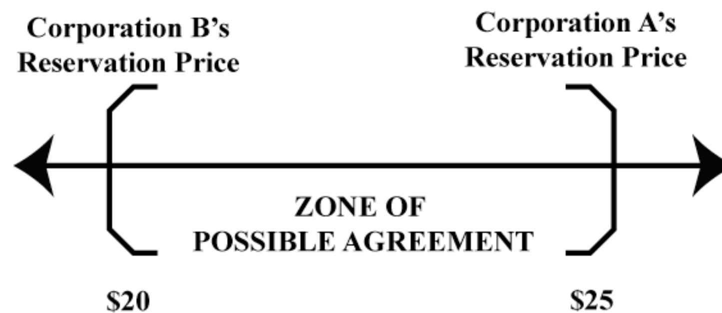
The second cost relates to the hidden expenses associated with uncertainty. Most obviously, a second HSR request or litigation surrounding a preliminary injunction involves additional transactions costs.[162] It also extends the time period between the public announcement of the deal and the closing. As discussed earlier, the longer the period of uncertainty, the greater the risk of negative impacts on employees, customers, and general business momentum. These factors must also be considered in the reservation price for the deal.

Corporation B faces similar issues. If in a risk free environment they would be willing to accept payment of $20 per share for their stock, they are going to

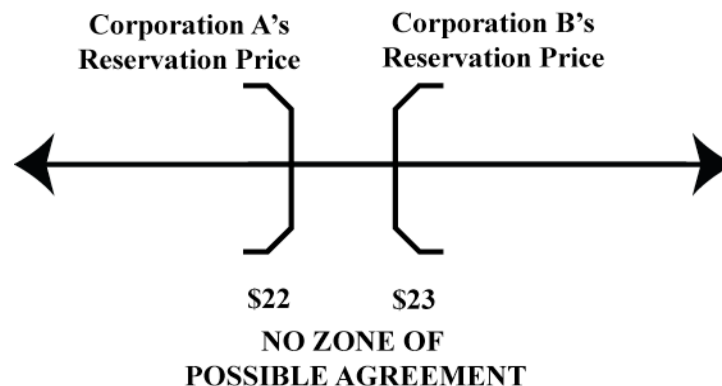
[162] See SULLIVAN & GRIMES, *supra* note 8, at 583.

demand higher compensation when the level of uncertainty increases. Corporation B risks suffering lost transaction costs if the deal fails to go through. If the acquisition agreement includes any type of earn-out or contingent-price clause, they also risk making less on the deal if delays and uncertainty caused by second requests or litigation hurt the value of the ongoing business. It is logical, therefore, that Corporation B would demand a higher sale price than otherwise necessary in a risk-free environment, to move forward with the transaction. For example, they may demand $23 per share rather than $20 per share.

What impact do these uncertainties have on the deal? Given the original parameters in this hypothetical scenario, a fairly broad ZOPA existed between the two companies' reservation prices of $25 per share and $20 per share. A number of deals could have been struck providing each organization with more value than their BATNA.



Once the cost of increased uncertainty is included in the analysis, however, the ZOPA effectively disappears. Corporation A is only willing to pay $22 per share while Corporation B is demanding at least $23 per share. There is no longer room for a deal. Each corporation is better off with its BATNA. The risks associated with the deal have eliminated the potential for a transaction that, absent the uncertainty, would have created considerable value for each side.



Obviously, all transactions involve risk. The hypothetical scenario's analysis of a risk-free transaction is overly simplistic. Conceptually, however, the ZOPA impact of moving from some risk to considerably more risk is similar to the impact described above. On an individual basis, it means that individual M&A negotiators will end up walking away from deals that otherwise could be value creating for both organizations.

On a macro level, each of these individual negotiator decisions, when aggregated, can lead to the sub-optimal functioning of M&A activity in concentrated markets. A broad swath of deals that would make U.S. companies more competitive will never occur. The uncertainty involved forces businesses to forego deals that under a regime of more transparent and consistent court action would have taken place and would have benefited both sides. The impact, therefore, is felt both in the increased number of deals halted by the courts and – even more substantially – the increased number of value-creating deals never pursued due to fear that they might raise antitrust concerns.

