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The Efficiency Defense Under Section 7 of the Clayton Act

*Timothy J. Muris**

Though seemingly a fundamental issue throughout antitrust law, efficiency has never played much of a role in the analysis of mergers challenged under section 7 of the Clayton Act. It appears that the reasons for the underplay given that potential justification are four: That such a defense is incompatible with economic theory, that the legislative history of section 7 reveals a congressional desire to forbid such a defense, that the Supreme Court has in its section 7 opinions precluded such a defense, and that the admissibility of efficiency evidence would unduly complicate trials. Professor Muris categorically challenges each of those arguments and concludes that an efficiency justification should be, and is, available to defendants whose acquisitions are challenged under the Clayton Act.

INTRODUCTION

THAT THE antitrust laws should promote efficiency would seem beyond question.¹ Society benefits from lower costs, innovation, and higher quality.² Indeed, in speaking of the basic anti-

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1. Efficiency is so engrained in antitrust that any argument on the subject generally concerns whether efficiency is the *only* relevant value. See, e.g., *Antitrust Jurisprudence: A Symposium on the Economic, Political and Social Goals of Antitrust Policy*, 125 U. PA. L. REV. 1182 (1977).

2. For a discussion of the meaning of efficiency, see notes 14–19 & 175–86 *infra* and accompanying text.

trust statute, the Supreme Court has stated:

The Sherman Act . . . rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic, political and social institutions.³

Mergers can increase efficiency. Horizontal mergers may provide the volume necessary to obtain the economies that result from large size. Vertical mergers may increase efficiency where the internal costs of operation are less than the costs of nonintegrated firms using the market. Conglomerate mergers may allow a more efficient management to acquire control of a firm.⁴ Despite the efficiency-generating potential of mergers, the enforcement agencies⁵ and many commentators⁶ contend that, in

3. Northern Pac. Ry. Co. v. United States, 356 U.S. 1, 4 (1958).

4. These examples are not meant to be exhaustive. For a more detailed analysis of the possible efficiencies resulting from mergers, see notes 173-211 *infra* and accompanying text.

5. The Department of Justice guidelines for horizontal mergers state:

Economies. Unless there are exceptional circumstances, the Department will not accept as a justification for an acquisition normally subject to challenge under its horizontal merger standards the claim that the merger will produce economies (i.e., improvements in efficiency) because, among other reasons, (i) the Department's adherence to the standards will usually result in no challenge being made to mergers of the kind most likely to involve companies operating significantly below the size necessary to achieve significant economies of scale; (ii) where substantial economies are potentially available to a firm, they can normally be realized through internal expansion; and (iii) there usually are severe difficulties in accurately establishing the existence and magnitude of economies claimed for a merger.

Department of Justice Press Release, Merger Guidelines (May 30, 1968), *reprinted in* [1978] 1 TRADE REG. REP. (CCH) ¶ 4510.

Concerning vertical mergers, the guidelines are somewhat more generous toward efficiency. A vertical merger will probably be undisturbed when it "clearly" appears to result in significant economies "of production or distribution unrelated to advertising or other promotional economies." *Id.* Otherwise, however, economies are not regarded as a justification. *Id.* Reducing the cost of transacting, a potentially important efficiency incentive for vertical mergers, see notes 161-62 *infra* and accompanying text, is ignored.

For conglomerate mergers, the guidelines express an unwillingness to consider efficiency when substantial market power (*i.e.*, the ability to decrease output and increase price) may exist. *Id.* Thus, at best, the Justice Department's merger guidelines cautiously recognize efficiency as a relevant consideration in mergers that increase market power. If the merger does not increase market power, it is legal regardless of efficiency. Consequently, the only general consideration under the guidelines for determining legality is the effect of the merger on market power.

The other enforcement agency, the Federal Trade Commission, appears to possess an even harsher attitude. In a recent study of FTC opinions in horizontal merger cases between 1970 and 1977, Professor Liebler found that when efficiency was mentioned, it was a factor against the merger. See Liebler, *Antitrust and the New FTC*, in K. CLARKSON & T. MURIS, *THE FEDERAL TRADE COMMISSION SINCE 1970: GOVERNMENT REGULATION*

proceedings under section 7 of the Clayton Act,⁷ defendants should be barred from asserting efficiency as a legal justification for a merger. Four arguments are frequently advanced to deny an efficiency defense in challenged mergers:

- 1) If a merger increases market power, increased efficiency will not outweigh the adverse impact of that power;⁸
- 2) Congress precluded efficiency as a justification for a merger;⁹
- 3) Supreme Court decisions, particularly *Brown Shoe*,¹⁰ *Philadelphia National Bank*,¹¹ and *Procter & Gamble*,¹² hold that efficiency cannot justify, and may even be evidence against, a merger;
- 4) Judges and attorneys face intractable hurdles in dealing with an efficiency issue in the context of litigation.¹³

This article examines these arguments, concluding that each is unpersuasive and, moreover, that antitrust policy requires consideration of efficiency. Part I shows that even a small increase in efficiency will generally outweigh a relatively larger increase in market power. Part II demonstrates that not only did Congress not preclude an efficiency defense, but that legislative history explicitly indicates that efficiency should count for a merger's legality. Part III discusses the Supreme Court's failure thus far to decide definitely whether efficiency is a defense. Finally, Part IV concludes that, although consideration of efficiency will complicate merger proceedings, the issue can be litigated meaningfully to improve the quality of decisions made.

AND BUREAUCRATIC BEHAVIOR (unpublished, on file with the author). See generally Scanlon, *Policy Planning at the FTC: A Commissioner Who Really Believes In It*, 6 ANTITRUST L. & ECON. REV. 35, 37-47 (1973); 633 ANTITRUST & TRADE REG. REP. (BNA) AA-1 (Oct. 9, 1973).

6. Commentators rejecting an efficiency justification include R. BORK, *THE ANTI-TRUST PARADOX* 124-29 (1978); R. POSNER, *ANTITRUST LAW* 112 (1976); Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 HARV. L. REV. 226, 318-21 (1960); Brodley, *Potential Competition Mergers: A Structural Synthesis*, 87 YALE L.J. 1, 83-85 (1977).

7. 15 U.S.C. § 18 (1976). Section 7 prohibits all acquisitions whose effect "may be substantially to lessen competition, or tend to create a monopoly." *Id.*

8. See notes 14-41 *infra* and accompanying text.

9. See notes 42-83 *infra* and accompanying text.

10. *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962). See notes 86-106 *infra* and accompanying text.

11. *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321 (1963). See notes 107-19 *infra* and accompanying text.

12. *FTC v. Procter & Gamble Co.*, 386 U.S. 568 (1967). See notes 120-38 *infra* and accompanying text.

13. See notes 173-211 *infra* and accompanying text.

I. THE EFFICIENCY-MARKET POWER TRADEOFF

It is frequently asserted that a firm's ability to decrease output and raise prices, an ability often called market power, should be the only relevant issue in merger cases.¹⁴ According to this view, if a merger does not increase market power, it should be legal; if it increases market power, it should be illegal regardless of the efficiency gain. This argument is incorrect: Efficiency may justify some mergers that increase market power. The following discussion develops a model to define efficiency and related economic concepts as they apply to analysis of a merger under section 7 and to evaluate a merger that both increases efficiency (*i.e.*, lowers costs) and increases market power (*i.e.*, raises price). Objections and qualifications to this approach are also addressed.

A. *Economic Meaning of the Section 7 Standard*

Section 7 of the Clayton Act prohibits all mergers whose effect "may be substantially to lessen competition or tend to create a monopoly."¹⁵ Economically, the concepts of competition, monopoly, market power, and efficiency can be illustrated using Figure 1. Assuming that D is the demand curve for an industry and AC_1 the average cost of that industry's firms, any price above P_1 —for example P_2 —is what economists call "allocatively inefficient" because consumers do not receive units of output (in this case all of those between Q_2 and Q_1) for which they would be willing to pay at least the cost of production.¹⁶ Any merger that only reduces output, and thus raises price, increases market power and accordingly reduces allocative efficiency—or put in the terms of section 7, competition.¹⁷ Competition is at its greatest when output is increased to the level where price and cost are equated.

Curve AC_2 represents a second way to increase allocative efficiency, namely lowering costs, the subject of our concern here. Allocative efficiency is increased because lower costs allow pro-

14. See note 5 *supra*.

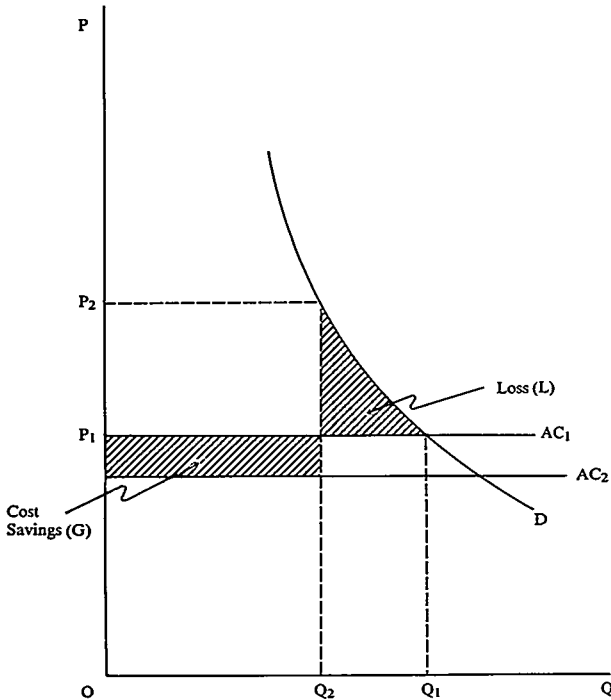
15. 15 U.S.C. § 18 (1976).

16. A more formal analysis of Figure I would reveal that allocative efficiency is maximized when the difference between the area under the demand curve and the area under the cost curve is at its greatest. This occurs when price equals cost.

17. Whether Congress and the Court concur that increases in allocative efficiency increase competition will be discussed at notes 42-83 & notes 84-153 *infra* and accompanying text.

duction of at least the same output as before, yet free resources to produce other goods that consumers value. Thus the efficiency defense, as that term as used in this article, refers to a cost-decrease. To avoid confusion, efficiency will refer to lower costs and competition to the concept of allocative efficiency.

Figure 1



B. The Tradeoff Analysis

What if a merger reduces both cost and output, thus raising the price? From the standpoint of competition, both a gain and loss have occurred. Can we determine on balance which effect is likely to dominate? Oliver Williamson has developed a method to answer this question.¹⁸ As an illustration of the model, let us return

18. Professor Williamson's method unfolded in three separate articles published over the course of a decade. Williamson, *Economies as an Antitrust Defense: The Welfare Tradeoffs*, 58 AM. ECON. REV. 18 (1968) [hereinafter cited as *Williamson I*] (technical corrections in this article were made in Williamson, *Economies as an Antitrust Defense: Correction and Reply*, 58 AM. ECON. REV. 1372 (1969)); Williamson, *Allocative Efficiency and the Limits of Antitrust*, 59 AM. ECON. REV. 105 (1969) [hereinafter cited as *Williamson II*]; Williamson, *Economies as an Antitrust Defense Revisited*, 125 U. PA. L. REV. 699 (1977) [hereinafter cited as *Williamson III*]. The Williamson method is an application of what economists call "partial equilibrium welfare" or "allocative efficiency" analysis. *Id.* at 708 n.27. The gains

to Figure 1, and assume that prior to the merger there are only two firms in the relevant market, acting competitively and having identical costs. AC_1 is the combined average premerger cost of the two firms, while AC_2 is the new cost. P_1 and Q_1 are the premerger price and quantity, while P_2 and Q_2 are the postmerger levels. Thus, the merger has both lowered costs and raised prices. What are the net effects?

Most economists would conclude that the loss from increased market power is the triangle, L, while the gain from increased efficiency is the rectangle, G.¹⁹ If G exceeds L, the merger produces a net benefit, despite increased price, decreased output, and increased profits to the firm. Only if L exceeds G is the net competitive effect negative.²⁰ Professor Williamson concludes that a small gain in efficiency normally outweighs a relatively much larger increase in market power. This follows in large part because the loss to society is measured only in terms of decreased units of output, while the gain is measured in terms of the entire output of the new firm. Unless the price increase is enormous or a small price increase triggers a large decrease in quantity demanded, the number of units still produced will exceed the drop in output resulting from an increase in market power. Thus, the gains are calculated over more units than are the losses.

One can be more precise about the relative magnitudes of the price increases and cost declines necessary for the merger to be beneficial. Table 1 provides data based upon Williamson's model.²¹

and losses under this analysis, which ignores distribution effects, are explained in the text accompanying notes 16-17 *supra*.

Throughout this part of the paper, the emphasis is on the horizontal merger, which of all mergers has the most potential for anticompetitive effect. Showing the benefits from an efficiency-market power tradeoff in horizontal mergers will reveal the propriety of such a tradeoff in other mergers.

19. Professor Posner disagrees that L represents the loss. See note 41 *infra*.

It is important to note that if cost reductions do not occur over all phases of production, the calculus must be adjusted. For example, if distribution costs are reduced four percent where distribution comprises only twenty-five percent of total costs, the appropriate figure for the tradeoff model is one percent.

20. With competition, output will eventually expand to the intersection of AC_2 and D, the demand curve. This is not relevant to the direct comparison of the premerger versus postmerger situation. If competition were currently sufficient to lower market price to this point, the market power effects of the merger could not occur. Competition would also cause costs to drop, although whether by merger or internal expansion depends on the relative costs of these two methods. See notes 31-41 *infra* and accompanying text.

21. The numbers in Table 1 are drawn from Liebler, *Market Power and Competitive Superiority in Concentrated Industries*, 25 U.C.L.A. L. Rev. 1231, 1298 (1978) (Kasden,

Table 1: Percentage cost reductions sufficient to offset percentage price increases for selected values of elasticity of demand.

Elasticity:		3	2	1	½
Price	1	.015	.01	.005	.002
Increase:	2	.060	.04	.020	.010
	5	.381	.25	.123	.061
	10	1.550	1.00	.484	.238
	15	3.544	2.25	1.072	.523
	20	6.400	4.00	1.878	.908
	25	10.156	6.25	2.893	1.393

For example, if elasticity of demand for the industry (but not for the firm²²) is two, and the merger would raise price ten percent, only a one percent decrease in cost will offset the price rise. Again, with elasticity of two, if price rises by five percent, a one-quarter of one percent drop in costs will offset the increase in market power. Relying on empirical evidence that a reasonable upper bound on elasticity is three, and that price increases rarely exceed ten percent above the competitive level, Williamson concludes that a merger “that promises nontrivial economies—say greater

Mathematical Appendix). Kasden’s numbers are used instead of Williamson’s because Kasden recomputed Williamson’s data “to take more accurate account of the form of the demand curves.” *Id.* at 1296.

It has been argued that if market power exists before the merger, then, to offset that power, efficiencies need to be more significant than Williamson asserts. Jackson, *The Consideration of Economies in Merger Cases*, 43 J. Bus. 439 (1970). This is correct as a matter of mathematics, since the closer one starts to zero output, the larger the market loss (*i.e.*, triangle L in Figure 1) for any given percentage price rise. The argument is, however, insensitive to economic analysis. If prices have already risen ten percent above the competitive price, it does not necessarily follow that an increase of an additional ten percent is readily accomplished. Firms will not raise prices an additional ten percent if that amount is above the profit maximizing point, which it may be, depending upon the elasticity of demand. Moreover, the firm’s demand curve is influenced by other firms’ supply responses and the higher the initial price is above the competitive level, the more the threat of entry limits further price increases.

22. Table 1 uses industry elasticity because that figure reveals the anticompetitive effect on an industry of a price increase resulting from a merger.

