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The U.S. Supreme Court and the Merger Efficiency “Defense”

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Abstract: Firms’ principal motives for merging are not to increase market power, but rather to improve firm outcomes through changes in internal operations or structure. Of the 17000+ mergers that occur annually in the U.S., 90% or more have no expectation of an anticompetitive price increase or output reduction. They can profit only by better performance. As a result, the way that we analyze mergers puts the cart before the horse. Rather than using an efficiency “defense” to a prima facie unlawful merger, we should consider how the merger affects a firm’s operations and performance. That is in fact the position that the Supreme Court has taken in its analysis of merger efficiencies.

Antitrust merger actions examine the relationship between merging firms and their markets in order to assess the threat of higher prices, reduced market output or restrained innovation. The important issues are the number of other firms in the market, their size distribution, product differentiation, entry barriers, and any features about pricing practices or information flow that might facilitate or obstruct anticompetitive outcomes.

But questions about a merger’s effects on the firm’s own organization and operations are equally important, and quite aside from the market in which the firm is located. These are mainly questions of technology, engineering, firm organization and operational gains from the union of complements. Of the 16000-25000 mergers that occur in the U.S. in a typical year, far fewer than 1% are ever challenged.¹ The vast

¹ See, e.g., <https://www.ftc.gov/news-events/news/press-releases/2023/12/ftc-doj-issue-fiscal-year-2022-hart-scott-rodino-notification-report>.

majority of mergers occur, not because of anticipated effects on the market, but because of changes in the structure and operation of the firm.

This latter question also lies at the heart of any inquiry into merger “efficiencies.” For example, the question whether a merger of two medical practices produces significant cost savings largely gets the same answer whether the practices are in a town of 5000 or a city of 5,000,000. Will they have greater ability to invest in durable equipment? Can support staff be better utilized over a larger group of physicians? Will a larger practice take better advantage of shared space, be able to offer more specialties, or be better able to offer 24-hour on-call service? These performance questions are extremely varied and specific to the merging firms.

The structural metrics used to evaluate the market impact of mergers are crude and noisy. They are justified by the need to make presumptive assessments of a large number of mergers. By contrast, questions about the effect of a merger on the firm’s own operations are more minute and require a close look at the firm’s own structure and workings. Merger policy must consider both. The presumptive reasons that most firms merge are the structural and operational gains that the parties anticipate from the merger.

The dominant way of thinking about merger efficiencies today is that they are a “defense” to a merger challenge. First, the challenger uses structural or other market data to make a *prima facie* prediction that the merger will result in higher prices or some other competitive harm. If that case is made the defendants will have an opportunity, and very likely the burden, to show that the post-merger firm will have lower costs, a better product, or some other attribute that makes the price increase or other harm unlikely.

This approach to merger efficiencies is cumbersome. It also puts the cart before the horse. In any event, the Supreme Court has not generally embraced it. One old decision, *Procter & Gamble*, did state that “possible economies cannot be used as a defense to illegality,” suggesting that the question of efficiencies might operate as a “defense.”² Other Supreme Court decisions have looked at the efficiencies question differently, however, bundling it into the basic requirement that a merger must threaten competitive harm.

For example, the Supreme Court’s *Philadelphia National Bank* decision never spoke of efficiencies. Rather it considered and rejected as unproven a claim that the merger would enable the merging firm to compete more effectively with larger out-of-state banks.³ That argument was based on economies of scale and scope. In subsequent decisions the Supreme Court decisions incorporated efficiencies into the

² *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 580 (1967).

³ *United States v. Phila. Nat’l Bank*, 374 U.S. 321, 370-371 (1963).

primary theory of harm. For example, in *Brunswick* a unanimous Supreme Court rejected a private plaintiff's claim that a merger enabled Brunswick to rehabilitate failing bowling alleys that it had acquired, thus preserving them as competitors with the plaintiff.⁴ Brunswick was also their creditor, and it had a strong interest in ensuring their success. The plaintiffs complained "that by acquiring the failing centers petitioner preserved competition, thereby depriving respondents of the benefits of increased concentration." The lower court had described Brunswick's plans as "cost-savings" resulting from "investing in new equipment."⁵ The Supreme Court addressed this claim, not as an efficiency "defense," but rather as failing to show the right kind of merger harm. While the plaintiff competitor may have been harmed, it was from more competition in the market rather than less. As a result, the merger had not been shown to "lessen competition," as the statute required.