IV. HOW COURTS SHOULD ANALYZE EFFICIENCIES: SOME PROPOSED GUIDELINES

Some preliminary thoughts …

1. Evaluate efficiencies independently of market concentration / other factors
2. Quantify efficiencies as percentage of revenue
3. Recognize qualitative efficiencies depending upon market structure
4. Develop consistent framework for treatment of variable and fixed cost efficiencies (current merger guideline review focus)
5. Eliminate consumer-pass through requirement as a recognition criteria (black/white) and instead defer the question of the appropriate level of consumer pass through to the balancing analysis

CONCLUSION

Although courts give lip service to the value of merger-generated efficiencies, they consistently fail to recognize efficiencies in close Clayton Act cases. Over the past decade, U.S. antitrust enforcement has grown increasingly lax. Under this regime almost all mergers have been approved—whether procompetitive or not. This permissive policy has masked the gap between how courts say they are analyzing the competitive effects of proposed deals and what they are in fact doing. A

careful look at Section 7 judicial decisions, however, reveals the lack of congruence between courts' statements and their actions.

As future administrations shift to more aggressive antitrust enforcement, this gap will present increasing problems for corporate negotiators in concentrated markets. Companies merge for a variety of reasons, often to capture strategic synergies. Although not all mergers create significant efficiencies, it is imperative that those that do are truly recognized and weighed in Section 7 competitive effects balancing analyses. Furthermore, when courts evaluate efficiencies, they should consider both the short-term and long-term positive impacts of a merger. It is often easiest for courts to focus on short term cost savings, like reduced manufacturing costs. Many important longer-term benefits, however, such as research and development or innovation synergies, significantly contribute to the ability of U.S. companies to grow and develop their competitive skills and capabilities. Although these efficiencies are more difficult to quantify, they must be recognized.

APPENDIX I: CASE ANALYSIS OF MARKET CONCENTRATION & EFFICIENCIES LEVELS

CASE	PRODUCT MARKET / CONCENTRATION	EFFICIENCIES
FTC v. Staples (D.D.C. 1997)	***High*** • Product market: consumable office supplies sold through office supply superstores[163] • HHI ranges from 3,597 to 6,994 pre-merger; post-merger HHI ranges from 5,003 to 10,000; avg. HHI increase 2,715 points[164]	***Low*** • Efficiencies not verifiable,[165] not merger specific,[166] and not likely to be fully passed through to consumers[167]

[163] Federal Trade Commission v. Staples, Inc., 970 F.Supp. 1066, 1074 (D.D.C. 1997).
[164] Id. at 1081.
[165] "Mr. Painter's testimony was compelling, and the Court finds, based primarily on Mr. Painter's testimony, that the defendants' cost savings estimates are unreliable… The Court also finds that the defendants' projected "Base Case" savings of $5 billion are in large part unverified, or at least the defendants failed to produce the necessary documentation for verification." Id. at 1089.
[166] "… the evidence shows that the defendants did not accurately calculate which projected cost savings were merger specific and which were, in fact, not related to the merger… In fact, Mr. Painter testified that, by his calculation, 43% of the estimated savings are savings that Staples and Office Depot would likely have achieved as stand-alone entities." Id. at 1090.

CASE	PRODUCT MARKET / CONCENTRATION	EFFICIENCIES
FTC v. Swedish Match (DC 2000)	***High*** • Loose leaf chewing tobacco market[168] • HHI increased from 3,219 to 4,733[169]	***Low*** • Not verifiable & lack of consumer pass through[170]
FTC v. Cardinal Health (DC 1998)	***High*** • Wholesale distribution market for prescription drugs[171] • HHI increased from 1,648 to 3,079[172]	***Low*** • Not merger specific[173]
FTC v. University Health (11th Cir. 1991)	***High*** • Market is provision of in-patient services by acute care hospitals[174] • HHI increased by 630 points to 3,200[175]	***Low*** • Not verifiable & lack of consumer pass through[176]

[167] "In addition to the problems that the Court has with the efficiencies estimates themselves, the Court also finds that the defendants' projected pass through rate – the amount of projected savings that the combined company expects to pass on to customers in the form of lower prices – is unrealistic." Id.