As the text indicates, empirical evidence suggests that price increases from mergers rarely exceed ten percent, which in turn implies that the firm’s elasticity of demand will normally greatly exceed that of the industry. This follows even with mergers in concentrated industries because actual and potential competitors of the merged firm limit, although not necessarily eliminate, the merged firm’s ability to price noncompetitively. Where this effect on the merged firm does not exist, for example where government regulation bars new entry, price increases larger than those in Table 1 become more likely. For the effect of such larger increases on the trial of a merger case, see note 188 *infra* and accompanying text.

than two percent—will generally yield a net allocative efficiency gain.”²³ In other words, even if only a small drop in costs can be shown, the presumption should be that the merger is beneficial.²⁴

C. *Objections and Qualifications*

Two objections are frequently raised to Williamson’s conclusion.

1. *Efficiency May Be Available to Only Some Firms Within the Industry*

Williamson illustrates his model with a merger of 100 percent of the relevant market. Since mergers in fact involve less than 100 percent, is not Williamson’s presumption in favor of mergers that increase efficiency weakened, especially if the merger leads to a price rise over all of industry output? Consider an example with demand elasticity of two, a merger involving twenty-five percent of the industry, and an industrywide ten percent price increase. Costs must then drop by four percent, not one percent as shown in Table 1, to offset the effects of the price increase.

Closer analysis, however, reveals at least three reasons why small efficiency gains still justify mergers. First, even in this example, a cost reduction of four percent would offset a price rise two and one-half times its size. More important, it is unlikely that a merger of two firms with only twenty-five percent of the market could by itself cause a ten percent price increase.²⁵ Since merger cases rarely, if ever, involve the creation of so-called dominant

23. *Williamson III*, *supra* note 18, at 709 (where Williamson also justifies his assumptions). Based on the recomputed numbers, *see* note 21 *supra*, the 2% figure could actually be lowered to around 1.5%.

The reader might ask why in Table 1 more elastic demand curves appear to yield greater monopoly power than less elastic demand curves. Economic theory, of course, teaches that monopoly power will cause greater losses where demand is inelastic. Rather than contradicting economic theory, the table uses a different base of measurement. Instead of comparing a move from competition to monopoly, Williamson assumes a fixed, identical price increase over all elasticities. Under these assumptions, the more elastic the demand curve, the greater the decrease in output from a fixed price increase. Hence, more elastic demand curves produce greater welfare losses.

24. Throughout the remainder of this article, “presumption in favor of mergers that increase efficiency” or the “Williamson presumption” will be used to refer to this presumption.

25. As in all litigated cases, the mergers discussed here involve two firms. Efficiency is not discounted where a trend toward concentration exists because the trend is only relevant when tacit or explicit collusion becomes a problem. Moreover, as Professor Bork argues, such a trend is much more likely to be consistent with efficiency than with market power. R. BORK, *supra* note 6, at 231.

firms,²⁶ the competitive problem in mergers is the facilitation of tacit or explicit price fixing. Since the number of firms is only one of many factors that influence collusion,²⁷ and since mergers typically involve the elimination of only one firm, we cannot with certainty conclude that elimination of only one firm will lead to collusion. Thus, even if it were certain that successful collusion could lead to as large as a ten percent price increase, this figure would have to be discounted to compensate for the uncertainty over whether the merger will actually result in collusion. Even if the maximum possible discounted price increase is as high as five percent,²⁸ with industry elasticity of two, costs need decrease by only one percent to offset the market power increase.²⁹ Finally, the price increase may not occur over the industry's entire output. If only some firms in the industry are part of the collusion, the average rise in industrywide prices would correspondingly be less.³⁰

If the merger constitutes a dominant share of the industry, say seventy-five percent, significant price increases may occur over most of industry output. The cost savings, however, would then also occur over a significant share of industry output. Thus, even with elasticity as high as three, if price were to increase ten percent industrywide, cost need only drop approximately two percent to offset that increase.

2. *Efficiency Obtainable Through Internal Growth*

Since internal growth can increase efficiency, why not ignore efficiency in merger cases, thereby avoiding the possibility of increased market power?³¹ Preventing the merger would produce

26. As used here, a dominant firm is one that is able to reduce output to raise the industry's average price for an appreciable period of time.

27. For an excellent discussion of the many factors besides concentration influencing the ability to collude, see R. POSNER, *supra* note 6, at 39-77.

28. For the figure to be five percent, there would need to be a fifty percent chance that the merger would lead to successful collusion raising the price to ten percent. See note 23 *supra* and accompanying text.

29. If there were only a few firms in the industry, then elimination of one would be more important. Most industries, however, contain a larger number of firms.

30. Collusion could successfully exist over a limited period of time without involving all members of an industry. Other firms would eventually increase output, but the delay might still allow for benefits to accrue from the collusion. Moreover, even if all firms are members of the cartel, some might cheat, and thus not actually be part of the collusion.

31. See I P. AREEDA & D. TURNER, *ANTITRUST* 106 (1978); W. BREIT & K. ELZINGA, *THE ANTITRUST PENALTIES* 99-103 (1976); Bok, *supra* note 6, at 340; Department of Justice Press Release, *Merger Guidelines*, *supra* note 5.

better results since the efficiency would then result without an increase in market power. There are at least four reasons why the possibility of internal growth does not rebut the Williamson presumption in favor of efficiency from merger.

First, internal expansion may increase costs relative to expansion by merger. Internal growth may duplicate facilities, particularly where demand is stagnant or declining. Duplication could occur even in a growing market if the merger would result in some specialized efficiency peculiar to the merging firms or if the market is not growing quickly enough to sustain both existing industry capacity and that added internally. Moreover, if firms in fact use mergers to reduce costs, in many cases mergers will presumably be a cheaper method of obtaining the economies than will internal expansion.³² Merger may also be a faster and therefore preferable method of obtaining efficiency. Forcing internal expansion would therefore produce less efficiency.

Second, since cartels are unstable,³³ their market power tends to dissipate. Where demand is growing, making internal expansion likely to occur more rapidly, market power is also likely to decrease more quickly since entry is generally facilitated when demand increases.³⁴ Thus, where reliance on internal growth to produce efficiency is most warranted, there is less reason to fear market power. Dissipation could even make internal expansion irrelevant. If the market power dissipates by the time that internal growth would occur, internal growth is preferable to merger only if the market power effects had outweighed the efficiency effects at the time of the merger.³⁵ The appropriate policy would then be to ignore internal growth and compare efficiency and market power as explained above. There is one reason why such dissipation can frequently be expected. Cartels, whether explicitly or tacitly organized, are usually broken by increases in output, either from new firms entering the industry or from industry members not part of, or cheating on, the cartel. This new output requires planning and implementation similar or identical to that needed for internal expansion. Indeed, to the extent that the new output comes from

32. This follows because profit-maximizing firms will choose the lower cost of two alternative routes to the same end. *But see* note 36 *infra*.

33. *See* R. POSNER, *supra* note 6, at 50-52; F. SCHERER, *INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE* 158-64 (1970).

34. *See* R. BORK, *supra* note 6, at 130.

35. This problem could be analyzed more formally by comparing the discounted values of L and G in Figure 1, with L appropriately adjusted for its decline and G for the possibility for internal growth. *See Williamson I, supra* note 18, at 29.

existing factories of firms already in the industry, dissipation of market power will occur *before* internal expansion.³⁶

Third, in most mergers attacked today, the possibility that collusion will be facilitated, although often real, appears to be slight.³⁷ When efficiency can be demonstrated, the possibility that internal growth will produce greater benefits than mergers accordingly decreases. When internal growth will result in the same efficiencies only after the merger would have,³⁸ banning the merger would sacrifice gains for the relatively speculative costs of possible increased market power.

Fourth, where demand is stable, concentration—and with it the facilitation of collusion—increases just as much with internal growth as with mergers. If merger is cheaper or faster in realizing efficiency, it is preferable to internal expansion. Moreover, even where demand is growing, internal expansion is not necessarily without market power consequences.³⁹

36. Evaluating the relevance of internal growth becomes more complicated when increasing market power motivates the merger. For example, internal growth may be a cheaper form of lowering costs than a merger, yet the merger may be preferred to increase market power. See note 27 *supra* and accompanying text. Partly for this reason, internal growth is sometimes relevant and its possibility could even rebut the Williamson presumption. See note 40 *infra* and accompanying text.

37. To illustrate this proposition, consider fifteen recent decisions preventing horizontal mergers. (The sample includes all substantive decisions of the Supreme Court and all cases since 1975 where sufficient information of the type described below was available. A list of these cases may be obtained from the author.) Even focusing only on concentration, most of the mergers in these cases are not prime candidates for facilitating collusion. In only six did postmerger, four-firm concentration exceed sixty percent; in only five did the combined share of the merging firms exceed twenty percent; and in only three did the smaller of the merging firms have a premerger share above ten percent (this last criterion is a very rough proxy for whether the merger removed a significant competitor). Further, only four satisfied the first two criteria, while only three met all three tests.

It might be suggested that if the possibility of facilitating collusion from such mergers is not great, then the solution is not to search for efficiency, but simply to permit the mergers regardless of lowered costs. Given the inability of economics to speak with precision as to when collusion will occur, however, see, e.g., notes 203–04 *infra*, we cannot dismiss the possibility that many mergers which occur in settings not prime candidates for collusion, still facilitate collusion, albeit perhaps only in some small way. Assuming that litigation costs are not overly burdensome, if these mergers produce no countervailing benefits, then a safe response would be to ban them. The question of the appropriate policy toward these mergers therefore becomes one of benefits such as lower costs. See also notes 206–11 *infra* and accompanying text, discussing the practical significance of an efficiency defense.

38. Although mergers do not instantaneously lower costs, relative to internal expansion, it is easy to envision the greater rapidity with which mergers can usually reduce costs. For example, vertical mergers that lower transaction costs begin to have this effect when exchanges with outsiders are no longer made, a step that can follow quickly upon merging. In general, it probably takes longer to build new facilities than to utilize existing ones.

39. For example, some firms might enjoy a comparative advantage in internal growth

This is not to say that the possibility of internal growth will never be relevant to merger policy. In very large mergers where new entry will be slow, it will be crucial.⁴⁰ Nevertheless, the four factors discussed above indicate that the possibility of internal expansion does not, in most mergers, rebut the presumption in favor of a merger resulting in nontrivial cost-savings.⁴¹

and use this advantage to increase their relative market shares and, perhaps, concentration. For a formal analysis of the market power effects of internal growth, see Williamson, *Economies as an Antitrust Defense: Correction and Reply*, *supra* note 18, at 1374-76.

40. Slow entry and a merger combining a large share of the industry create a situation ripe for collusion or for dominant firm pricing, making internal expansion highly relevant. Of course, to the extent that entry is slow because of stagnant demand, internal expansion is unlikely. For this reason, and because it will increase concentration, it would then be irrelevant. The rate of entry, however, is a function of more than merely the growth in demand. Other factors influence entry, including the scale of entry needed for efficient operation and government regulation.

If the merger is vertical, the possibility of internal growth can be ignored, at least as to foreclosure, the most commonly cited competitive problem of such mergers. Merger and expansion yield an identical level of foreclosure.

41. Although not echoed by others, Professor Posner has made one other important objection to Williamson's model. He argues that Williamson's analysis is incomplete since "[t]he expected profits of the merger will generate an equivalent amount of costs as the firms vie to make such mergers or, after they are made, to engross the profits generated by the high postmerger price through service competition or whatever." Posner, *The Social Cost of Monopoly and Regulation*, 83 J. POL. ECON. 807, 821 (1975). Williamson argues that the problem of an equivalent amount of costs exists "only under carefully delimited conditions, which are not present in the merger-for-economies contexts." *Williamson III*, *supra* note 18, at 723. In addition to Williamson's points, *id.* at 713-23, the major ones of which are that normally functioning entry and the market for corporate control prevent the problem, two other points undermine Posner's argument. First, in most mergers litigated today, the possibility of increased market power is small. *See* note 37 *supra*. The less prevalent market power is, the more likely efficiency considerations will prevail, and accordingly there is less of an incentive to waste resources. The competition that then occurs for the benefits is largely efficient, not wasteful. Second, where facilitation of collusion is the manner in which market power is increased, potential acquiring firms will usually not need to expend large resources identifying the best potential partners since important firm-specific attributes that facilitate collusion such as market share are already known. Further, since all firms in the industry enjoy the benefits of collusion, the acquiring firm will not face a costly bidding war when collusion is its goal.

Nevertheless, Posner's argument, although overstated, raises the importance of costs other than those of decreased output for reducing the net benefits of mergers. In cases where these costs are significant, they qualify the analysis. Fortunately, these other costs will often be detectable. For example, as Williamson notes, the increased prices from market power may cause firms from other regions or from other countries to ship goods to consumers in the merged firm's market, causing inefficiency because the real cost in supplying consumers has increased by the incremental transportation expense even if the effect of the shipping is to constrain the market power of the merged firm. *See Williamson III*, *supra* note 18, at 712-13 & 734-36.

C. Summary

The foregoing analysis yields an important proposition for evaluating mergers: where even small economies exist, a merger can be presumed to be procompetitive. There are, however, three objections to an efficiency justification unrelated to the theoretical tradeoff between efficiency and market power. We turn next to the first of these—that Congress precluded efficiency as a defense.

II. CONGRESS AND THE EFFICIENCY JUSTIFICATION

Despite the compatibility just demonstrated between economic theory and an efficiency justification, the defense is unavailable if Congress precluded its exercise or indicated that efficiency was to count *against* a merger.⁴² Analysis of this question begins with a brief chronology of the events leading to the 1950 amendment of section 7 by the Celler-Kefauver Antimerger Act.⁴³ The discussion then addresses whether Congress' preoccupation with what it perceived as a dangerous rise in concentration supports preclusion of efficiency as a defense. The analysis then shifts to those aspects of the legislative history directly discussing efficiency, and concludes by evaluating indirect evidence of congressional intent regarding an efficiency justification.

A. Chronology⁴⁴

Although some congressmen introduced merger bills during the 1930's, the effort to amend section 7 of the Clayton Act began in earnest in 1941 when Congress' Temporary National Economic Committee (TNEC) issued its final report and recommendations.⁴⁵ Fearing increased concentration and wanting to close the

42. For arguments that Congress intended to preclude certain mergers regardless of economic considerations such as efficiency, see Bok, *supra* note 6, at 318; Pitofsky, *The Political Content of Antitrust*, 127 U. PA. L. REV. 1051, 1060-65 (1979); Fox, Book Review, 54 N.Y.U. L. REV. 446, 460 (1979); *see also* notes 88-106 *infra* and accompanying text.

As have the courts in mergers since 1950, we concentrate on the 1950 amendment, which was a complete overhaul of the seldom used section 7 of the 1914 Act. Particularly as to the meaning of the competitive impact standard, under which arguments concerning an efficiency defense would fall, Congress was writing on a clean slate in 1950. *See* Brodley, *supra* note 6, at 41-42 n. 161.

43. 15 U.S.C. § 18 (1958).

44. This story is told in more detail elsewhere. *See, e.g.*, Handler & Robinson, *A Decade of Administration of the Celler-Kefauver Antimerger Act*, 61 COLUM. L. REV. 629, 652-74 (1961); Note, *Section 7 of the Clayton Act: A Legislative History*, 52 COLUM. L. REV. 766 (1952).

45. S. Doc. No. 35, 77th Cong., 1st Sess. (1941) [hereinafter cited as TNEC Report]. As early as 1921, bills to amend section 7 were introduced. Note, *supra* note 44, at 766 n.3.

loophole in original section 7 that permitted one corporation to purchase the assets of another corporation regardless of competitive effect, the TNEC called for significant changes. Its proposed bill would have closed the asset loophole and given the Federal Trade Commission authority to forbid acquisitions of an, as of then, undetermined size unless the merging companies could demonstrate "that the purpose and apparent effect of such consolidation would be desirable."⁴⁶ Desirability was to be determined by findings on issues such as concentration and effect on competition.⁴⁷ Thus, the proposed legislation required that certain mergers receive prior approval.