Then in its 1986 *Cargill* decision the Court rejected a competitor plaintiff's claim that following the merger the defendant would reduce prices, which would make the plaintiff's business less profitable.⁶ Under the plaintiff's theory the defendant "would be in a position to do this because of the multiplant efficiencies its acquisition" would produce. The Court did not characterize its analysis as an efficiencies "defense," however. Rather, it held that it would be "inimical" to the purpose of antitrust law to condemn a merger on the theory that it would reduce prices. The lower prices were the injury that the plaintiff competitor claimed, but that was not a statutory lessening of competition. On this point, *Cargill* silently overruled *Brown Shoe*, which condemned the *Brown-Kinney* merger for that very reason.⁷

Viewing efficiencies in this way undermines one argument against them, which is that the Clayton Act does not contain an explicit efficiency "defense."⁸ The statute does require a showing of probable harm, however, and if the principal "harm" is lower prices or improved products, the merger does not meet the statute's "lessen competition" standard. Both *Brunswick* and *Cargill* made this clear.

Brown Shoe itself took the perverse approach of identifying better products and lower costs as the "harm" caused by the merger. While it spoke of the rise in industrial concentration, it did not identify any link between concentration and the harms that the Court found, which had nothing to do with market concentration. It actually

⁴ *Brunswick corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488-492 (1978).

⁵ *Id.* at 492, quoting the decision below. 523 F.2d 262, 268 (3d Cir. 1975).

⁶ *Cargill, Inc. v. Monfort of Colorado, Inc.*, 479 U.S. 104, 114-115 (1986).

⁷ *Brown Shoe v. United States*, 370 U.S. 294, 314, 344 (1962).

⁸ See, e.g., *FTC v. Penn State Hershey Med. Ctr.*, 838 F.3d 327 (3d Cir. 2016) (expressing skepticism that such a defense "even exists"); accord *FTC v. Hackensack Meridian Health, Inc.*, 30 F.4th 160 (3d Cir. 2022). See Daniel A. Crane, *Rethinking Merger Efficiencies*, 110 *Mich. L. Rev.* 347, 355 (2011).

concluded that the market was “fragmented.” Rather, the harm was lower costs and product improvements:

In this fragmented industry, even if the combination controls but a small share of a particular market, the fact that this share is held by a large national chain can adversely affect competition. Testimony in the record from numerous independent retailers, based on their actual experience in the market, demonstrates that a strong, national chain of stores can insulate selected outlets from the vagaries of competition in particular locations and that the large chains can set and alter styles in footwear to an extent that renders the independents unable to maintain competitive inventories. 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.⁹

Today, the government’s Merger Guidelines follow the consensus view in regarding efficiencies as a defense to a *prima facie* unlawful merger. However, they also incorporate the Supreme Court’s theory of merger harm as developed in decisions such as *Brunswick* and *Cargill*: efficiencies will be recognized only to the extent that they result in a reduction of prices to pre-merger levels. Under the 2023 Merger Guidelines proven efficiencies “must be of a nature, magnitude, and likelihood that no substantial lessening of competition is threatened by the merger in any relevant market.” In that case, the absence of an explicit efficiencies “defense” becomes irrelevant, because the statutory requirement of harm to competition has not been satisfied.

Mergers harm competition when they permit the post-merger firm to raise its prices, reduce the amount or quality of the market’s output, or restrain innovation anticompetitively. Cost savings from mergers have the opposite result. Although most efficiencies result from a reduction in costs, predicted price effects are the most common metric for assessing them. Most “retrospective” studies of past mergers focus on what happened to prices. Pricing is most easily observed from public data and can be gathered for large numbers of firms. As a result, use of pricing data permits empirical studies that examine post-merger pricing of groups of firms over time. Further, the primary explanations for a price reduction are lower costs or increased complementarity.

One limitation of post-merger price studies is that they do not “predict” post-merger pricing so much as observe post-merger price changes that have occurred in the past. For example, one large study of mergers in highly concentrated markets

⁹ *Brown Shoe*, 374 U.S. at 344.

found that 25% of them led to higher prices, 25% to lower prices, and the remaining 50% showed little change.¹⁰ Looking entirely *ex post*, 25% of these mergers should have been challenged (none were), even though they occurred in highly concentrated markets. But viewing them *ex ante*, how do we identify that 25%?