[168] FTC v. Swedish Match, 131 F.Supp 2d 151, 157 (D.D.C. 2000).

[169] Id. at 167.

[170] "… the Court ultimately finds that the defendant's efficiency evidence is insufficient to rebut the presumption that the merger may substantially lessen competition… The savings that will be passed on to the consumers in the form of lower prices in this case is at best speculative… Without significantly more evidence to substantiate the savings purported in this case, and without greater clarity on the state of antitrust law in this circuit, the defendants are unable to rebut the presumption here with an efficiencies defense." Id. at 171-172.

[171] Federal Trade Commission v. Cardinal Health, Inc., 12 F.Supp.2d 34, 47 (D.D.C. 1998).

[172] Id. at 53.

[173] "Weighing the evidence before it, this Court finds that the Defendants have sufficiently proved that significant efficiencies would likely result from the proposed mergers…However, this Courts finds the evidence presented by the FTC strongly suggests that much of the savings anticipated from the mergers could also be achieved through continued competition in the wholesale industry." Id. at 63.

[174] Federal Trade Commission v. University Health Inc., 938 F.2d 1206, 1210-1211 (11th Cir. 1991).

[175] Id. at 1211.

[176] "Here, however, the appellees have failed to introduce sufficient evidence to demonstrate that their transaction would yield any efficiencies, and the district court's factual finding to the contrary is clearly erroneous." Id. at 1222. "We hold that a defendant who seeks to overcome a presumption that a proposed acquisition would substantially lessen competition must demonstrate that the intended acquisition would result in significant economies and that these economies ultimately would benefit competition, and hence, consumers… The appellees here have not presented sufficient evidence to support their claim that the intended acquisition would generate efficiencies benefiting consumers." Id. at 1223.

CASE	PRODUCT MARKET / CONCENTRATION	EFFICIENCIES
FTC v. PPG Industries (DC Cir. 1986)	***High*** • "High technology" aircraft transparencies market[177] • Broader transparencies market had HHI of 1,943. Merger would increase this to 3,295.[178]	***Low*** • Efficiencies not merger specific[179]
FTC v. Alliant Techsystems (DC 1992)	***High*** • Products & services involved in the manufacture & related servicing of all current 120 mm tank ammunition rounds & in the development of advanced tactical rounds [180] • Merger-to-monopoly; HHI would be 10,000[181]	***Low*** • Efficiencies small and not verifiable[182]
FTC v. Libbey (DC 2002)	***High*** • Food service glassware market[183] • HHI projected to increase from 5,251 to 6,241.[184]	***Low*** • Lack of consumer pass through[185]

[177] FTC v. PPG, Industries, 798 F.2d 1500, 1502 (D.C. Cir. 1986).
[178] Id. at 1502-1503.
[179] "Finally the district court found that a merger of PPG and Swedlow might lead to the development of more sophisticated materials and/or transparencies… the gains to be derived from technological cooperation are not exclusive to a PPG-Swedlow marriage; cooperation with other market participants could yield similar results without causing the same market concentration." Id. at 1508.
[180] Federal Trade Commission v. Alliant Techsystems, 808 F.Supp. 9, 20 (D.D.C. 1992).
[181] Id. at 15. This case is interesting as the defendants' proposed merger was a direct response to the Army's decision to competitively bid a five-year sole-source contract in the 120 mm market. Whether the defendants merged or the Army continued forward with its competitive bidding process, there was ultimately only going to be one supplier left in the market. Id. at 15-16.
[182] The Court found the claimed benefits of the merger of reducing risk were speculative. "Defendants' concerns regarding the risks of transferring technology to cost, delay, and quality are speculative at best... Defendants furthermore fail to consider the not insignificant restructuring and transaction costs that would result from the merger." Id. at 21.
[183] Federal Trade Commission v. Libbey, 211 F.Sup.2d 34, 45 (D.D.C. 2002).
[184] Id. at 50-51.
[185] "Although the evidence presented by the defendants demonstrates that there could potentially be some positive results of the acquisition, the Court does not believe that those results outweigh the potential harm to the market that could result given the fact that there has not been sufficient evidence to establish how RCP will be able to compete effectively given the higher costs it will have to pay for its glassware, ***and why Libbey will not use this opportunity to raise its own prices.*** (emphasis added)" Id. at 53. The Court did not believe that merger-related efficiencies would be passed-through to consumers.