Although the House Judiciary Committee endorsed prior approval in 1946,⁴⁸ its bill died in the Rules Committee. Representative Kefauver introduced an identical bill in 1947, which, after extensive hearings, was reintroduced without the prior approval requirement. The modified proposal outlawed mergers where "there is a reasonable probability that the effect of such acquisition may be to substantially lessen competition or tend to create a monopoly."⁴⁹ In 1949, Representative Celler introduced H.R. 2734, a bill very similar to the reintroduced Kefauver bill. The House approved this bill in August 1949,⁵⁰ and, after further hear-

In 1927, the Federal Trade Commission, already dissatisfied with judicial interpretation of section 7, began its nearly annual call for amendment. *Hearings on H.R. 2734 Before the Subcomm. of the Senate Comm. on the Judiciary*, 81st Cong., 1st & 2d Sess. 13, 20 (1950) [hereinafter cited as *H.R. 2734 Hearings*]. *But see* D. MARTIN, *MERGERS AND THE CLAYTON ACT 187* (1959) (concluding that the FTC did not begin a determined effort to amend section 7 until 1935).

46. TNEC Report, *supra* note 45. For brief discussions of the case law on the asset loophole, see Handler & Robinson, *supra* note 44, at 653-54; Comment, *Corporate Consolidation and the Concentration of Economic Power: Proposals for Revitalization of Section 7 of the Clayton Act*, 57 *YALE L.J.* 613, 620-21 (1948).

47. TNEC Report, *supra* note 45.

48. H.R. 1480, 79th Cong., 2d Sess. (1946).

49. *See Hearings on H.R. 515 Before Subcomm. No. 2 of the House Comm. on the Judiciary*, 80th Cong., 1st Sess., 118-19 (1947) [hereinafter cited as *H.R. 515 Hearings*]. The language of current section 7, *see* note 7 *supra*, is interpreted in terms of reasonable probabilities.

The reintroduced bill, H.R. 3736, 80th Cong., 1st Sess. (1947), did not adopt the competitive standard of original section 7. That standard prohibited acquisitions "where the effect of such acquisition may be to substantially lessen competition between the corporation whose stock is, or whose assets are, so acquired and the corporation making the acquisition, or to restrain such commerce in any section or community, or to tend to create a monopoly of any line of commerce." Many congressmen expressed fear that this was not the flexible approach to mergers that they desired, since taken literally, all horizontal mergers would be barred. *H.R. 515 Hearings, supra*, at 22-24 & 118.

50. The House vote was 223 to 92, 117 not voting. 95 *CONG. REC.* 11506 (1949).

ings, Senate approval followed in December 1950.⁵¹ President Truman signed the bill on December 29, 1950.⁵²

B. *The Fear of Rising Concentration*

During the 1940's, Congress perceived that concentration was high and, more troubling, rising.⁵³ Many legislators were worried over the consequences of failing to pass effective legislation to blunt that rise. Representative Celler, floor manager and sponsor of the bill that became amended section 7, argued that, without an amendment, "big business will be hellbent for more and more mergers."⁵⁴ The specter of more mergers drew impassioned pleas from many quarters, including Kefauver, by then a Senator, who decried the evils of having one's life controlled by individuals who lived far away.⁵⁵ There was even fear that increased concentration would transform America into a fascist or socialist state.⁵⁶ Senator O'Connor, floor manager of the bill in the Senate, concluded the debate by asserting that the amendment was necessary to "protect and preserve the American system of free enterprise."⁵⁷ Existing legislation was found unable to check these perceived evils. Because of the asset loophole original section 7 would not stop untoward acquisitions. Nor, given Supreme Court

51. The Senate vote was 55 to 22, 19 not voting. 96 CONG. REC. 16507 (1950).

52. 1950 PUB. PAPERS 763.

53. See, e.g., H.R. 1480, *supra* note 48, at 4; TNEC Report, *supra* note 45. For a summary of this point, see Bok, *supra* note 6, at 234-36.

There was considerable reliance on an FTC report, *The Merger Movement: A Summary Report*. An analysis of the report and its use are found in D. MARTIN, *supra* note 45, at 230-33. A 1950 article revealed that the Commission was wrong—concentration was not increasing. Lintner & Butters, *The Effect of Mergers on Industrial Concentration, 1940-47*, 32 REV. ECON. STAT. 20 (1950). Although this article was discussed in the Senate debate, proponents of the legislation discounted it. 96 CONG. REC. 16457 (1950). Congressional reliance on the FTC report and the general fear of rising concentration prompted Professor Adelman to remark that "[i]f it is revolting to decide a case on no better a ground than that it was so decided under Henry IV—it is humiliating to have our courts decide it on the basis of what economists showed nearly a decade ago was a made-up story." Adelman, *Economic Aspects of the Bethlehem Opinion*, 45 VA. L. REV. 684, 685-86 (1959) (footnotes omitted).

54. 95 CONG. REC. 11485 (1949) (statement of Rep. Celler).

55. Shall we permit the economy of the country to gravitate into the hands of a few corporations, even though they may have very widespread stockholder distribution, with central-office managers remote from the places where their products are made, and the destiny of the people determined by the decisions of persons who they never see, or even know of?

96 CONG. REC. 16450 (1950) (statement of Sen. Kefauver).

56. See, e.g., 95 CONG. REC. 11486 (1949) (statement of Rep. Celler); 96 CONG. REC. 16507 (1950) (statement of Sen. O'Connor).

57. 96 CONG. REC. 16505 (1950) (statement of Sen. O'Connor).

decisions, would the Sherman Act.⁵⁸

Although some have inferred that, fearing concentration, Congress intended to stop mergers despite, or even because of, increased efficiency,⁵⁹ a close reading of the legislative history supports the conclusion that the new law was not meant to preclude efficiency as a justification for merger. Many feared concentration because of its anticompetitive effects in fostering collusion,⁶⁰ a fear based on economic theory. As already demonstrated, when increased concentration results in efficiency that outweighs possible increases in market power, economic theory supports the merger.⁶¹ Hence, to anyone concerned with the competitive consequences of mergers, efficiency would be relevant and generally count in favor of the merger.

Moreover, the legislative history reveals an assumption that it was unnecessary to choose between concentration and inefficiency.⁶² Many congressmen believed that large mergers did not usually increase efficiency, but rather that available efficiencies were obtainable at sizes smaller than those of large or dominant firms.⁶³ If efficiency explained neither bigness nor the trend toward concentration, one could oppose large mergers on both economic and noneconomic grounds. On this assumption, there is no harm in stopping large mergers, collusion might be deterred, and social values furthered. However great the fear that concentration would damage the American system, it was simply not felt that efficiency need be sacrificed to safeguard free enterprise.⁶⁴

58. See, e.g., *United States v. United States Steel Corp.*, 251 U.S. 417 (1920) (dominant firm merger approved).

59. See note 42 *supra*.

60. Senator Kefauver, for example, argued that "the same economic ends can be achieved through the power of giant corporations [formed by mergers] as through conspiracies." *H.R. 2734 Hearings*, *supra* note 45, at 14.

61. See notes 14-41 *supra* and accompanying text.

62. As Representative Celler stated, "Bigness does not mean efficiency, a better product, or lower prices." 95 CONG. REC. 11486. See also *id.* at 11496 (statement of Rep. Boggs); TNEC Report, *supra* note 45, at 13 (statement of President Roosevelt); *id.* at 292.

Thus, although it is in some sense true that Congress "brushed aside" efficiency, Bok, *supra* note 6, at 318, it was not because Congress thought that mergers would lead to a choice between efficiency and deconcentration. While Congress preferred the noneconomic advantages of deconcentrated markets to what it felt were no increases in the costs of operations, the evidence does not reveal an intention to make efficiency irrelevant in cases where it existed. See note 64 *infra*.

63. See, e.g., *H.R. 2734 Hearings*, *supra* note 45, at 8 (statement of Sen. O'Mahoney).

64. Courts should not use congressional skepticism about efficiency to ignore efficiency justifications for merger. The possibility that mergers might lower costs is more widely recognized today than it was in the 1940's. See, e.g., note 77 *infra*. Given that the overall purpose of the 1950 amendment was to promote competition and not the welfare of

This does not tell us, however, congressional reaction to a case where concentration and efficiency both increased. Perhaps the clear congressional concern over rising concentration indicated that efficiency was to be ignored even where it might exist. In evaluating this argument, it will be helpful to consider how Congress responded to situations where mergers were believed to enhance efficiency.

C. *Direct Evidence on Efficiency*

Although not a major theme of the legislative history,⁶⁵ efficiency was occasionally discussed. Four aspects of the congressional debates are relevant: treatment of efficiency in prior approval bills, mergers of small firms to compete with larger firms, mergers of failing companies, and an example concerning the newspaper industry. When the possibility that a merger would increase efficiency was raised, sponsors of the bill indicated that efficiency was relevant as pointing toward legality.

1. *The Prior Approval Bills*

First among the six specific findings required under the original TNEC bill was "that the acquisition is in the public interest and will be promotive of greater efficiency and economy of production, distribution, and management."⁶⁶ Thus, in the first serious effort to amend section 7, an efficiency defense existed. Indeed, under the TNEC proposal, efficiencies had to be *demonstrated* before the merger could be approved. Although many efficient mergers might have been prevented, particularly if rigorous proof of efficiency were required, the bill did show that its proponents thought efficiency to be relevant and to count in favor of a merger.

Prior approval legislation was first introduced in Congress in 1943 with an efficiency standard approving the merger if it "would not be incompatible with greater efficiency in economy of opera-

competitors, *Brown Shoe Co. v. United States*, 370 U.S. 294, 319-20 & 344 (1962), courts would appropriately respond to that purpose by recognizing the possibility of efficiency creation via merger. Moreover, as is argued below, Congress believed that when efficiency exists it should count for a merger. See notes 66-82 *infra* and accompanying text.

65. "To anyone used to the preoccupation of professors and administrators with the economic consequences of monopoly power, the curious aspect of the debates is the paucity of remarks having to do with the effects of concentration on prices, innovation, distribution, and efficiency." Bok, *supra* note 6, at 236.

66. TNEC Report, *supra* note 45, at 39.

tions."⁶⁷ Where the TNEC would have required a positive showing of efficiency, this version required only that the merger not reduce efficiency. After hearings, the final prior approval bill was reintroduced in 1945 with no efficiency requirement at all.⁶⁸

What, if anything, can be made of the history of the efficiency defense under the prior approval bills?⁶⁹ Deletion of an efficiency defense cannot be interpreted as a rejection of the defense or as a congressional decision to trade off concentration and efficiency.⁷⁰ Although those supporting the bill deleted the efficiency finding, the apparent reason for the deletion is consistent with a congressional sensitivity to the procompetitive importance of efficiency. Kefauver explained the shift to the "not incompatible" standard as necessary to avoid blocking too many mergers.⁷¹ Deletion of the "not incompatible" requirement followed the National Association of Manufacturers' attack on the requirement as too burdensome,⁷² and accordingly appears to have been based upon similar

67. S. 577 & H.R. 1517, 78th Cong., 1st Sess. (1943). See Handler & Robinson, *supra* note 44, at 655.

It is not clear how the tradeoff between efficiency and increased market power would have been accomplished under the prior approval bills. Given the belief that stopping mergers did not involve an efficiency sacrifice and the ignorance of the tradeoff model, this is not surprising.

68. H.R. 4519, 79th Cong., 1st Sess. quoted in *Hearings on H.R. 2357 Before a Subcomm. of the House Comm. on the Judiciary*, 79th Cong., 1st Sess. at 371-72 (1945) [hereinafter cited as *H.R. 2357 Hearings*]. Prior approval was required only if the merger involved at least a five percent share of the market. *Id.*

69. Some commentators argue that little can be concluded from the prior history of unsuccessful bills. Bok, *supra* note 6, at 251. While this may be true about the general history of section 7, it is not true for the efficiency question, at least insofar as the history reveals the attitude of Kefauver, who sponsored both the prior approval bills and the legislation that ultimately passed. There is no evidence that Kefauver's attitude changed between his sponsorship of the prior approval bills and of the act that bears his name.

70. See Blair, *Conglomerate Mergers—Theory and Congressional Intent*, in PUBLIC POLICY TOWARD MERGERS 179, 189-91 (J. Weston & S. Peltzman eds. 1969) for such an interpretation.

71. [T]here is a substantial difference between an administrative affirmative finding that a proposed merger will promote greater efficiency and economy and a finding that it will not be incompatible with that result. I can well understand why an administrative agency would hesitate to make such an affirmative finding in any but the most obvious circumstances and this would tend to block a large proportion of all mergers on that score alone. By contrast under the [current] provisions, while mergers found to be incompatible with greater efficiency and economy could not meet the required standard, mergers found to be compatible and those found to be not incompatible with that standard could be approved, provided all the other requirements were met.

Letter from Senator Kefauver to the Yale Law Journal (Dec. 8, 1947) reprinted in *id.* at 190. The letter is also cited in Comment, *supra* note 46, at 626 n.59.

72. *H.R. 2357 Hearings*, *supra* note 65, at 369. The National Association of Manufacturers seemed to have read the "not incompatible" standard to require a finding similar to the earlier standard of promoting greater efficiency. *Id.*

grounds. Both changes would have permitted more, not fewer, mergers. As such, dropping the requirement does not manifest a desire to strike down even efficient mergers.

2. *Mergers Between Relatively Small Firms*

The legislative history of amended section 7 reveals that two relatively small firms could legally merge to offer increased competition to larger companies. For example, in response to a question whether two small manufacturers of an automobile part could merge to facilitate competition with a larger concern that has lower costs, Representative Celler answered:

[t]here is nothing whatsoever that will prevent those corporations—you call them small corporations—from merging. In the first place they are small corporations. Small corporations do not come within the purview of this act. In the case you have indicated there would be an increase of competition—not a suppression of competition.⁷³

Thus, a sponsor of the bill approved a merger, albeit between “small” corporations, that would, despite increased concentration in an industry that was already at least somewhat concentrated, increase competition because of lower costs.

3. *Failing Companies*

The legislative history also demonstrates that even major firms could legally acquire competitors who were “failing.” For example, during the Senate debate, Senator Thyne described a small mill that could no longer survive and asked whether a big mill could purchase its smaller, struggling competitor and bring its assets to a

73. 95 CONG. REC. 11488 (1949) (statement of Rep. Celler).

The argument might be made that this small business exception was created to insure that de minimis mergers were not challenged. The legislative history, however, shows that the exception is broader than just de minimis mergers. Most discussions of de minimis mergers during the legislative history concerned the elimination of the 1914 standard that, read literally, barred all horizontal mergers. See note 49 *supra*. The 1914 language was modified to prevent de minimis mergers from being held illegal. See *H.R. 515 Hearings*, *supra* note 49, at 112–19, 259. Given this reason for modification of the 1914 language, it is difficult to believe that anyone would construe the amendment to cover de minimis mergers. Hence, the repeated references to small business mergers presumably make a different, or at least a broader, point. Finally, discussions of small business mergers did not arise only in the context of trivial mergers, but often arose in discussions of small firms competing with bigger companies. Discussion of such competition would seem to imply concern for efficiency. Although Congress appeared to think that big firms did not normally need to merge for efficiency reasons, a different attitude appeared to prevail regarding their relatively smaller competitors. Bok agrees that the small business example was not limited to de minimis mergers. Bok, *supra* note 6, at 241.

large milling center. After Senator O'Mahoney, TNEC Chairman and sponsor of the first bill to amend section 7, replied affirmatively, Senator Thye stated that he raised the question to insure that small businesses could still sell to large businesses because large firms "can conduct the operation more efficiently."⁷⁴

Nevertheless, Derek Bok argues that efficiency "cannot be accorded much importance in accounting for the [failing company] exception."⁷⁵ His argument—that Congress was generally unconcerned with efficiency—does not, however, justify his conclusion. Instead, this lack of concern reflected a belief that most mergers did not increase efficiency.⁷⁶ For mergers that appeared to lower costs, the legislative history reveals support for such acquisitions, the failing company doctrine being but one example.⁷⁷

4. *The Newspaper Example*

An important exchange concerning the role of efficiency under the amendment occurred between Senator Kefauver, a principal sponsor of the bill, and Senator O'Connor, floor manager of the bill. Kefauver was concerned with whether "two newspapers might enter into an operating arrangement whereby, *in order to save the expense of operating in two separate buildings*, they would have an arrangement by which one plant would print both newspapers, with each one following its own editorial policy."⁷⁸ Senator O'Connor responded:

[T]his bill, if enacted, would not have adverse effects upon such a proposal as he describes. . . .