For perfectly competitive products, merger efficiencies typically relate to scale in production or procurement economies, and sometimes to more efficient management or advertising scale.¹¹ Most mergers do not enable firms to attain production economies quickly because the merger does not automatically give the firms a larger or more efficient plant.

In fact, most efficiency claims in contested merger cases relate to complementarity rather than competition.¹² While market definition may require treating the merging firms as competitors, one firm possesses some asset or other feature whose benefits can be shared with the other firm. Courts sometimes speak of “synergies” that might result from a merger, which refers to the union of complementary products or processes.¹³ When markets function well, complements are often supplied by separate firms. For example, automobile manufacturers typically buy rather than make their tires, and farmers usually purchase their tools and seed. When markets function less well, however, unions of complements can reduce costs and improve product quality.¹⁴ When the asset is specialized to a firm, then the gains from internal production can be significant.¹⁵

Assessing the role of complementarity should be part of the evaluation of a merger’s threats to competition, not an efficiency defense. Problematically, however, concentration indexes such as the HHI do not speak to complements at all. As a result they tend to exaggerate the anticompetitive impact of mergers between firms that are less than perfect substitutes for one another. Differing amounts of product complementarity also serve to explain why mergers that involve similar products and concentration metrics nevertheless have different price or quality effects.

¹⁰ Vivek Bhattacharya, Gaston Illanes & David Stillerman, *Merger Effects and Antitrust Enforcement: Evidence from U.S. Retail*, NBER #31123 (2024).

¹¹ See 4A Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 975 (4th ed. 2016) (classifying permissible efficiencies).

¹² See Herbert Hovenkamp, *The Structure of Merger Law*, *Notre Dame L. Rev.* (forthcoming, 2025), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4851593.

¹³ E.g., *FTC v. Tronox Ltd.*, 332 F. Supp. 3d 187, 216-17 (D.D.C. 2018) (identifying synergies with efficiencies); *FTC v. CCC Holdings, Inc.*, 605 F. Supp. 2d 26, 73 (D.D.C. 2009) (noting that firms had hired consultants to explore range of likely synergies). See generally Louis Kaplow, *Rethinking Merger Analysis* 94-95, 170-173 (MIT, 2024).

¹⁴ See Simon Loertsher & Michael H. Riordan, *Make and Buy: Outsourcing, Vertical Integration, and Cost Reduction*, 11 *Am. Econ. J.: Microeconomics* 105 (2019).

¹⁵ Benjamin Klein, Robert G. Crawford & Armen A. Alchian, *Vertical Integration, Appropriable Rents and the Competitive Contracting Process*, 21 *J.L. & Econ.* 297 (1978).

The economic literature on cost savings from vertical integration is large and rich. What is not so well developed in legal doctrine, however, is that these costs savings can come from any type of product complementarity and are not limited to vertical integration as such. Many mergers formally characterized as “horizontal” in fact include significant amounts of product complementarity, and gains from lower costs or better products are likely for these as well. For example, two retailers may compete, but at different locations,¹⁶ price points,¹⁷ or quality levels.¹⁸ One of them may offer products, services, or features that the other does not. As a result, the post-merger firm can provide a wider or better set of goods or services than it did prior to the merger. This is particularly true of mergers of networks, including those for transportation, where interconnection gains can dwarf competitive losses.

The widespread presence of complements in merger cases suggests that many of these mergers produce significant benefits in at least some of the markets in which they operate. It also places a premium on getting outcomes right. If horizontal mergers produced only harms but no benefits, then some overdeterrence might not be a problem. But that is not the case. A merger policy that is too tolerant will permit the creation of more monopoly, with its resulting harms to both consumers and labor. However, an overly aggressive merger policy that condemns output-increasing mergers can do the same thing. Further, condemning a merger without due consideration of cost reductions or product improvements will harm workers as well as consumers.

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¹⁶ *United States v. Von's Grocery*, 384 U.S. 270 (1966).

¹⁷ *United States v. JetBlue Airways Corp.*, 712 F.Supp.3d 109 (D. Mass. 2024).

¹⁸ *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962) (commenting on how Kinney, the acquired firm, made cheaper shoes than Brown).