CASE	PRODUCT MARKET / CONCENTRATION	EFFICIENCIES
U.S. v. United Tote (Del. 1991)	***High*** • North American totalisator systems for pari-mutuel wagering (horse betting)[186] • HHI projected to increase from 3,940 to 4,640.[187]	***Low*** • Efficiencies not merger-specific; consumer pass through concerns[188]
FTC v. H.J. Heinz Co. (DC Cir. 2001)	***High*** • Baby food market[189] • HHI projected to increase from 4775 to 5285[190]	***Low*** • Efficiencies not merger specific[191] and not verifiable[192]

[186] United States v. United Tote, Inc., 768 F.Supp. 1064, 1065-1070 (Del. 1991).

[187] Id. at 1069.

[188] "With regard to financing, unlike *International Harvester*, United Tote has failed to show that the merger is necessary to acquire the financial and service capabilities it needs." Id. at 1084. "The Court's finding is guided, in part, by the reality that even if the merger resulted in efficiency gains, there are no guarantees that these savings would be passed on to the consuming public." Id. at 1084-1085.

[189] Federal Trade Commission v. H.J. Heinz Co., 246 F.3d 708, 716 (D.C. Cir. 2001).

[190] Id.

[191] "Finally, and as the district court recognized, the asserted efficiencies must be "merger-specific" to be cognizable as a defense. That is, they must be efficiencies that cannot be achieved by either company alone because, if they can, the merger's asserted benefits can be achieved without the concomitant loss of a competitor. Yet the district court never explained why Heinz could not achieve the kind of efficiencies urged without a merger. As noted, the principal merger benefit asserted for Heinz is the acquisition of Beech-Nut's better recipes, which will allegedly make its product more attractive and permit expanded sales at prices lower than those charged by Beech-Nut, which produces at an inefficient plant. Yet neither the district court nor the appellees addressed the question whether Heinz could obtain the benefit of better recipes by investing more money in product development and promotion – say, by an amount less than the amount Heinz would spend to acquire Beech-Nut." Id. at 721-722. "In addition, the district court described Heinz's distribution network as much more efficient than Beech-Nut's. It failed to find, however, a significant diseconomy of scale in distribution from which either Heinz or Beech-Nut suffers. In other words, although Beech-Nut has an inefficient distribution system, it can make that system more efficient without merger. Heinz's own efficient distribution network illustrates that a firm the size of Beech-Nut does not need to merger in order to attain an efficient distribution system." Id. at 721, note 19. Note that this statement assumes that the distribution efficiencies are a function of scale and not capabilities.

[192] "In the absence of reliable and significant evidence that the merger will permit innovation that otherwise could not be accomplished, the district court had no basis to conclude that the FTC's showing was rebutted by an innovation defense." Id. at 723.

CASE	PRODUCT MARKET / CONCENTRATION	EFFICIENCIES
FTC v. CCC Holdings, Inc. (DC Cir. 2009)	***High*** • Partial loss and total loss software market for insurance claims[193] • HHI in Estimatics (partial loss software) market would increase from 3,650 to 5,685[194] • HHI in Total Loss Valuation software market would increase from 4,900 to 5,460[195]	***Low*** • Efficiencies not verifiable,[196] consumer pass through concerns,[197] and merger specificity issues[198]
US v. Rockford Memorial Corp. (N.D. Il. 1989)	***High*** • Acute inpatient hospital care market[199] • HHI on a state inventoried beds basis increase from 2555 to 4603[200] • HHI on inpatient admissions basis increases from 2789 to 5111[201] • HHI on inpatient days basis increases from 3026 to 5647[202]	***Low*** • Qualitative efficiencies (improved quality and services to consumers) deemed irrelevant[203] • Net efficiencies not verifiable[204] • Efficiencies not merger-specific[205]