[N]o such proposed consideration or acquisition would be vio-

74. 96 CONG. REC. 16445 (1950) (statement of Sen. Thye). Senator O'Mahoney then thanked "the Senator for his example." *Id.*

75. Bok, *supra* note 6, at 340. He instead argues that "perhaps the strongest reason . . . stemmed from a legislative concern over the various interests involved in the life of a failing enterprise." *Id.* Although this concern was no doubt relevant, efficiency cannot be dismissed as easily as Bok does, as the text following this footnote indicates. *See also* R. POSNER, *supra* note 6, at 20-22 (discussing nonefficiency reasons for the doctrine).

76. *See* notes 62-65 *supra* and accompanying text.

77. Since the efficiency involved in the failing business case may often be a subclass of the efficiencies facilitated by the market for corporate control, *see* note 164 *infra* and accompanying text, the question arises why Congress did not explicitly recognize this market. The benefits of the market for control, however, were not made known to Congress, which is not surprising since the leading article on the subject was not written until 1965. *See* Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965).

For a final example of congressional unwillingness to protect small businesses at the expense of efficiency, *see H.R. 515 Hearings*, *supra* note 49, at 47-48 (statement of Rep. Case).

78. 96 CONG. REC. 16456 (1950) (statement of Sen. Kefauver) (emphasis added).

lative of the law, unless in a section of the country it would result in a substantial lessening of competition in industry generally. *It may well be that by effecting a better arrangement for a more profitable undertaking, in the manner described, competition would be stimulated rather than lessened.*⁷⁹

Again, when confronted with the suggestion that a merger would increase efficiency, the leading proponents of the bill suggested that efficiency would count in favor of the merger.

D. *Indirect Evidence*

Two points deserve emphasis. First, Congress wanted mergers to be evaluated in the context of the particular industry involved, along with the broad range of relevant economic evidence.⁸⁰ As the Senate Report to the amendment stated, "full consideration will be given to all matters bearing upon the maintenance of competition, including the circumstances giving rise to the acquisition."⁸¹ Since efficiency is one of several potentially significant competitive attributes of a merger, as well as a reason for merging, it would accordingly seem relevant.

Second, the conduct of the amendment's opponents is instructive. The opponents showed little concern over efficiency, other than questioning the legality of certain types of mergers, such as those between small firms, where efficiency might be involved. The bill's proponents diffused opposition based on such lost efficiency by arguing that these mergers would be legal or at least that the lower costs would be relevant in the decisional calculus.⁸² If

79. *Id.* (statement of Sen. O'Connor) (emphasis added).

80. See the discussion of the legislative history of section 7 in *Brown Shoe Co. v. United States*, 370 U.S. 294, 311-23.

81. S. REP. NO. 1775, 81st Cong., 2d Sess. 7 (1950).

82. Even opponents of the bill did not seek to argue that the interests of large companies would be infringed unwisely or unfairly by the bill. Instead, their opposition was pitched on such arguments as the excessive authority given the Federal Trade Commission, the vagueness of the act, the danger that small businesses might find it hard to sell out, and the fact that concentration was not in fact increasing.

Bok, *supra* note 6, at 307 n.252.

There were, of course, exceptions. For example, it was argued that the bill would hinder small and medium-sized companies from lowering costs by forever foreclosing their opportunity to approximate the size or efficiency enjoyed by their larger competitors. 95 CONG. REC. 11487 (1949) (statement of Rep. Goodwin). To the extent that his argument was involved with the small firm mergers already discussed, this fear was effectively rebutted. A detailed statement was presented during the hearings, part of which suggested that corporations were big because they were successful at pleasing consumers, a form of efficiency. *H.R. 2734 Hearings, supra* note 45, at 224-36 (statement of Prof. King). The members of the subcommittee, however, did not pursue this inquiry into the basic assumptions

efficiency were to be irrelevant under the bill—or a reason for illegality—opponents would probably have raised this point, just as opponents of the prior approval bills had done regarding the treatment of efficiency in those proposals. This failure to raise questions about efficiency indicates that efficiency was neither irrelevant to nor intended to militate against the legality of a merger.

E. Summary

Congress did not intend to trade off efficiency and concentration.⁸³ On the contrary, Congress did not believe that inefficiency would result from a tougher antimerger law. Nor did Congress intend that increased efficiency count against a merger. Although the issue was not squarely addressed, indeed efficiency was infrequently discussed, the evidence indicates that increased efficiency weighs in favor of a merger. Congress wanted mergers to stand or fall upon a host of economic considerations, including efficiency.

III. THE SUPREME COURT AND THE EFFICIENCY JUSTIFICATION

Some have read the Supreme Court's interpretations of section 7 to preclude an efficiency justification and perhaps even to hold that efficiency can be used to condemn a merger.⁸⁴ The first three parts of this section analyze the Court's major statements on efficiency in the context in which they were made, including the development of the arguments at trial and before the Court.⁸⁵ The

underlying the legislation. Instead, they chose to discuss Professor King's favorite professors while he attended the University of Nebraska. *Id.* at 243.

83. For a concurring view, see Turner, *Conglomerate Mergers and Section 7 of the Clayton Act*, 78 HARV. L. REV. 1313, 1326 (1965).

It is true, however, that Congress recognized the so-called "entrenchment" theory by which a merger might be illegal if the acquisition gave the new firm "decisive" advantages over its competitors. See, e.g., H.R. REP. NO. 1191, 81st Cong., 1st Sess. 8 (1949). Nevertheless, this theory does not represent a general attack on efficiency, and can be employed only under limited circumstances. See notes 128-32 *infra* and accompanying text.

84. See, e.g., Department of Justice Press Release, Merger Guidelines, *supra* note 5; notes 112-44 *infra* and accompanying text.

85. Placing the statements in their respective contexts is crucial because the Court was responding to aspects of the cases that can only be understood completely within those contexts. Of course, the Court could have reached out to address the issue of an efficiency justification regardless of the context of that issue before it. As we shall see below, however, the Court does not appear to have taken this step. Nor does the analysis attempt to study the question from the standpoint of predicting how the Court *would* (as opposed to *should*) decide the efficiency issue. The Warren Court—the Court that decided most of the opinions discussed in this section—often mishandled economic analysis, and hence a pre-

discussion concludes with an examination of other cases relevant to determining whether the Court has precluded an efficiency justification.

A. Brown Shoe

In November 1955, the Justice Department challenged the proposed merger between Brown Shoe Company and G. R. Kinney Company, both of whom retailed and manufactured shoes.⁸⁶ The government argued that the merger, particularly in its vertical integration between manufacturing and retailing, was anticompetitive because, *inter alia*, it *lowered* prices. Much of the trial and the arguments that followed involved government attempts to show that vertical integration allowed the new firm to reduce retail prices as much as \$2.00 or \$3.00 a pair.⁸⁷ Brown expended a like amount of effort denying that any such advantage existed.

In finding the merger illegal, the district court echoed the government, noting:

[I]ndependent retailers of shoes are having a harder and harder time in competing with company-owned and company-controlled retail outlets. National advertising by large concerns has increased their brand name acceptability and retail stores handling the brand named shoes have a definite advertising advantage. Company-owned and company-controlled retail stores have definite advantages in buying and credit; they have further advantages in advertising, insurance, inventory control and assists [*sic*] and price control. *These advantages result in lower prices or in higher quality for the same price* and the independent retailer can no longer compete in the low and medium-priced fields and has been driven to concentrate his business in the higher-priced, higher-quality type of shoes—and, the higher the price, the smaller the market. He

diction of no defense would have been warranted for the Court. But this article shows that the Warren Court did not decide the issue. The Court has since become more receptive to economic analysis, *see* notes 139–53 *infra* and accompanying text, although the current Court has also not decided the efficiency issue.

86. Neither Brown nor Kinney had large national market shares. Brown's four percent share in manufacturing made it the nation's fourth largest manufacturer. *See* Peterman, *The Brown Shoe Case*, 18 J. LAW & ECON. 81 (1975). While Kinney operated "the largest family-style shoe store chain in the United States," *Brown Shoe Co. v. United States*, 370 U.S. 294, 303 (1962), its sales accounted for only 1.2% of all national retail sales. *Id.*

87. The first five volumes of the record are replete with discussions of possible lower prices. For a discussion of this evidence, *see* Peterman, *supra* note 86, at 111–35.

has been placed in this position, not by choice, but by necessity.⁸⁸

Because of advantages such as these, the court concluded that "the merger would establish a manufacturer-retailer relationship which deprives all but the top firms in the industry of a fair opportunity to compete."⁸⁹

On appeal to the Supreme Court, both sides filed extensive briefs, perhaps in part because *Brown Shoe* was to be the first major substantive decision under amended section 7. Although Brown devoted most of its 200-plus pages to the factual background and the appropriate product and geographic markets, it discussed some of the efficiency-creating possibilities of the merger, including those that the district court had found. Brown denied the existence of advantages associated with integration,⁹⁰ asserting instead that the "undisputed facts" showed that the vertical integration produced no economic advantages⁹¹ and that, at the retail level, "small independent retailers are efficient and able to compete with other shoe outlets—there are no significant economies of size in shoe retailing."⁹² Thus, Brown denied what, by any definition, is a consumer benefit resulting from increased efficiency.

The record does provide only minimal support for the district court's efficiency findings.⁹³ Thus, while Brown could not perhaps have argued in good faith that the merger increased efficiency in the manner indicated, it need not have acquiesced in the argument that benefiting consumers was an evil. Furthermore, other effi-

88. *United States v. Brown Shoe Co.*, 179 F. Supp. 721, 738 (E.D. Mo. 1959) (emphasis added).

89. *Id.* at 741.

90. For example, Brown stated that "the so-called 'advantages' enjoyed by company-owned and company-controlled retail outlets, which the district court purported to find, are not borne out by the record. There is nothing to show that any possible advantages of the acquisition will be decisive." Brief for Petitioner at 111, *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962).

91. *Id.* at 182. Further, in a six-page section entitled "The so-called advantages enjoyed by company-controlled and company-owned retail outlets," Brown denied point by point the advantages that the district court had found. For example, Brown contended the record did not support the district court's finding that the merger resulted in lower prices or in higher quality for the same price. *Id.* at 193-99.

92. *Id.* at 177.

93. Peterman, *supra* note 86, at 106-17, discusses the vertical aspects of the case. Although there was evidence in the record that Brown did have lower costs than some of its competitors, that evidence was not linked to vertical integration. Indeed, there was very little evidence or even discussion of advantages that related strictly to vertical integration. Instead, there were merely the statements by relatively small competitors of Brown and Kinney, claiming that the more efficient vertically integrated firms had hurt smaller firms. *See, e.g.*, Record, Vol. 1, at 350-68; Record, Vol. 2, at 88-94.

ciency arguments were possible yet not pursued.⁹⁴ At the very least Brown owed some cogent explanation of why the merger occurred, yet it provided little information, particularly regarding whether the merger made economic sense.⁹⁵

The government's brief is also troubling. Like Brown's, most of the government's attention went to two of the three major issues involved: defining the relevant product and geographic markets. In discussing the third issue, the merger's anticompetitive effect, the government relied on testimony of independent retailers to assemble a compendium of "evils" that the merger allegedly caused: creating lower costs, permitting better quality, allowing Brown to

94. In its brief, Brown gave little reason for acquiring Kinney other than that Brown wanted to enter the retail market by merger rather than *de novo*. Its reasons were twofold. First, Brown felt that its relative inexperience in retailing made merger the best means of expansion into the retail market. Second, Kinney's long record of success in its part of the retail market made it a particularly lucrative acquisition. Brief for Petitioner at 100. During the trial, three other reasons were advanced, each of which revealed the possibility of lower costs. First, the president of Kinney suggested that Brown could produce at a lower cost than Kinney and that Brown could help Kinney improve its manufacturing. Record, Vol. 3, at 1449-51. The record, however, contains little other evidence on this matter. See Peterman, *supra* note 86, at 132-37. Presumably these statements had some basis in fact which could have been elaborated and tested. Second, Peterman suggests a possible efficiency explanation growing out of the desire of retailers to enter the burgeoning, new marketplace—the shopping center—that was rapidly expanding during the 1950's. Peterman, *supra* note 86, at 135-37. Independent retailers, with whom Brown primarily dealt, were expected to decline in number, thus forcing Brown to decide how best to secure distribution in shopping centers. Although shopping centers were explicitly discussed at trial and Brown indicated its desire to enter the shopping centers other than by *de novo* entry, it did not suggest an efficiency explanation for not simply adjusting its production plans to supply those firms that would expand in relative importance as shopping centers grew. Finally, Peterman hypothesizes possible benefits from integration as opposed to contracting. *Id.* at 133-35. Peterman did not test this hypothesis, nor did the proceedings provide evidence on the issue. The argument is a transaction cost one, a form of efficiency that will be subsequently discussed. See notes 155-65 *infra* and accompanying text.

95. As Peterman concludes:

Given the government's approach, Brown seems to have been led to reveal as little as possible about the expected gains from its merger with Kinney. The result was that the proceedings were conducted in a way which made it very difficult to discover or understand the economic arrangements in the shoe industry.

Peterman, *supra* note 86, at 143-44.

Significantly, Brown passed up the unique opportunity to argue explicitly an efficiency justification under amended section 7 before the Supreme Court had interpreted that section. Brown did criticize the district court's reasoning, quoted in the text accompanying note 88 *supra*, by arguing that it was error to equate injury to competitors with injury to competition. Brown did not, however, pursue this point further.

Another puzzling aspect of the appellant's brief is its treatment of the legislative history. Brown made only five brief references to the history of amended section 7, while the government cited the history twenty-five times, despite the history being more supportive of Brown on the efficiency question than it is of the government's position. See notes 42-83 *supra* and accompanying text.

“utilize the modern efficient Kinney retail organization to introduce new styles”, developing merchandising and promotional innovations, and—the ultimate anticompetitive act—lowering prices.⁹⁶

Only against this background can the Supreme Court discussion of efficiency in *Brown Shoe* be understood. In considering the legality of the horizontal aspects of the merger, the Court mentioned the efficiencies that the lower court had found:

A third significant aspect of this merger is that it creates a large national chain which is integrated with a manufacturing operation. The retail outlets of integrated companies, by eliminating wholesalers and by increasing the volume of purchases from the manufacturing division of the enterprise, can market their own brands at prices below those of competing independent retailers. Of course, some of the results of large integrated or chain operations are beneficial to consumers. Their expansion is not rendered unlawful by the mere fact that small independent stores may be adversely affected. It is competition, not competitors, which the Act protects. But we cannot fail to recognize Congress' desire to promote competition through the protection of viable, small, locally owned businesses. Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets. It resolved these competing considerations in favor of decentralization. We must give effect to that decision.⁹⁷

This baffling passage raises several observations and questions. First, the passage effectively states that while a merger is not unlawful merely because small competitors may be adversely affected, a merger will be unlawful when competition may be adversely affected.⁹⁸ Second, at the end of the section on vertical mergers, the Court implied that the merger might be saved if it produced “any countervailing competitive, economic, or social advantages.”⁹⁹ At the end of the section on horizontal mergers, the opinion again implied that “mitigating factors” might save the merger.¹⁰⁰ Why then did Chief Justice Warren fail to find that the consumer benefits qualified as countervailing economic advantages or as mitigating factors? Perhaps Brown's failure to argue

96. Brief for Respondent at 48, 121, 135-36. In its reply brief, Brown again denied that the merger lowered costs. Reply Brief for Petitioner at 33-37.

97. *Brown Shoe Co. v. United States*, 370 U.S. 294, 344 (1962).

98. See Bork & Bowman, *The Crisis in Antitrust*, 65 COLUM. L. REV. 363, 373 (1965).

99. 370 U.S. at 334.

100. *Id.* at 346. Although the Court mentioned small firm mergers and the failing company defense in discussing mitigating factors, it did not limit mitigating factors to these possibilities. *Id.*

efficiency as a defense was crucial, particularly since it allowed the Court to conclude that Brown had presented no mitigating factors.¹⁰¹

Third, that the Court discussed the advantages of vertical integration under the horizontal merger section of the opinion is puzzling. The Court appears confused, as it also does in other parts of the horizontal merger section. Besides this confusion and the ambiguity over whether harm to small business leads to illegality, the Court, in the space of but a few pages, argued that the merger was harmful both because it led or might lead to higher prices and then because it led to lower prices.¹⁰² Finally, recall that Congress did not require a tradeoff between concentration and inefficiency.¹⁰³ In fact, in a passage preceding the one quoted above, the *Brown Shoe* Court correctly concluded that Congress wanted to deter only mergers "having demonstrable anticompetitive effects. . . . Taken as a whole, the legislative history illuminates congressional concern with the protection of *competition*, not *competitors*, and its desire to restrain mergers only to the extent that such combinations may tend to lessen competition."¹⁰⁴ This passage appears to mandate an economic approach to merger cases, and thus conflicts directly with the other *Brown Shoe* passage quoted earlier.¹⁰⁵ The Court gave no explanation for its inconsistent views of the legislative history.

The *Brown Shoe* opinion leaves the efficiency defense in limbo. Not only is the opinion not definitive, it is also internally inconsistent, once within a space of two sentences.¹⁰⁶ Perhaps most importantly, the Court was confronted with the government argument and the district court finding that the merger was illegal because it lowered prices, while the defendant denied that it had such an effect. In this context, it is perhaps surprising that the Court was as cautious as it was on the efficiency issue. In any event, the Court simply neither was presented with, nor did it squarely address, the issue of efficiency as a justification.

101. *Id.*

102. *Id.* at 340-44.

103. See notes 59-64 *supra* and accompanying text.

104. 370 U.S. at 319-20 (emphasis in the original). For interpretations of this passage similar to that of this paper, see R. POSNER, *supra* note 6, at 101-05; 1 P. AREEDA & D. TURNER, *supra* note 31, at 11. Further, the Court noted that mergers were to be functionally viewed within a broad range of relevant economic evidence. 370 U.S. at 321-22.

105. See text accompanying note 97 *supra*.

106. *Id.*

B. Philadelphia National Bank

In February 1961, the Justice Department challenged a merger between the Philadelphia National Bank (PNB) and Girard Trust Corn Exchange Bank, the second and third largest commercial banks headquartered in the Philadelphia metropolitan area. Although the government presented opinion testimony that the merger would hurt small banks, it did not stress efficiency as the problem with the merger.¹⁰⁷ The argument that prevailed in the Supreme Court was that the increase in concentration in an already oligopolistic market facilitated noncompetitive performance.¹⁰⁸

The bank attempted to justify the merger. Although by no means its major justification,¹⁰⁹ one of PNB's arguments was that Philadelphia needed a larger bank to develop new business and stimulate economic development.¹¹⁰ In finding for the government, the Court commented upon this justification:

107. For a discussion of this testimony, see *United States v. Philadelphia Nat'l Bank*, 201 F. Supp. 348, 353 (E.D. Pa. 1962). Although the government may have been using this evidence to attack *Brown Shoe*-type efficiency, the Court in *Philadelphia Nat'l Bank* criticized reliance on testimony of competitors, thus indirectly criticizing *Brown Shoe*. The Court noted that high profits by competitors of the merged firm did not support the merger since competitors could prosper under the higher prices of noncompetitive conduct, yet the market could be extremely noncompetitive. *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 367 n.43 (1963). Conversely, when competitors complain, it could be an indication that competition is very effective.

108. The merged bank controlled at least 30% of the relevant market and the merger increased two-bank concentration from 44% to 59%. 374 U.S. at 363-65.

109. According to PNB, the fundamental reason for the merger was to secure an increased lending limit which would allow it to remain competitive in the large loan market with out-of-state banks, particularly those in New York. 374 U.S. at 370. The Court responded:

We reject this application of the concept of "countervailing power." If anticompetitive effects in one market could be justified by procompetitive consequences in another, the logical upshot would be that every firm in an industry could, without violating section 7, embark on a series of mergers that would make it in the end as large as the industry leader. For if all the commercial banks in the Philadelphia area merged into one, it would be smaller than the largest bank in New York City.

Id. (citation omitted).

Although a detailed discussion of this argument is beyond the scope of this article, a few comments are relevant. Although the justification is not necessarily based on lower costs, by requiring balancing, it resembles the efficiency tradeoff already discussed. See notes 18-24 *supra* and accompanying text. Even if the above-quoted passage is read expansively to conclude that efficiency in one market could not justify anticompetitive effects in another market, it would still not preclude efficiency evidence in the market at issue. For a discussion of this aspect of *Philadelphia Nat'l Bank* that also distinguishes between the justification discussed in this footnote and an efficiency justification, see Pitofsky, *supra* note 42, at 1071-73.

110. 374 U.S. at 334, 371; Brief for Respondent at 17, 70.

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. A value choice of such magnitude is beyond the ordinary limits of judicial competence, and in any event, has been made for us already, by Congress when it enacted the amended § 7. 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.¹¹¹

Although one court has cited this passage as precluding an efficiency defense,¹¹² the language cannot within its context be so read. The Court was not responding to a justification that lower costs benefit competition in the relevant geographic market. Although PNB had offered testimony at trial that the merger would result in economies of scale,¹¹³ when the lower court did not mention this justification and PNB did not pursue it on appeal, the Court considered the point abandoned.¹¹⁴ Instead of a tradeoff between efficiency and market power, the bank in effect suggested that even if the merger would decrease competition the Court should balance this decrease against other beneficial impacts on the Philadelphia community. The Court did say that the merger could not be saved by an "ultimate reckoning of . . . economic debits and credits," but in this context, "economic" does not refer to lowering costs, but instead to benefits to the economic environment of the Philadelphia community. Had the Court engaged in the suggested balancing it would have set sail on the "sea of doubt" that antitrust courts have long eschewed.¹¹⁵ The quoted

111. 374 U.S. at 371.

112. See *International Tel. & Tel. Corp. v. General Tel. & Elec. Corp.*, 518 F.2d 913, 936 (9th Cir. 1975).

113. Record at 1595, 1607, *United States v. Philadelphia Nat'l Bank*, 201 F. Supp. 348 (E.D. Pa. 1962).

114. 374 U.S. at 334-35 n.10.

115. From the earliest days of the antitrust laws, courts have rejected justifications for blatantly anticompetitive practices, even when the practices purportedly kept prices "reasonable", prevented "cut-throat" competition, or produced other alleged benefits. See, e.g., *United States v. Addyston Pipe & Steel Co.*, 85 F. 271 (6th Cir. 1898), *modified and aff'd*, 175 U.S. 211 (1899). The "sea of doubt" phrase was coined by Judge Taft in *Addyston*. 85 F. at 287. For a discussion of how this development is consistent with using economic evidence and excluding evidence such as that offered by the bank, see Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division*, 75 *YALE L.J.* 373 (1966). See also *National Soc'y of Professional Eng'rs v. United States*, 435 U.S. 679, 689-92 (1978).

passage from *Philadelphia National Bank* represents but another example of the Court's longstanding refusal to let practices, found under economic analysis to be anticompetitive in the relevant market, escape condemnation because of some alleged general benefits to society as a whole or because the results of competition were considered untoward. Read in its context, the Court is supporting the use of economic analysis, not rejecting it.

Indeed, that the thrust of *Philadelphia National Bank* is almost entirely economic was amply demonstrated when the Court echoed the then conventional economic criticism of concentration.¹¹⁶ Moreover, the Court did not establish *per se* rules against specified levels of concentration, but instead would have allowed "evidence clearly showing that the merger is not likely to have . . . anticompetitive effects."¹¹⁷ Efficiency, of course, can constitute such evidence.¹¹⁸

A final reason which prevents the quoted passage from being read to preclude an efficiency justification concerns the Court's apparent refusal to hear justifications once the merger is found to be anticompetitive. Since this point is also relevant to the Court's *Procter & Gamble* decision, it will be considered with that case.¹¹⁹

C. Procter & Gamble

In September 1957, the Federal Trade Commission challenged the acquisition of Clorox Chemical Company, the nation's largest manufacturer of liquid household bleach, by Procter & Gamble Company (P&G), the largest producer of soaps, detergents, and related products. Although the Commission believed that increased efficiency should not always count against mergers,¹²⁰ one of its principal arguments rested upon lower costs, particularly the belief that P&G, which had previously not sold bleach, could obtain advertising at a twenty-five to thirty percent discount

116. The consensus regarding the market concentration doctrine was, in its simplest form, that there was a close correlation between concentration and noncompetitive performance. Such a consensus no longer exists. *See generally* INDUSTRIAL CONCENTRATION: THE NEW LEARNING (H. Goldschmid, *et al.* eds. 1974).

117. 374 U.S. at 363.

118. *See* notes 14-41 *supra* and accompanying text.

119. Whether *Ford Motor Co. v. United States*, 405 U.S. 562 (1972), expands *Philadelphia Nat'l Bank* is discussed later. *See* notes 142-46 *infra* and accompanying text.

120. "In general, advantages afforded by merger which reflect simply greater efficiencies ought not to be a basis for holding the merger illegal; efficiency is, after all, the prime goal of antitrust. But that principal is inapplicable we believe to the circumstances of the case." Brief for Petitioner at 47, *FTC v. Procter & Gamble Co.*, 386 U.S. 568 (1967).

over that available to Clorox.¹²¹ These discounts, together with P&G's extensive financial resources, had "increased the power of Clorox, by dominating its competitors and discouraging new entry, to foreclose effective competition in the industry."¹²² Moreover, the Commission felt that bleach advertising did not promote competition, but instead meaninglessly differentiated the product.¹²³ Accordingly, any savings in advertising costs harmed, rather than aided, competition.

P&G countered that the advantages, particularly the advertising discounts, were nonexistent.¹²⁴ Because Clorox already marketed its product as effectively as possible, P&G could only try to do as well.¹²⁵ Although correct about the discounts,¹²⁶ P&G can be faulted for inadequately justifying the merger and perhaps for failing to raise efficiency as a justification. Internal P&G memoranda recommending the acquisition predicted that there would be large savings in promotion, sales, and distribution, but the company did not present evidence of these efficiencies during the litigation.¹²⁷

One of the anticompetitive effects cited by the Supreme Court in striking down the merger was related to the size and prominence of P&G.¹²⁸ In an argument that has come to be known as "entrenchment," the Court expressed the fear that the substitution of P&G for Clorox would make smaller bleach firms wary of reaction by P&G and hence more cautious in competing. The substitution would also cause potential entrants to be more reluctant to enter the market to face P&G than they would have been to face Clorox. Although entrenchment can encompass an attack upon

121. Procter & Gamble Co., 63 F.T.C. 1465, 1501, 1563-65 (1963).

122. *Id.* at 1569. Although in the 1960's most economists were hostile to product differentiation of the P&G and Clorox variety, this consensus no longer exists. See generally INDUSTRIAL CONCENTRATION: THE NEW LEARNING, *supra* note 116.

Although in administrative proceedings, the FTC and its staff listed many possible sources of lower costs, 63 F.T.C. at 1502-15, including management and distribution, on final appeal the efficiency arguments were limited to financial resources and discounts. 386 U.S. at 580.

123. 63 F.T.C. at 1580-82.

124. Brief for Respondent at 35-41; see also Peterman, *The Clorox Case and Television Rate Structures*, 11 J. L. & ECON. 321, 339 (1968).

125. Brief for Respondent at 34-35.

126. In fact, Clorox and P&G purchased television advertising at the same rate. Although there was a difference in price between network and local advertising, neither company bought network advertising time for bleach. Peterman, *supra* note 124.

127. For a discussion of these reports, see 63 F.T.C. at 1541-42.

128. *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 572 (1968). The other effect that the Court found concerned elimination of potential competition. *Id.*

efficiency,¹²⁹ it does not, at least for mergers where entrenchment is not an issue, preclude an efficiency justification. Moreover, because of its theoretical weakness¹³⁰ and because of the unusual facts of *Procter & Gamble*, the doctrine would appear to have very limited application. P&G, probably the most successful marketer of consumer goods in the world,¹³¹ acquired the dominant firm in a concentrated industry where, compared to firms in most industries under antitrust scrutiny, that dominant firm was small.¹³² In few, if any, other cases is the entrenchment doctrine as appealing.

Of more importance to an efficiency justification was the Court's statement that: "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 struck the balance in favor of protecting competition."¹³³

Although again seeming to preclude an efficiency justification,¹³⁴ a close reading belies such a conclusion. To begin with, the passage immediately follows the Court's discussion of entrenchment and precedes the discussion of other anticompetitive effects. In that context, the statement can be limited to precluding efficiency as a defense to entrenchment. Further, the words "possible", "illegality", and "lessen competition" are crucial. For economies to be a justification, the merged firm must show that lower costs are more certain than merely possible, making the efficiency defense proposed in this article distinguishable from the defense that aroused the Court's concern. In deciding whether a

129. Often the entrenchment argument seems to consist mainly of a general fear of the "deep pockets" of large businesses. See, e.g., *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 523 F.2d 262, 268-70 (3d Cir. 1975), *vacated and remanded on other grounds*, 429 U.S. 477 (1976). See notes 148-51 *infra* and accompanying text. One of the reasons small firms should fear larger ones, indeed perhaps the only logical reason, is lower costs of the larger firms. The P&G Court did not consider the anticompetitive implications of this point. The United States Court of Appeals for the First Circuit has suggested that entrenchment applies only to pecuniary, not real, economies. See *Emhart Corp. v. USM Corp.*, 527 F.2d 177, 182 (1st Cir. 1975). The real/pecuniary distinction is discussed in note 155 *infra*.

130. The entrenchment argument is anomalous because it implies that P&G should not have been allowed to enter the bleach market, even were it to do so through internal expansion. See R. POSNER, *supra* note 6, at 119-20.

131. P&G dominates several industries, often after entry against large, successful firms. For a discussion of P&G's organization and its successes, see 63 F.T.C. at 1484-85, 1498-1502.

132. Clorox had annual sales slightly less than \$40 million, while P&G's were nearly 30 times larger. 386 U.S. at 571-72.

133. 386 U.S. at 380 (quoting *Brown Shoe Co. v. United States*, 370 U.S. 294, 344 (1962)).

134. See, e.g., Mantell, *Conglomerate Mergers, Allocative Efficiency, and Section 7 of the Clayton Act*, 56 TEX. L. REV. 207, 218 (1978).

merger is illegal, the focus is upon whether it lessens competition. As economic theory¹³⁵ and basic antitrust principles establish, efficiency is one of the variables in the competition calculus and one of the reasons competition is valued.¹³⁶ Therefore, a merger's legality turns in part on the existence and magnitude of economies.¹³⁷ At the worst for an efficiency defense, then, the passage is highly confusing. Finally, the parties did not place the issue of a general efficiency justification before the Court. The government did not contend that all efficiencies are irrelevant, nor did the defendant assert an efficiency defense. Thus, it cannot be said that the Court was responding to an argument that efficiency could (or could not) justify a merger.¹³⁸

D. *Other Decisions*

Although not so well known as the cases already discussed, other decisions are relevant to the issue of an efficiency justification. A discussion of these cases provides some evidence that efficiency can indeed justify mergers.