[193] Federal Trade Commission v. CCC Holdings, 2009 WL 723031, 30 (D.D.C. 2009).
[194] Id. at 45.
[195] Id. at 46.
[196] "The Defendants have not demonstrated here that their efficiencies are verifiable …" Id. at 73.
[197] "Even assuming *arguendo* that the Defendants will achieve significant cost savings in a timely manner, there is no evidence to suggest that a sufficient percentage of those savings will accrue to the benefit of the consumers to offset the potential for increased prices." Id. at 74. "Second, while reducing the costs of doing business provides several advantages for the merged firm, these advantages could show up in higher profits instead of benefiting customers or competition… Mr. Ramamurthy admits that CCC will give its shareholders much of any savings… Andrew Balbirer, similarly stated that the synergies from the deal would either be invested in new products or go to company profits… Mr. Sun of Mitchell stated that the cost savings are likely to go to "building value added products" rather than lowering consumer costs." Id.
[198] "Furthermore, there is little evidence that these promises of increased R&D spending are merger-specific." Id. at 75.
[199] United States v. Rockford Memorial Corporation, 717 F. Supp. 1251, 1292 (N.D. Ill. 1989), *aff'd*, 898 F. 2d 1278 (7th Cir. 1990).
[200] Id. at 1280.
[201] Id.
[202] Id.
[203] "As to qualitative benefits to consumers, the defendants proclaim that the merger of SAH and RMH will provide the Rockford community with a first class regional tertiary referral center that will eventually rival tertiary referral centers in Madison, Chicago, Milwaukee and Rochester. The defendants promise that the number, depth, and quality of services at the hospital will improve… The court finds the defendants' intention to create a state-of-the-art tertiary referral center and all its corresponding benefits in quality and community development as irrelevant for the present Sec. 7 inquiry." Id. at 1288-89.

CASE	PRODUCT MARKET / CONCENTRATION	EFFICIENCIES
US v. Franklin Electric Co. (W.D. Wis. 2000)	***High*** • Submersible turbine pump market[206] • Merger-to-monopoly[207]	***Low*** • Efficiencies not verifiable[208] • No consumer pass-through[209]
FTC v. Butterworth (W.D. Michigan 1996)	***High*** • General acute and primary care inpatient hospitals services[210] • General acute inpatient services HHI increases 1064 -1889 points to final range of 2767-4521[211] • Primary care inpatient services HHI increases1675-2001 points to final range of 4506-5079[212]	***High*** • Court recognized significant merger-specific efficiencies[213]
FTC v. Illinois Cereal Mills (N.D. Ill. 1988)	***Medium*** • Industrial milled prime products market[214] • HHI increased by 480 points to 2606[215]	***Low*** • Efficiencies not verifiable[216] • No consumer pass through[217]

[204] "Thus, the one-sided study projects the savings derived from the merger and none of the expenses … In short, the study does not reflect the net savings of the merger, only the cost savings." Id. at 1289. "Some of the savings in these areas would occur not so much because of the economies effected by the merger, but from a drop in production." Id. at 1290. "Another aspect of the defendants' savings in the area of overhead that is troubling is the lack of information on the input/output relationship in the area of laboratory/pathology fees. Therefore, assumptions as to these savings are impossible to verify." Id. at note 21.

[205] "Moreover, monopoly rents could far outweigh the savings presented, particularly in light of the fact that much of the savings cited by the defendants were not clearly and convincingly generated by the merger. Large amounts of savings could be achieved independent of a merger through alternative action…" Id. at 1291.

[206] United States v. Franklin Electric Co., 130 F.Supp.2d 1025, 1027-1028 (W.D.Wis. 2000).

[207] Id. at 1035.

[208] The court held that the evidence of true efficiencies was "wanting." Id.