1. *Tampa Electric Co. v. Nashville Coal Co.*¹³⁹

Tampa agreed to purchase from Nashville all the coal required over twenty years for boiler fuel at a power station. A dispute subsequently arose during which Nashville claimed that this long-term requirements contract violated section 3 of the Clayton Act. In finding that the contract was permissible, the Court stated that the advantages of the arrangement, such as reducing the risk and the transaction costs that the parties would face from having to

135. See notes 14-41 *supra* and accompanying text.

136. See note 1 *supra* and accompanying text.

137. The Court attempts to brush the question [of efficiencies] aside by asserting that Congress preferred competition to economies, but neglects to determine whether certain economies are inherent in the idea of competition. If it is conceded, as it must be, that Congress has reasons for favoring competition, then more efficient operation must have been among them. It is of course true that a firm's ability to achieve economies enhances its competitive position, but adverse effect on competitors must be distinguished from adverse effects on competition.

386 U.S. at 597 (Harlan, J., concurring). Justice Harlan concurred in the result because he agreed with the Commission that the efficiencies in question were not beneficial. *Id.* at 603-04.

138. This is not to argue that the Court could not have reached out to decide the issue if it chose to do so. It would be much easier, however, to read the quoted passage as precluding an efficiency defense if the parties had explicitly presented that issue. Since the parties did not, and since the passage is obscure and subject to varying interpretations, the opinion should not be read to bar an efficiency justification.

139. 365 U.S. 320 (1961).

deal in the market, counted *for* the transaction in the antitrust calculus.¹⁴⁰ Although not brought under section 7, *Tampa* is relevant because requirements contracts are a form of vertical integration similar in effect to vertical mergers.¹⁴¹

2. Ford Motor Co. v. United States¹⁴²

The government successfully challenged Ford's acquisition of Electric Autolite Company, as an independent manufacturer of spark plugs and other automotive parts. After agreeing with the district court that the merger was anticompetitive, the Court noted that "It is argued, however, that the acquisition has some beneficial effect in making Autolite a more vigorous and effective competitor . . . than Autolite had been as an independent. But what we said in *United States v. Philadelphia National Bank* . . . disposes of the argument."¹⁴³

Although this passage in *Ford* has been read as extending *Philadelphia National Bank* from precluding justifications not related to competition to precluding the economic justification of efficiency,¹⁴⁴ the context does not compel such a conclusion. Ford's argument was not based upon lower costs, but instead principally upon Autolite's market share increase after the merger, while that of its major competitor decreased.¹⁴⁵ Indeed, Autolite's increase could be attributed to Autolite providing spark plugs to its new owner, Ford, rather than to the smaller Chrysler as it had before the merger. Thus, the increase could be attributed to what the Court felt were the anticompetitive aspects of the merger, namely, foreclosure of Autolite from Ford's competitors.¹⁴⁶

140. *Id.* at 331-32. Professor Sullivan also suggests that *Tampa* supports an efficiency defense. L. SULLIVAN, ANTITRUST 631 (1978).

It should be noted that in the *Standard Stations* case, the Court found a requirements contract to be illegal despite mentioning its advantages. *Standard Oil Co. of Cal. v. United States*, 337 U.S. 293 (1949). The Court seemed to feel that section 3 prohibited consideration of these efficiencies. The *Tampa* Court distinguished *Standard Stations* without commenting on the earlier decisions' treatment of efficiency.

141. *Tampa* could have integrated via merger with Nashville and obtained the same result as the contract integration: the guaranty of a long-term supply of coal.

142. 405 U.S. 562 (1972).

143. *Id.* at 569-70. The Court then quoted the passage accompanying note 111 *supra*.

144. Pitofsky, *supra* note 42, at 1068.

145. Brief for Petitioner at 26. Although not one of its principal arguments, Ford did argue that the merger increased efficiency because Ford had an extensive program for quality control (on which Ford spent \$4.5 million annually) that other owners were not likely to duplicate. *Id.* at 52.

146. Justice Stewart argued this position in concurrence, as did the government in its brief. 405 U.S. at 580 n.3 (Stewart, J., concurring); Brief for Respondent at 38. On the

3. *More Recent Cases*

Since 1974, the Court has become more receptive to economic analysis. In merger cases, the Court has looked more closely at economic evidence to determine competitive effect.¹⁴⁷ Although this approach has yet to include evidence of efficiency, such evidence is consistent with the Court's recent approach. Further, the Court has declined to follow the anticompetitive implications of *Brown Shoe*. In *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*,¹⁴⁸ the lower courts found liability in a private section 7 action based upon entrenchment.¹⁴⁹ Although the viability of the entrenchment doctrine was not at issue, the Supreme Court condemned the theory that a party could receive damages solely because its anticipated market share increase failed to materialize when a merger kept a competitor in business. The Court cited *Brown Shoe* for the proposition that competition, not competitors, was to be protected,¹⁵⁰ thus ignoring that *Brown Shoe* might also be read to support competitors at the expense of competition.¹⁵¹ Finally, in *GTE Sylvania*,¹⁵² the Court overturned an earlier decision holding vertical market division to be *per se* illegal, and not only vigorously applied economic analysis, but also insisted that antitrust doctrine be grounded upon such analysis.¹⁵³

basis of this argument, *Ford* is not necessarily an extension of the *Philadelphia Nat'l Bank* rationale.

147. See, e.g., *United States v. General Dynamics Corp.*, 415 U.S. 486 (1974) (horizontal merger); *United States v. Marine Bancorporation, Inc.*, 418 U.S. 602 (1974) (conglomerate merger).

A recent Note argues that an efficiency defense is inconsistent with *General Dynamics*, where the Court allowed economic evidence to be used to rebut the presumption that the market shares involved revealed the merger's anticompetitive nature. The Note bases this argument on the assertion that the defense "is not an attack on the . . . [use of the market shares] as inaccurately describing the impact of the merger; rather, it seeks to justify that impact." Note, *Horizontal Mergers After United States v. General Dynamics Corp.*, 92 HARV. L. REV. 491, 508 (1978). On the contrary, the defense, by demonstrating that the merger's net impact is procompetitive, does rebut the inference drawn from market shares.

148. 429 U.S. 477 (1977).

149. The Court of Appeals opinion contains the best statement of the entrenchment theory and its application to the particular facts. *NBO Industries Treadway Cos. v. Brunswick Corp.*, 523 F.2d 262, 268-70 (3d Cir. 1975).

150. The citation was to page 320 of the *Brown Shoe* opinion, not to page 344 which, although also stating that competition is to be protected, contains the ambivalence earlier discussed. See notes 97-106 *supra* and accompanying text.

151. The argument is not that *Brunswick* somehow overruled *Brown Shoe*, but merely that *Brown Shoe* could have been read to support a damage award. As argued in Section IIIA, however, *Brown Shoe* does not compel such a reading.

152. *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977).

153. Two other cases are worthy of mention. *Citizen Pub. Co. v. United States*, 394 U.S. 131 (1969), involved a joint venture between the only two daily newspapers in Tucson,

E. Summary

Only a reading of the Court's decisions that ignores their contexts could lead one to conclude that an efficiency defense is precluded. Within the context of the relevant decisions the worst that can be said for an efficiency justification is that it is precluded in entrenchment cases when efficiency is the source of the harm feared under that doctrine. This conclusion is not surprising since the most striking feature demonstrated is that no case before the Supreme Court has directly raised an efficiency justification. There simply has yet to be a definitive decision.

IV. THE EFFICIENCY JUSTIFICATION AND THE JUDICIAL PROCESS

Several commentators contend that because efficiency is an "intractable subject for litigation", it should be precluded as a justification for merger.¹⁵⁴ To evaluate this argument, this section first considers the nature of efficiency. The analysis next explores how different types of efficiency arguments might be presented in a trial. Finally, the discussion frames this argument against an

Arizona, to manage all facets of the business, except news and editorials. Thus, the case presented the opportunity to raise the arguments that Senators Kefauver and O'Connor had presented on the floor of the Senate. See notes 78-79 *supra* and accompanying text. Although the possibility for economies appears to exist and although the district court found that the joint venture "had resulted in substantial cost savings," *United States v. Citizen Pub. Co.*, 280 F. Supp. 978, 982 (D. Ariz. 1968), the defendant did not raise this issue before the Supreme Court. The National Association of Newspapers, however, mentioned economies of scale. Amicus Brief of Nat'l Ass'n of Newspapers at 29-30. In striking down the merger, the Court did not bother with the economic justification; instead, it discussed only the failing business defense and the first amendment of the Constitution. All other arguments were "too trivial for discussion." 394 U.S. at 140. Although Justice Stewart dissented and Justice Harlan concurred in the result, both opinions concerned the failing company defense, not efficiency. *Id.* at 140 (Harlan, J., concurring); *id.* at 143 (Stewart, J., dissenting).

The second case, *United States v. Continental Can Co.*, 378 U.S. 441 (1964), involved the merger of a company involved primarily in the production of metal containers with another company specializing in the manufacture of glass containers. Although the defendant did not maintain that the merger created efficiencies benefiting consumers, it did argue that diversification had "competitive" advantages. *Id.* at 463-64. The Court, apparently agreeing that there were advantages, nevertheless found against the merger because of anticompetitive effects, without stating or implying whether its rejection of the advantages went to an efficiency justification.

154. R. BORK, *supra* note 6, at 123-29, 192-95; R. POSNER, *supra* note 6, at 111-12. Among economists in favor of considering efficiency, the best known is Joe S. Bain. J. BAIN, *INDUSTRIAL ORGANIZATION* 658 (2d ed. 1968); Bain, *Discussion*, 40 AM. ECON. REV. 64-66 (Papers & Proceedings 1950).

efficiency defense in the context of the broader issue of how anti-trust rules should be formulated.

A. *The Nature of Efficiency*

In merger litigation, an increase in efficiency should be defined as a decrease in costs.¹⁵⁵ Efficiency results when the same product is produced at a lower cost or the merger allows a superior product to be produced at the previous cost (thus effectively lowering cost). This definition may be too narrow for purposes other than merger litigation. For example, in evaluating which of two manufacturers of soft drinks provided more benefits to consumers, selecting the one that produced at the lowest cost would not necessarily be correct if the other company produced a product for which consumers were willing to pay a higher price.¹⁵⁶

It is unlikely, however, that courts can define efficiency in merger cases based on consumer satisfaction. Judges would rarely have enough postacquisition evidence to determine whether the judgment of the market indicated an increase in consumer welfare, and would, in any event, have trouble distinguishing efficiency from monopoly explanations of success. Because efficiency based on consumer satisfaction is excluded, Professor Bork has argued that an efficiency justification is unwarranted. "The real objection to . . . efficiency defenses in antitrust law is that they are spurious. They cannot measure the factors relevant to consumer welfare, so that after the economic extravaganza was completed we would know no more than before it began."¹⁵⁷ In mergers, however, efficiency evidence would improve decision-making. As already demonstrated, if the evidence reveals that the merger will result in nontrivial economies, the merger will usually be procompetitive, justifying a merger that could otherwise be

155. Courts should distinguish pecuniary from real cost savings. Pecuniary economies, such as cost savings from tax advantages, merely transfer wealth without reducing the resources spent to produce the product in question. See generally P. STEINER, *MERGERS* 47-127 (1975). Even here, however, pecuniary and real cost savings may be linked, as Frank Easterbrook has pointed out to me. Acquisition of an unprofitable firm confers tax advantages, but if the now displaced management caused the poor performance, efficiency could also increase.

156. This, of course, assumes that both companies are viable, *i.e.*, able to receive a price sufficient to generate at least a competitive rate of return. For more detailed discussions of this type of efficiency, see R. BORK, *supra* note 6, at 104-06; McGee, *Efficiency and Economies of Size* in *INDUSTRIAL CONCENTRATION: THE NEW LEARNING*, *supra* note 116, at 88-89.

157. R. BORK, *supra* note 6, at 124.

condemned.¹⁵⁸ Merely because some efficiencies are beyond facile demonstration does not justify preclusion of an efficiency defense.

Among mergers that lower costs, it is useful to distinguish technical from nontechnical efficiencies. Technical processes such as economies of scale, whereby a firm with larger planned volume reduces unit costs, are an important source of lower costs. As Professor McGee has argued, however, exclusive focus on "technical processes . . . leaves out much of the real problem [in measuring efficiency]: recruitment, evaluation, and promotion; product design; research; planning; administration; cost and quality control; financing; marketing; and so on."¹⁵⁹ Further, some individuals, some teams, some factors of production, and some firms are simply more competent than others.

An important nontechnical efficiency involves transaction costs, a good example of which is found in vertical mergers. Vertical integration can reduce cost by facilitating technological interdependence, such as when a steel furnace and rolling mill are combined to limit the need for separate reheating.¹⁶⁰ Efficiency, however, goes beyond such interdependence and involves what Professor Coase has called "the supersession of the price mechanism."¹⁶¹ Where the costs of a buyer and seller transacting through the market are higher than those of one who performs the same function within a single entity, integration will be preferred. A vertical merger for this purpose thus increases efficiency.¹⁶²

There are other nontechnical efficiencies. For example, size permits risk-pooling to lower the cost of raising capital. The average capital advantage of a one billion dollar firm over a ten mil-

158. See notes 14-41 *supra* and accompanying text.

159. McGee, *supra* note 156, at 69. On the nature of the efficiency of a "team" of employees or managers, see Alchian & Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777 (1972).

160. F. SCHERER, *supra* note 33, at 70.

161. Coase, *The Nature of the Firm*, reprinted in READINGS IN PRICE THEORY 331, 334 (G. Stigler & K. Boulding eds. 1952). Professor Williamson contends that transaction cost efficiencies are more important than technical efficiencies in mergers, particularly in conglomerate and vertical mergers. *Williamson III*, *supra* note 18, at 723-24.

162. Coase, *supra* note 161, at 336. Conglomerate mergers can also provide transaction economies. For example, conglomerates with a central office acting as a broker for internal competition for funds may be able to allocate capital at less cost than the capital market, due to savings such as lower costs from negotiating the transfer of funds. Further, since division managers who receive the capital are insiders, they may be more cooperative with the central office than with outsiders, thus providing the central office (which rations the funds) with better sources of information. See O. WILLIAMSON, *MARKETS AND HIERARCHY: ANALYSIS AND ANTITRUST IMPLICATIONS* 141-48 (1975).

lion dollar firm is nearly one percentage point.¹⁶³ Another nontechnical efficiency involves replacing an incumbent management team with a more competent one. For publicly owned companies, takeovers can produce such change in management. Managers who do not perform well will see the price of their company's stock decline, inducing others to acquire the low-priced stock and to change management to improve the company's performance.¹⁶⁴

Technical efficiencies often hold the attention of courts and commentators to the exclusion of nontechnical efficiencies.¹⁶⁵ This mistake must not be repeated with mergers. Although technical efficiencies will often be easier to demonstrate than nontechnical efficiencies, this difficulty should not preclude an efficiency justification. Such an argument for preclusion is analogous to that made by Professor Bork regarding efficiencies based on consumer satisfaction and should be rejected for the same reason. The perfect should not be the enemy of the good. Whether the "good" is sufficient, however, depends on whether defendants can satisfactorily demonstrate any efficiencies at trial.

B. *Applying the Efficiency Justification*

Although an efficiency justification might seem to require

163. Scherer, *Economies of Scale and Industrial Concentration*, in INDUSTRIAL CONCENTRATION: THE NEW LEARNING, *supra* note 116, at 42 (summarizing studies using 1960's market conditions). Some of the advantages of size are discussed in note 162 *supra*.

164. See Manne, *supra* note 77. Of course, the market for control is not the only, or even necessarily the most important, forum for disciplining managers. For example, the direct market for managerial talent serves an important role in stimulating managers to maximize profits. See Fama, *Agency Problems and the Theory of the Firm*, J. POL. ECON. (manuscript in preparation).