[209] "Defendants have not made the necessary showing that efficiencies would result *and* that they would lead to benefits for consumers in the relevant market. Not only is the evidence of true efficiencies wanting, but the profits such efficiencies would generate would be unlikely to affect the American consumer." Id.

[210] Federal Trade Commission v. Butterworth Health Corporation, 121 F. Supp. 1285, 1291 (W.D. Mich. 1996), *aff'd* 121 F. 3d 708 (6th Cir. 1997).

[211] Id. at 1294.

[212] Id.

[213] "In sum, the Court is persuaded that the proposed merger would result in significant efficiencies, in the form of capital expenditure avoidance and operating efficiencies, totaling in excess of $100 million. This is, by any account, a substantial amount and represents savings that would, in view of defendant's nonprofit status and the Community Commitment, invariably be passed on to consumers." Id. at 1301.

[214] *Federal Trade Commission v. Illinois Cereal Mills,* 691 F.Supp. 1131, 1141 (N.D.Ill. 1988), *aff'd* 868 F.2d 901 (7th Cir, 1989).

CASE	PRODUCT MARKET / CONCENTRATION	EFFICIENCIES
California v. American Stores Co. (C.D. Cal. 1988)	***Medium*** • Product Market: "Supermarkets," full line grocery stores with more than 10,000 square feet[218] • Across markets affected, HHI increased average of 245 points from a starting average of 2040[219]	***Low*** • Efficiencies not verifiable and pass through concerns exist[220]
FTC v. Arch Coal (DC 2004)	***Medium*** • Southern Powder River Basin coal market[221] • HHI of reserves market is 2,054. Merger will increase it by 49 points to 2,103[222]	***Medium*** • Some efficiencies recognized; most considered not to be merger specific or verifiable[223]

[215] Id. at 1144.
[216] "Elders and ICM's first argument fails to persuade this court because it rests heavily on the assumption that eastern and western geographic markets for prime products exist." Id. at 1146.
[217] "Even assuming Elders is (sic) unable to efficiently operate the Lincoln mill, it does not follow that competition in the relevant geographic market will be enhanced by the challenged acquisition. Rather than lower prices for consumers, the likely result of the Lincoln acquisition will be greater mill profitability." Id.
[218] State of California v. American Stores Company, 697 F. Supp. 1125, 1129 (C.D. Cal. 1988), *aff'd in part and rev'd in part on other grounds,* 872 F.2d 837 (9th Cir. 1989), *rev'd on other grounds*, 495 U.S. 271 (1990).
[219] Id. at 1130.
[220] "Moreover, even assuming these efficiencies savings do result, the Court is not convinced that defendants will invariably pass these savings on to consumers. As the State queried "And, most importantly, is it really true that the new firm can achieve $50 million in savings after servicing the debt they assumed in leverage [sic] this $2.5 billion buy-out?" Id. at 1133.
[221] Federal Trade Commission v. Arch Coal, 329 F. Supp.2d 109, 121 (D.C. 2004).
[222] Id. at 128. "Based on reserves, then, the proposed transaction may raise significant competitive concerns – although just barely." Id.
[223] "Of this amount, $27.4 million is general and administrative expenses, which Mr. Lange himself acknowledges is not merger-specific because "another coal company" without an adjacent mine could achieve it. This leaves $107.4 million in claimed merger-specific savings from the combination. Even as to that remaining amount, however, defendants have not made a strong case on efficiencies. Plaintiffs have systematically pointed out deficiencies in defendant's estimates of efficiencies and shown that defendants have not been able to quantify with precision the savings netted by the proposed transaction. Some of the efficiencies identified by defendants are not merger-specific while others are undercut or reduced on the basis of the evidence." Id. at 151. "The realized savings are more likely to be in the $35 to $50 million, rather than $130 million to $140 million range over the five year period from 2004 through 2008." Id. at 153.

CASE	PRODUCT MARKET / CONCENTRATION	EFFICIENCIES
FTC v. Foster Refining (D. New Mexico 2007)	***Medium*** • Bulk gasoline market[224] • Court recognized a weak prima facie case based upon market concentration figures[225]	***Medium*** • Court commented that they believed that efficiencies existed, but this factor did not play a determinative role in their decision[226]
U.S. v. Country Lake Foods (Minn. 1990)	***Low*** • Fluid milk processor market[227] • Court did not accept narrow geographic market proposed by Agency. No HHI figures for broader geographic market provided.[228]	***High*** • Significant efficiencies recognized[229]
US v. Long Island Jewish Medical Center	***Low*** • Government failed to establish relevant product market as anchor hospital providing primary / secondary service[230] • Relevant product market is general acute care inpatient hospital services[231] • No HHI figures calculated, but court had no concerns about concentration[232]	***High*** • Significant efficiencies recognized[233] • Court confident of significant consumer pass through[234]

[224] Federal Trade Commission v. Foster Western Refining, 2007 WL 1793441, 1 (D.N.M.)

[225] "With the inclusion of the various firms who do or could supply Albuquerque after a small but significant price increase, the post-merger combined market share of Western and Giant is 5.7%, which corresponds with a change in HHI of only fifteen. While a change of fifteen would not be significant, the Court does not believe that it should include all Gulf Coast refiners, because the record does not establish that all refiners are actually or currently sending product to the relevant market. The potential is there, but the market remains concentrated. Both parties' experts admitted the market is concentrated, but it appears that most such markets are similarly concentrated. Thus, the Court will find that the FTC has made a *prima facie* case under the *Merger Guidelines*, but it is a weak *prima facie* case." Id. at 28.

[226] "The Court is also convinced that there will be efficiencies resulting from the merger …The efficiencies of the merger have not played a determinative role in this case." Id. at 49-57.

[227] United States v. Country Lake Foods, 754 F.Supp. 669, 671 (Minn. 1990).

[228] Id. at 673.

[229] "Significant efficiencies will be realized by Country Lake's acquisition of Superior. This acquisition will enable Country Lake to increase its capacity substantially. This will result in lower plant and transportation costs and other savings. At minimum, these efficiencies will enable Country Lake to compete head-to-head with Marigold, the top-selling dairy in the MSP/MSA." Id. at 674.

[230] United States v. Long Island Jewish Medical Center, 983 F.Supp. 121, 139-140 (E.D.NY 1997).

[231] Id.

CASE	PRODUCT MARKET / CONCENTRATION	EFFICIENCIES
U.S. v. Carilion Health System (4th Cir. 1989)	***Low*** • Acute patient inpatient hospital services and certain clinical outpatient health care services[235] • No HHI figures calculated. Court did not have exact concentration figure.[236] • Case tried under Sherman Act due to non-profit status[237] • "[M]erger would not constitute an unreasonable restraint of trade under Sherman Act"[238]	***High*** • Significant efficiencies recognized[239]
FTC v. Tenet Health Care Corporation (8th Cir. 1999)	***Low*** • Primary and secondary inpatient hospital care services[240] • FTC failed to establish a specific geographic market[241]	***Medium*** • District court should have looked at "enhanced efficiencies" such as better medical care[242]

[232] "Here, the Court finds that the merged entity will not have an undue share of the relevant product and geographic markets." Id. at 145. Note that in addition to the lack of market concentration, the court did explicitly state that other factors also led them to believe that the risk of anticompetitive effects was minimal. "In sum, the evidence in this case indicates that, in the event the merger is consummated, it is unlikely that there will be a price increase… In making this determination, the Court must balance the reduced competition and increased market share of the merged hospitals against the suitable available alternatives, the multi-diverse economic forces that are driving down hospital populations and the efficiencies to be gained from such a merger." Id. at 145. While these factors may have contributed to the court's ultimate judgment that anticompetitive effects were unlikely, the fact that no high market concentration was proven was critical to this determination.

[233] "Reviewing the testimony as to the claimed efficiencies in its totality, the Court finds the proposed merger will result in significant efficiencies in the form of annual operating savings in expenses in the sum of approximately 25 to 30 million dollars per year. In addition, there will be some capital avoidance in an unknown amount." Id. at 148-149.