165. See, e.g., *In re Great Lakes Carbon Corp.*, 82 F.T.C. 1529 (1973); P. AREEDA & D. TURNER, *supra* note 31, ¶ 408; Scherer, *supra* note 163. Scherer's work is particularly instructive since it represents a major effort to determine whether efficiency explains the extent of concentration in twelve industries. Although Scherer attempted to incorporate transaction costs such as transportation cost and to calculate multiplant economies, he ignored managerial efficiencies and he seemed to equate plant economies with firm economies. See McGee, *supra* note 156, at 103. See also the comment of Professor Schwartz, *Dialogue* in INDUSTRIAL CONCENTRATION: THE NEW LEARNING, *supra* note 116, at 106.

An additional problem with these studies is the weakness of the data involved. See generally the exchange between B. Bock and L. Weiss in BUSINESS DISCLOSURE: GOVERNMENT'S NEED TO KNOW 264-307 (H. Goldschmid, ed. 1979). Further, besides failing to measure all that is relevant in lowering costs, they can ignore relevant variables that raise costs, such as diseconomies of scale in management. Since it is equally possible that the missing variables lower or raise costs, where an engineering study shows that certain costs drop, the government should have the burden of persuasion that relevant cost increases are ignored. On the nature of the trial, see notes 166-87 *infra* and accompanying text.

courts to compare costs and benefits,¹⁶⁶ it has already been shown that a court need not normally measure the costs of the merger (*i.e.*, the extent of increased market power).¹⁶⁷ Instead, if the defendant can show the existence of nontrivial economies—that is in the magnitude of only one to two percent—the merger should be presumed to be procompetitive.¹⁶⁸

How can the defendant show the existence of nontrivial economies? One method would be to show the magnitude of the cost-savings through engineering or statistical studies.¹⁶⁹ Engineering studies typically involve economists analyzing data from engineers (who often compile the relevant data on their own) to estimate the costs of facilities of different sizes. Statistical studies assemble data on costs, outputs, and other relevant characteristics, and then use statistical techniques to estimate the cost-scale relationship. These studies have measured certain forms of efficiencies.¹⁷⁰

As an example of demonstrating efficiency, consider the brewing industry. From 1947 to 1976, the number of plants in the industry decreased from 465 to 94, and the number of firms from 404 to 49. From the late 1950's to the early 1970's the Justice Department attacked almost every brewing merger between local, regional, or national firms that involved companies with significant market shares.¹⁷¹ The potential for efficiencies appeared substantial, particularly in mergers not involving the top few firms in the industry. Compared to these few large firms which had built new plants, other firms used outdated breweries or operated at less than full capacity or both. Mergers would have enabled the consolidation of several brands into fewer plants, permitting longer product runs, thereby reducing unit costs by spreading set-up costs over a larger volume.¹⁷² Further, the volume increase would have

166. R. BORK, *supra* note 6, at 125; R. POSNER, *supra* note 6, at 112.

167. See notes 14–41 *supra* and accompanying text.

168. *Id.* But see note 188 *infra* and accompanying text.

169. Scherer, *supra* note 163, at 18–19.

170. For a leading study, see Scherer, *supra* note 163.

171. Scherer, *supra* note 163, at 64–74. Many of the mergers involved firms which were not industry leaders and would have had, even after the merger, market shares smaller than the larger firms in the relevant markets. The leading cases include *United States v. Falstaff Brewing Co.*, 410 U.S. 526 (1973); *United States v. Pabst Brewing Co.*, 384 U.S. 546 (1966); *United States v. Joseph Schlitz Brewing Co.*, 253 F. Supp. 129 (N.D. Cal.), *aff'd per curiam*, 385 U.S. 37 (1966). By the mid-1970's, the Justice Department ceased bringing such actions, perhaps because of the efficiencies discussed in the text.

172. For the seminal treatment of this form of efficiency, see Alchian, *Costs and Outputs*, in *THE ALLOCATION OF ECONOMIC RESOURCES* 23 (M. Abramovitz, *et al.* eds. 1959).

facilitated both the modernization and expansion of the plants, again lowering unit costs. Finally, excess capacity and redundant management and distribution would have been eliminated.¹⁷³

Of course, these advantages could eventually have been realized without mergers. It is conceivable that the small firms would have gone bankrupt if they could not have merged, thus producing the same advantages in roughly the same time as mergers. Even in this extreme case, there is no competitive reason to prevent the merger (assuming that the costs of merging do not exceed those of bankruptcy). Indeed, the merger would probably qualify under the failing company doctrine.¹⁷⁴ Moreover, at least some disadvantaged firms are likely to merge before their condition is precarious enough to dictate bankruptcy, making merger a faster route to lower costs.

The magnitude of some of the cost-savings in the brewing industry have been measured.¹⁷⁵ One problem that plagued brewing—shipments from less than optimal size plants—is a significant problem in American manufacturing industries, since such shipments are now approaching fifty percent.¹⁷⁶ More important,

For an excellent application to a specific industry, see McGee, *Economies of Size in Auto Body Manufacture*, 16 J. L. & ECON. 239 (1973).

173. Keithahn, *The Brewing Industry* (FTC Staff Report 1978).

174. See notes 74–77 *supra* and accompanying text.

175. Scherer estimated that a plant one-third of the minimal scale had costs five percent more than a plant of optimal scale. *Id.* at 21. See generally Keithahn, *supra* note 173; D. Norman, *Structural Change and Performance in the U.S. Brewing Industry* (unpublished Ph.D. dissertation, UCLA, 1975).

Courts do have some experience with engineering studies. Under the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79 (1976), utilities have used engineering studies of cost savings to justify integrated public utility holding companies. The Act limits a company to a single integrated system unless an additional system, *inter alia*, "cannot be operated as an independent system without the loss of substantial economies which can be secured by the retention of control by such holding company . . ." *Id.* § 79K(b)(1)(A). Under this provision, utilities have occasionally demonstrated nontrivial cost savings (*i.e.*, at least one percent). Although such proof provides some support that the efficiency defense is suitable for litigation, the evidence must be viewed skeptically. Even when the Securities and Exchange Commission, which had initial jurisdiction under the Act, was willing to concede the existence of nontrivial economies, this concession could be viewed as gratuitous since the Commission interpreted the Act as requiring economies far greater than nontrivial. Further, when the cost savings estimate was larger (*e.g.*, greater than five percent of expenses), the SEC usually concluded that the estimates were overstated. Thus, to a considerable extent, the SEC experience is irrelevant for the purposes of this analysis. For an exhaustive study of this economies defense, see R. RITCHIE, *INTEGRATION OF PUBLIC UTILITY HOLDING COMPANIES* 135–91 (1954). See also Brodley, *Industrial Concentration and Legal Feasibility: The Efficiencies Defense*, 9 J. ECON. ISSUES 365, 368–70 (1975).

176. For a summary of this evidence, see Weiss, *The Structure-Conduct Performance Paradigm: Antitrust Considerations*, 127 U. PA. L. REV. 1104, 1115–19 (1979).

economists have found a systematic tendency for the percentage of suboptimal shipments to decrease as concentration increases.¹⁷⁷ In other words, firms with larger market shares can use optimally-sized plants, product runs, and output. This evidence indicates that there are potential efficiency gains from mergers, with the beer industry as only one example. Ignoring efficiency in these horizontal mergers is anticompetitive.¹⁷⁸

Statistical and engineering studies are, however, ill-suited to measure many nontechnical efficiencies and may, at times, fail even to quantify technical ones. It will be more difficult to develop even a good estimate of the cost savings from at least some types of nontechnical efficiency and there will be technical efficiencies where reliable estimates of magnitude are difficult to obtain. Discussing efficiency within litigation will still be relevant if a defendant shows that the merger will probably result in non-trivial economies, even when it cannot show their precise magnitude. To explore this point, it will be helpful to divide the proof of efficiency into two components: existence and magnitude. Merely showing the existence of the efficiency may constitute sufficient justification. If the defendant shows that the merger will increase efficiency and if the cost savings can be projected over a substantial part of the production process, the merger may then be justi-

177. For example, Professor Scherer's study found that a 1% increase in concentration led to a .95% reduction in shipments from suboptimal plants. See Scherer, *The Determinants of Industry Plant Size in Six Nations*, 55 REV. ECON. & STAT. 135 (1973). Scherer hypothesizes that one reason why this phenomenon exists involves the importance of significant transportation costs, forcing firms with small shares to operate from smaller plants since the small share limits the amount that can be sold close to the plant and transport costs limit sales elsewhere. *Id.* This disadvantage makes the position of these small firms insecure, unless they have other advantages, such as a product with special appeal to certain consumers. Although such advantages, in a rigorous market definition, would lead to their separation from other firms, it is extremely unlikely that antitrust courts fine-tune market definition to this extent. In any event, mergers could alleviate the disadvantages discussed in the text, whether or not there are compensating advantages.

178. This evidence had led Professor Weiss to change his mind and conclude that horizontal merger policy has been too harsh. Weiss, *supra* note 176, at 1117-18.

This evidence points to one significant source of efficiency from horizontal mergers. Managerial acumen is another potentially significant source of efficiency. Regarding vertical mergers, there is considerable evidence suggesting that these mergers often lead to efficiencies. See, e.g., note 161 *supra*; F. SCHERER, *supra* note 33, at 70. Only in conglomerate mergers does there appear substantial disagreement about whether efficiency even occasionally results. Compare, e.g., note 162 *supra* and Steiner, *supra* note 155, at 60-69, 196-200 (conglomerate mergers can be efficient) with 915 ANTITRUST & TRADE REG. REP. (BNA) A-9 (May 24, 1979) and Mueller, *The Effects of Conglomerate Mergers, A Survey of the Empirical Evidence*, 1 J. BANK. & FIN. 315 (1977) (conglomerate mergers generate negligible efficiencies).

fied, particularly where proof of possible market power is weak. Moreover, this approach is perfectly consistent with the Clayton Act, which is concerned with probabilities, not certainties.¹⁷⁹

As to proving the existence of efficiency, a defendant as in the brewing example could use two methods to infer lower costs where reliable estimates of magnitude are unavailable. First, a defendant could use a generally accepted economic or engineering theory concerning the capacity of mergers to increase efficiency, followed by evidence that the necessary steps would be, were being, or had been taken to implement such efficiency. For example, the defendant might argue that reducing excess capacity would lower cost through better plant utilization and elimination of excess capacity. A second method of showing the existence of efficiency involves determining how market share is distributed among the firms in the industry. For example, two companies may merge where firms similar to their premerger size had been losing market share to larger firms. This fact implies efficiency from the merger particularly if firms the size of the new firm have been growing.¹⁸⁰ Although a court might not want to rely exclusively on such evidence, it would nonetheless provide additional grounds for finding nontrivial economies where a reliable magnitude estimate is unavailable.

To understand the demonstration of nontechnical economies, consider the example of the automobile industry. Once a manufacturer has entered into a contract with an independent owner of dies for parts, the manufacturer desires ready access to the giant presses used to stamp body parts if it faces a higher cost (e.g., from delay) in obtaining alternative supplies of specific body parts. Because of the automaker's dependency, die owners have an incentive to engage in opportunistic behavior to increase the contract price to the higher price that the manufacturer would have to pay its next best supplier. Opportunistic behavior may involve steps such as delay by overt or implied threats and lack of cooperation.¹⁸¹

In 1926, General Motors acquired Fisher Body. Before the

179. See, e.g., *FTC v. Procter & Gamble*, 386 U.S. 568, 577 (1967).

180. This technique is known as "survivorship" and traces its origin to Alchian, *Uncertainty, Evolution and Economic Theory*, 58 J. POL. ECON. 211 (1950) and to Stigler, *The Economies of Scale*, 1 J. L. & ECON. 54 (1958). For a discussion of this technique, particularly its uses and limits, see McGee, *supra* note 156, at 80-83.

181. The best statement of this theory and its application to the merger discussed here is Klein, Crawford & Alchian, *Vertical Integration, Appropriable Rents and the Competitive Contracting Process*, 21 J. L. & ECON. 297, 308-310 (1978).

merger, Fisher had tried to obtain higher prices from GM and also refused to locate its body plants adjacent to GM's assembly plants. Although GM claimed that relocation would lower costs, moving the body plants required a large investment from Fisher that would have made it vulnerable to future opportunistic behavior from GM.¹⁸² The merger thus arguably reduced the costs of haggling, lowered the risk to GM, and perhaps most importantly, it guaranteed the adjacent location of the body plant to the motor assembly plant, thereby lowering costs. If General Motors could have demonstrated its problems with Fisher and the cost-savings potential in adjacent locations, existence of efficiency would have been shown. Whether the savings were nontrivial depended upon whether they applied to a significant part of the production process, which, assuming that the costs of stamping and assembling were a large part of the costs of production, appears to be the case. A reliable estimate of the magnitude of cost savings would thus have been unnecessary.¹⁸³

None of this is meant to deny the fact that the efficiency defense will complicate trials. Some efficiencies will not be sufficiently demonstrable, and some proceedings will devolve into a mass of conflicting, confusing testimony.¹⁸⁴ Three factors, how-

182. Opportunism is possible because once the plants were adjacent, Fisher would find it more costly to deal with anyone but GM. Although the possibility for opportunistic behavior can work both ways, the General Motors-Fisher contract prohibited GM from dealing elsewhere, limiting the opportunity for General Motors to gain from opportunism. Apparently contract clauses as easily drafted and enforced did not exist to protect General Motors, and the parties' attempt to draft a complicated formula for Fisher's compensation did not work well in protecting GM.

Three other points are noteworthy. First, the problem was not monopoly. Even if GM had several options as attractive as Fisher before the contract was signed, once the parties began to work together, the arrangement assumed such a specialized posture that GM would have had to pay a premium if it suddenly had to purchase elsewhere. Second, vertical integration would not solve the opportunism problem if the specific asset that engendered the problem was human capital since companies cannot fully integrate into the labor of others. Third, on the assumption that spark plugs seem to be easily standardizable among different cars, the Ford-Autolite merger cannot be explained on this ground. See notes 142-46 *supra* and accompanying text. Klein, Crawford & Alchian, *supra* note 181, at 308.

183. Whether the efficiencies justify the merger depends upon whether the court thinks that the competitive harm will be in the normal range that Williamson discusses. See notes 18-24 *supra* and accompanying text. If not, then a closer inquiry into market power would be necessary. See note 188 *infra* and accompanying text. Further, even if a court had considered internal growth relevant, this possibility would have been unlikely to change the conclusion reached in the text. Forcing internal growth could have limited GM and Fisher in utilizing the common experience and familiarity that they had gained.

184. One proposed measurement technique that appears faulty is suggested in Mantell, *Conglomerate Mergers, Allocative Efficiency, and Section 7 of the Clayton Act*, 56 TEX. L.

ever, will ameliorate this problem. First, postacquisition evidence may be available. Between the merger and the trial, the new firm may have implemented some of the efficiencies. Evidence of implementation will reduce uncertainty about the existence of lower costs.¹⁸⁵ Second, allowing a defense creates incentives to develop improved methods of demonstrating efficiency. It is unreasonable to assume that the current ability of economists to demonstrate efficiency will not improve.¹⁸⁶ Finally, when judges have difficulty in evaluating conflicting evidence, the Federal Rules of Evidence¹⁸⁷ permit appointment of an independent expert to assist

REV. 207 (1978). There are two problems with the model that he suggests for measuring efficiency in merger cases. First, although the author states that he is not "invariably" using profitability as a measure of market power, in applying his model to condemn Procter & Gamble's acquisition of Clorox, *id.* at 233 n.70, he relies on increased profits as a measure of such power. Superiority, rather than market power, may just as easily have caused the increase in profits. On the difficulties of using profitability to measure market power, see generally Demsetz, *Two Systems of Belief About Monopoly* in *INDUSTRIAL CONCENTRATION: THE NEW LEARNING*, *supra* note 116, at 164. Second, his model appears to contain a theoretical flaw. In developing his model, he uses a merger that lowers cost as well as increases market power and a merger that only increases market power. In analyzing gains and losses of the former merger, he appears not to include the benefits of the extra units produced (relative to the merger that only increased market power) because of lower costs. If these units are not counted, the benefits of a merger that both increases market power and reduces costs are understated.