[234] "Therefore, the Court finds that, with reasonable certainty, the "efficiencies" gained in this merger will ultimately result in benefits to the consumers." (citing agreement with New York AG to pass on to the community cast savings equal to $100 million during five year period). Id. at 149.

[235] United States v. Carilion Health System, 707 F.Supp. 840, 842 (W.D.Vir. 1989), *affd* 892 F.2d 1042 (4th Cir. 1990) Unpublished opinion.

[236] Id. at 848.

[237] Id. at 841.

[238] Id. at 849.

[239] "Based on Roanoke Memorial's serious need to expand and Community's need for more patients, they have found various ways in which more efficient operations can save money and thereby enable them to offer their services more competitively than ever, to patient's benefit." Id. at 849. "In conclusion, the court finds that the planned merger would probably improve the quality of health care in western Virginia and reduce its cost and will strengthen competition between the two larger hospitals that would remain in the Roanoke area." Id. at 846.

CASE	PRODUCT MARKET / CONCENTRATION	EFFICIENCIES
U.S. v. Oracle Corp. (N.D. Cal. 2004)	***Low*** • Enterprise Resource Planning ("ERP") application software market[243] - plaintiffs failed to establish narrower "high function HRM and FMS" market[244] • Plantiffs failed to prove that HHI in relevant product and geographic markets would fall outside of Merger Guidelines safe harbor[245]	***Low*** • Efficiencies are not verifiable[246]
U.S. v. Mercy Health Services (N.D. Iowa 1995)	***Low*** • Acute care inpatient hospital services[247] • Government failed to establish the relevant geographic market – no relevant HHI figures[248]	***Low*** • Efficiencies not merger specific and not verifiable[249]

[240] Federal Trade Commission v. Tenet Health Care Corporation, 186 F.3d 1045, 1051-1052 (8th Cir. 1999).

[241] "The question before us is whether the FTC provided sufficient evidence that the proposed merger will result in the merged entity possessing market power within the relevant geographic market. Because we conclude that the FTC produced insufficient evidence of a well-defined relevant geographic market, we find that it did not show that the merged entity will possess such market power. The FTC's failure to prove its relevant geographic market is fatal to its motion for injunctive relief." Id. at 1053.

[242] "We further find that although Tenet's efficiencies defense may have been properly rejected by the district court, the district court should nonetheless have considered evidence of enhanced efficiency in the context of the competitive effects of the merger. The evidence shows that a hospital that is larger and more efficient than Lucy Lee or Doctors' Regional will provide better medical care than either of those hospitals could separately. The merged entity will be able to attract more highly qualified physicians and specialists and to offer integrated delivery and some tertiary care… The evidence shows that the merged entity well may enhance competition in the greater Southeast Missouri area." Id. at 1054-1055.

[243] United States v. Oracle Corporation, 331 F.Supp.2d 1098, 1101 (N.D. Cal. 2004).

[244] Id. at 1108.

[245] Id.

[246] "The court finds Oracle's evidence on the claimed cost-savings efficiency to be flawed and unverifiable. Catz and Ellison's personal estimates regarding the potential cost-savings to Oracle are much too speculative to be afforded credibility. Oracle's efficiency defense based upon future innovations (e.g., the superset product) was not verified by internal documents. Oracle presented no evidence regarding the functionality of characteristics the innovative product will contain, nor any evidence regarding its date of availability. Accordingly, both claimed efficiencies are much too vague and unreliable to rebut a showing of anticompetitive effects." Id. at 1175.

[247] Federal Trade Commission v. Mercy Health Services, 902 F.Supp 968, 976 (N.D. Iowa 1995), *vacated as moot,* 107 F.3d 632 (8th Cir. 1997).

[248] Id. at 987.

[249] "The defendants have failed to meet this burden in several significant respects: (1) a merger is not required to achieve many of the efficiencies, (2) implementation of the steps

necessary to achieve the efficiencies is highly speculative, and (3) the Gallagher Report overstates the efficiencies which can be achieved." Id.