185. Since section 7 requires only a probability that the merger is harmful and that probability need not manifest itself before the trial and since firms could temporarily refrain from anticompetitive acts, the Court has criticized heavy reliance on postacquisition evidence to determine whether a merger would have an anticompetitive effect. See, e.g., *FTC v. Procter & Gamble*, 386 U.S. 568, 577 (1967); *FTC v. Consolidated Foods*, 380 U.S. 592, 598 (1965). Thus, postacquisition evidence can be irrelevant when it reveals no harmful effect. When determining if the merger has the procompetitive effect of efficiency, however, postacquisition evidence can demonstrate the existence of this benefit, and firms would have no reason to undo cost saving measures once litigation ended. Recently the Court approved use of postacquisition evidence where one could draw a more permanent inference from it than that feared in *P & G* and *Consolidated Foods*. See *United States v. General Dynamics Corp.*, 415 U.S. 486, 504-06 (1974) (postacquisition evidence of lack of coal reserves showed acquired company unable to compete effectively).

Under the recently enacted premerger notification provisions, Clayton Act § 7A, 15 U.S.C. § 18a, the government can more easily attack mergers at earlier stages than before and hence the amount of postacquisition evidence available will probably decrease.

186. See *Williamson II*, *supra* note 18, at 113.

187. See FED. R. OF EVID., 706. The expert's findings are given to both parties and are subject to cross-examination. A further step to help judges has been education in economics and in statistical techniques. See Guzzardi, *Judges Discover the World of Economics*, *FORTUNE*, May 21, 1979, at 58.

The lesson of this part of the paper can be summarized in an economic analysis of the judicial system. The economic goal of that system is to minimize the sum of the direct costs of the system and the costs of making errors. Posner, *An Economic Approach to Legal Procedure and Judicial Administration*, 2 J. LEG. STUD. 399 (1973). See also Ehrlich & Posner, *An Economic Analysis of Legal Rulemaking*, 3 J. LEG. STUD. 257 (1974). Direct

the judge.

A further complication is that the presumption that nontrivial economics outweigh any market power can be rebutted. The two most likely grounds for rebuttal, however, will probably be infrequent. Large price increases would appear to result only from the now extinct (and previously rare) mergers to monopoly and mergers that create a dominant firm. Further, internal growth will be crucial only when demand is growing, the potential market power increase is high, and entry from outside of the industry will be slow in coming. Given the impossibility of an explicit tradeoff, when the presumption is rebutted, courts will have to rely on more rigorous proof of efficiency before approving the merger. When it is possible to measure the magnitude of cost-savings, the court could engage in a rough balancing; if not, the merger would be disapproved. Thus, for example, if cost-savings could be reliably estimated at four percent, either the court would have to believe that the merger would probably raise prices by twenty percent (with elasticity of two) or that internal growth would far precede other entry before invalidating the merger.¹⁸⁸ If such cost-savings could not be reliably shown, the merger would be disapproved.

C. *Economic Evidence and Antitrust Proceedings*

Most of those opposing efficiency as a justification would have legality turn on "simple" tests, particularly concentration. For example, Professor Posner argues that, with an exception to be discussed below, horizontal mergers that increase four-form concentration to above sixty percent should be prohibited.¹⁸⁹ Such rules simplify the trial, making the determination of competitive effect turn on a single fact. Unfortunately, other relevant facts that may influence competition, such as efficiency, are totally ignored.

costs are those of the parties in litigation and of the public in providing the judicial forum. Error costs derive from mistaken decisions and are the product of the probability of error and the cost when an error occurs. Since a significant number of mergers lowers costs, *see* notes 160-64, 175-78 *supra* and accompanying text, and since even a small reduction in costs is likely to outweigh any increase in market power, *see* notes 14-41 *supra* and accompanying text, this article contends that failure to consider efficiency will significantly increase error costs. Although direct costs will also increase, this part of the article has argued that the efficiency issue can be litigated without that increase outweighing the reduction in error costs.

188. *See* Table 1 *supra*.

189. R. POSNER, *supra* note 6, at 111-12. For other largely market share tests, *see* R. BORK, *supra* note 6, at 221-22, 269-78.

Antitrust law has used two divergent methods to simplify trials. The first is the rule of reason under which some practices have come to be *per se* illegal. Trials involving naked horizontal price fixing, for example, have been greatly simplified by the implementation of a *per se* rule.¹⁹⁰ The only issue is the existence of the act; other evidence, such as an efficiency justification, is irrelevant. The decision to simplify price fixing trials has a firm economic foundation, since naked horizontal price fixing cannot be justified as reasonable; that is, it cannot be justified on economic grounds. Because the only relevant economic issue is the existence of the practice, price fixing is *per se* illegal. Other practices have been held to be similarly illegal, on the basis either that the practice cannot be justified or that the circumstances under which it can be justified are so rare that justification is not worth the effort.

*United States v. Topco Assoc.*¹⁹¹ illustrates the second, more unusual, manner in which antitrust courts have simplified antitrust trials. There, the Court found *per se* illegal a horizontal market division which was arguably ancillary to an integration of productive efforts. The Court refused to consider this justification, apparently because the Court felt itself incapable of performing the necessary economic analysis.¹⁹² The decision to simplify the antitrust trial was founded on judicial expediency, not economics. As Chief Justice Burger argued in dissent¹⁹³ and as the Court implied in its 1977 *GTE Sylvania* decision, this ground for simplification ignores the possibility that the practice might be justified under traditional rule of reason analysis and hence is aberrant.¹⁹⁴

Upon which foundation do merger rules that ignore efficiency lie? There are three bases that could bring them within the traditional rule of reason. First, economic *theory* might dictate that efficiency should be ignored. This argument does not withstand scrutiny of the costs and benefits possible from mergers. As illustrated earlier,¹⁹⁵ even a large price increase can be offset by rela-

190. A naked horizontal price fix is one that is not accompanied by an integration of productive facilities or efforts.

191. 405 U.S. 596 (1972).

192. *Id.* at 609-10.

193. *Id.* at 613 (Burger, C.J., dissenting).

194. *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, n.16 (1978). *See also* *National Soc'y of Professional Eng'rs v. United States*, 435 U.S. 679 (1978) (reemphasizing the importance of traditional rule of reason analysis). Of course, this is not to say that the costs of judges and the parties are totally irrelevant. *See* note 185 *supra*.

195. *See* notes 14-41 *supra* and accompanying text.

tively smaller increases in efficiency. Thus, economic theory does not justify exclusion of efficiency, as, of course, some opponents of the justification acknowledge.¹⁹⁶

Second, we could ignore efficiency if economic *fact* indicated that mergers were not a source of efficiency. To rebut this argument, mergers need not normally lower costs nor do mergers need to explain the cost patterns of most American industries. It is necessary only that a nontrivial number of (litigated) mergers lower costs. If mergers can reduce costs, then ignoring efficiency cannot be justified as preventing search for a nonexistent benefit. Many scholars contend, and evidence supports the conclusion, that mergers are a source of lower costs.¹⁹⁷ The consensus is strongest regarding vertical mergers. To the extent that this consensus reflects reality, an efficiency defense would be the most useful in vertical cases. Efficiency may occur less frequently in horizontal mergers, but is still possible as in the example of the beer industry.¹⁹⁸ The debate over the efficiency potential of conglomerate mergers is more heated, but most economists who are skeptical of efficiency claims for conglomerates would permit an efficiency defense in legislation designed to restrict conglomerate mergers.¹⁹⁹

Judges will, of course, find it more difficult to develop appropriate antitrust rules in cases where economists disagree. The potential for important disagreement makes it unlikely that courts will, or even should, accept simple rules based upon one view. Although litigation is an unlikely place to resolve theoretical disputes among economists, when the economists are in agreement about the relevant theory but disagree over the frequency of the practice, as they do to a significant extent with the issues of market power and efficiency, these factual differences are susceptible to intelligent discussion within the context of a trial.

The third basis that could bring the concentration-only rule within the rule of reason is that concentration rules might sufficiently protect efficiency. This, however, is not the case. As already seen,²⁰⁰ if the merger does lower costs, it is likely to be

196. See, e.g., R. POSNER, *supra* note 6, at 113; R. BORK, *supra* note 6, at 128.

197. See R. POSNER, *supra* note 6, at 111; R. BORK, *supra* note 6, at 128; Weiss, *supra* note 176; *Williamson III*, *supra* note 18.

198. See notes 171-78 *supra* and accompanying text.

199. See note 178 *supra* and accompanying text.

As will be explained, see notes 205-210 *infra* and accompanying text, even if most vertical or conglomerate mergers were not anticompetitive, there is an important practical reason for allowing an efficiency defense.

200. See notes 14-41 *supra* and accompanying text.

procompetitive even at high concentrations. On the other hand, if the merger does not create efficiency, it may pose a danger of raising prices even at lower concentrations.²⁰¹

Thus, exclusion of efficiency is much more consistent with the aberrant *Topco* analysis than with the more traditional approach. To preclude efficiency because it would be complicated is arbitrary when many efficiencies can be shown in a trial.²⁰² Exclusion seems all the more arbitrary when one realizes that at least some proponents of exclusion implicitly recognize that the merger trial must be complex if it is to bear any relation to relevant economic theory. For example, the market share rule encompasses only one factor influencing the ability of firms to collude. Other factors, notably ease of entry, are ignored, and a theoretically sound merger rule would encompass these other factors.²⁰³ Further, a necessary and often complex issue in using the concentration test is defining the market—determining what appropriate substitutes to include with the products of the merging firms. In short, if economics is to have a prominent role in merger cases, the trial will of necessity be complex, with or without an efficiency justification.²⁰⁴

201. See R. POSNER, *supra* note 6, at 112.

202. See notes 166–87 *supra* and accompanying text.

203. See, e.g., R. POSNER, *supra* note 6, at 112 (certain mergers in industries with a four-firm concentration below 60% should be stopped where other factors facilitating collusion are present). For a discussion of the many factors besides concentration that influence the ability to collude, see *id.* at 39–77.

Since Professor Bork's rules would permit almost all mergers, they are less susceptible to the claim that they do not protect efficiency than the rules of Professor Posner (although Professor Posner is correct in stating that his rule would result in challenges to significantly fewer mergers, and therefore would in this sense facilitate efficiency. *Id.* at 113). As a "concession to current oligopoly phobia," Bork suggests that horizontal mergers should be stopped when they leave less than three significant companies in the industry. R. BORK, *supra* note 6, at 221–22. As opposed to Posner, Bork would not deem relevant the factors that may facilitate collusion other than concentration. Thus, Bork's rule is vulnerable because it does not properly consider the harmful effects of mergers, particularly given the incomplete knowledge of economists about collusion. Further, as Bork admits, some efficient mergers may be prevented. Bork's rule may therefore stop a few efficient mergers, while at the same time allowing mergers that foster collusion, but do not increase efficiency.

Beside the methods discussed in the text of simplification under the traditional rule of reason, another method might be to simplify when the state of the economic art is such that the issue cannot be discussed sensibly in the context of litigation, even though simplification cannot be justified by the other methods. If this argument means that merger cases must be "simple," it is a confession that economics cannot guide antitrust on the issue of mergers. As argued in the text, even excluding efficiency, merger rules based upon economic theory require "complex" trials.

204. Defining the market and determining whether the industry is collusion-prone can be every bit as complex as determining efficiency. See 2 P. AREEDA & D. TURNER, *supra* note 31, at 346–88 (defining the market); R. POSNER, *supra* note 6, at 39–77 (determining whether the industry is collusion-prone).

Two other elements of the relationship of an efficiency defense to the development of proper antitrust rules should be emphasized. In many areas of antitrust law, courts, particularly the Supreme Court, have deemed certain facts relevant without expressing any cogent theory of why those facts are important.²⁰⁵ This has led to confusion and has given the decisions an ad hoc cast. Since economic theory impels the relevance of efficiency, utilization of the efficiency justification would represent the antithesis of the ad hoc approach.

Second, there may be an important practical ground for an efficiency justification. Antitrust courts and regulators are skeptical of many business practices, often appearing to condemn them based on no more than unfamiliarity.²⁰⁶ In merger cases, businesses have failed to justify their actions as contributing to efficiency, and they have even explicitly denied that efficiency was a reason for merging. Confronted with defendants who do not justify their practices and even with defendants like those in *Brown Shoe* who say as little as possible about the purpose of the merger,²⁰⁷ judges have perhaps found it easy to condemn mergers out of hand. They may have thought that even if the evidence of harm from the merger were insubstantial, the merger should nonetheless be aborted if the defendant could not articulate its benefits.²⁰⁸ An efficiency defense would forestall this judicial tendency. Positive evidence of the benefits of mergers should allow more procompetitive mergers to withstand antitrust scrutiny than will negative arguments based solely upon the small likelihood of anticompetitive effect. At the very least, the defense should reduce the use of efficiency against mergers.

Two recent examples where evidence of the benefits of the proposed action helped cause changes in the law lend support to the

205. Both R. BORK, *supra* note 6, and R. POSNER, *supra* note 6, provide excellent discussions of this point.

206. Coase, *Industrial Organization: A Proposal for Research in Policy Issues and Research Opportunities* in *INDUSTRIAL ORGANIZATION* 67 (V. Fuchs ed. 1972); Williamson, *Book Review*, 83 *YALE L.J.* 647, 661 (1974).

207. See notes 87-95 *supra* and accompanying text.

208. Bork maintains that the defense will lead agencies to conclude that direct proof is the only way to count efficiency. He states: "Economists, like other people, will measure what is susceptible to measurement and will tend to forget what is not, though what is forgotten may be far more important than what is measured." R. BORK, *supra* note 6, at 127. To the extent that Bork is correct, this argues *for* an efficiency justification. Given the current attitudes of judges, they will "forget" what is not shown, thereby being harsher on efficiency without the defense than they would be with it.

practical importance of an efficiency justification in mergers. In *GTE Sylvania*,²⁰⁹ the Court overruled the *Schwinn* decision that held, contrary to economic analysis, vertical territorial allocations to be *per se* illegal.²¹⁰ A strong case may be made that the intellectual battle against *Schwinn* was successful, not because of arguments and evidence that there is no harm from vertical territorial allocation, but because of arguments and evidence that the practice can be beneficial. Another triumph of economic analysis is the deregulation of commercial airlines. Demand for deregulation may have grown, not because scholars showed that regulation was contrary to our normal presumption in favor of markets, but because they showed that deregulation would produce large benefits to consumers.²¹¹

D. Summary

If merger law is to be based upon sound economic theory, efficiency must be explicitly considered. Although an efficiency justification will somewhat complicate merger proceedings and economies cannot always be demonstrated, the justification will increase the number of beneficial mergers that withstand judicial scrutiny. Further, antitrust jurisprudence and its relation to economics would seem to require efficiency evidence.

V. CONCLUSION

When a court intervenes to prevent a merger that would have resulted in even small economies, the effect is usually contrary to the purpose of the antitrust laws since the procompetitive benefits of efficiency will probably outweigh any anticompetitive effect. Despite this, defendants in merger cases have rarely attempted to justify their actions on the basis of efficiency; indeed, they have occasionally denied that the merger enhanced efficiency.

This conduct of defendants is unwarranted. Economic theory underscores the importance of efficiency. Further, neither Congress nor the Court has precluded an efficiency justification. In fact, evidence exists that Congress considered efficiency relevant and to weigh in favor of the merger. Finally, although an effi-

209. *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977).

210. *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967).

211. Of course, other variables, which can be generally described as "political," underlie any change in government policy. To admit the existence of these variables does not diminish the contention that ideas do occasionally matter.

ciency justification will make merger proceedings more complex, the issue is a suitable one for litigation. If economics is to guide courts in merger decisions, litigation must be complex, with the issue of efficiency an element of the trial.