Vanderbilt Journal of Transnational Law

Volume 26
Issue 5 *Issue 5 - January 1994*

Article 2

1-1994

Efficiencies and Merger Review in Canada, the European Community, and the United States

Mark A.A. Warner

Efficiencies and Merger Review in Canada, the European Community, and the United States: Implications for Convergence and Harmonization

*Mark A. A. Warner**

ABSTRACT

This Article examines economic efficiencies analysis in the merger review processes of Canada, the European Community, and the United States. In recent years, legal counsel, academics, and policymakers have given greater attention to international harmonization and convergence of competition and antitrust law and policy. This trend has been spurred by the increasing acceptance of efficiency-based economics in competition policy generally and in merger policy particularly. The author, nevertheless, asks whether efficiency-based merger analysis also may create new jurisdictional conflicts among national merger enforcement authorities. For instance, a state concerned with its own domestic competitiveness might emphasize domestic efficiency gains in approving a merger that otherwise create market power concerns in an international or global market. This approach could result from an attempt to weigh the domestic efficiency gains against the increase of the merged firm's domestic market power. This Article inquires whether such a merger should be regarded

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*Associate, Curtis, Mallet-Prevost, Colt & Mosle, Washington, D.C.; American Bar Association, Section on Antitrust Task Force on NAFTA; B.A. (Hons.), McGill University, 1986; M.A. (Economics), University of Toronto, 1988; LL.B. Osgoode Hall Law School/York University, 1991; LL.M. (International & Comparative Law), Georgetown University Law Center, 1993. Mr. Warner is also a participant in the Global Competition Policy Research Project of the Institute for International Economics, Washington, D.C. The author is solely responsible for the views expressed in this Article.

differently from an attempt by a state to cartelize a domestic market, either to export into the international or global market or to foreclose foreign penetration of the domestic market. After reviewing the economic analysis of efficiencies, the empirical evidence from completed mergers, and the laws of the three jurisdictions, the author: (i) proposes a two-step framework for analyzing efficiencies; and (ii) concludes that the best means of reducing potential conflicts would be to have merger reviews conducted by an international competition authority.

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I. INTRODUCTION

This Article discusses the manner in which economic efficiencies are examined in Canada, the European Community (EC), and the United States. The purpose of the inquiry is to determine a framework for an international convergence or harmonization of merger law.[1]

Economists and lawyers appear to be moving toward greater consensus on the importance of efficiencies in the analysis of competition and antitrust problems. The analysis of merger-related efficiencies highlights the differences and problems of merger enforcement in national and global markets. Should one state care whether static or dynamic efficiencies are realized directly within its borders? Alternately, should a state be content with the knowledge that efficiencies realized in another state may enhance aggregate world welfare and perhaps benefit other states

1. The focus of this Article is horizontal mergers, but a similar analysis applies to vertical and conglomerate mergers.

indirectly? These two questions point to the relationship between the analysis of efficiencies and industrial policy.

With the advent of a new administration in the United States, once discredited ideas of industrial policy are being dusted off and presented anew under the banner of "competitiveness"[2] and "human capital investments."[3] To the extent that these existing ideas spread to other regions of the world, the analysis of the dynamic efficiency effects of a merger may become a source of increased friction between states. This suggests that the growing acceptance of efficiency analyses of mergers may not lead to greater international convergence or harmonization of antitrust laws.

To examine these issues, Part II of the Article reviews the economics of efficiency analysis with respect to mergers, and examines the evidence of the efficiency effects of mergers. Part III focuses on Canada's treatment of merger efficiencies, because it possesses the most developed statutory and regulatory scheme in this regard. Parts IV and V analyze, respectively, the approaches to this issue in the European Community and the United States. Finally, this Article draws together the themes from the state studies and the economic analysis discussion to determine the implications for conflict or coordination in merger enforcement among states.

II. ECONOMIC ANALYSIS[4]

Economists generally identify three broad classes of efficiencies that are important for competition analysis: allocative, productive, and dynamic.[5] The term allocative

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2. *See generally* LAURA D. TYSON, WHO'S BASHING WHOM: TRADE CONFLICT IN HIGH-TECHNOLOGY INDUSTRIES (1992) (Tyson released this book prior to becoming the Chair of the President's Council of Economic Advisors).

3. *See generally* Robert B. Reich, *Who is Us*, HARV. BUS. REV., Jan.-Feb. 1990, at 53 (Reich released this book prior to becoming the Secretary of Labor).

4. This review of the economics of efficiency analysis in the context of mergers will ignore the overcharged debate about the meaning of "consumer welfare." Instead, this Article reflects an economic approach and discusses issues of economic redistribution explicitly. *See generally* Joseph F. Brodley, *The Economic Goals of Antitrust: Efficiency, Consumer Welfare, and Technical Progress*, *in* REVITALIZING ANTITRUST IN ITS SECOND CENTURY 95, 95-112 (Harry First et al. eds., 1991); Frederick R. Warren-Boulton, *Implications of U.S. Experience with Horizontal Mergers and Takeovers for Canadian Competition Policy*, *in* THE LAW AND ECONOMICS OF COMPETITION POLICY 337, 339-341 (Frank Mathewson et al. eds., 1990).

5. BRUCE DUNLOP ET AL., CANADIAN COMPETITION POLICY: A LEGAL AND ECONOMIC ANALYSIS 63-64 (1987).

efficiency references the economy-wide allocation of resources and the impact of particular structures and industry practices upon this allocation. Taking as an assumption the prior wealth distribution, allocative efficiency aims to ensure that economic distribution reflects the real, relative production costs and relative utility or satisfaction value each consumer places on the good or service.[6] Economists refer to this ideal state equilibrium as Pareto optimal; no person can be made better off without worsening someone else's position.[7]

Productive efficiency "is a narrower concept than allocative efficiency, and focuses on a particular firm or, perhaps, industry. It addresses the question of whether any given level of output is being produced at least cost, or alternatively whether any given quantum of inputs is producing the maximum possible output."[8]

Dynamic efficiency does not concern the "performance of an economy, industry or firm at a given point in time" (in contrast to static efficiency measures). Instead, dynamic efficiency inquires "whether appropriate incentives exist to increase productivity and engage in innovative activity over time that may yield cheaper or better goods for consumers or new products that afford consumers more satisfaction than previous consumption choices."[9]

Economists note that "in some settings all three [efficiencies] cannot simultaneously be realized, and where this is so, competition policy faces complex economic trade-offs."[10] Patents for new inventions present perhaps the most obvious example of these tradeoffs. By obtaining a patent, a firm may function as a monopolist for a defined period of time to recoup its ex ante costs. While this monopoly may be inefficient from an allocative standpoint, from a dynamic efficiency perspective, these temporary, recuperative, monopolistic profits are essential incentives to innovation.[11]

This Article addresses the myriad questions surrounding the issue of tradeoffs. Oliver Williamson classically framed the

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6. *Id.* at 63. At this point it is probably useful to remember the admonition of the great English economist, Joan Robinson, who said that "[u]tility is a metaphysical concept of impregnable circularity; *utility* is the quality in commodities that makes individuals want to buy them, and the fact that individuals want to buy commodities shows that they have *utility*." JOAN ROBINSON, ECONOMIC PHILOSOPHY 48 (1964).

7. DUNLOP ET AL., *supra* note 5, at 63-64.

8. *Id.* at 63.

9. *Id.*

10. *Id.* at 64.

11. *Id.*

tradeoff issue in a series of articles in the late 1960s.[12] Williamson set forth what he termed a "naive model" for discussing the issue, which we should consider as Williamson's tradeoff diagram.[13]

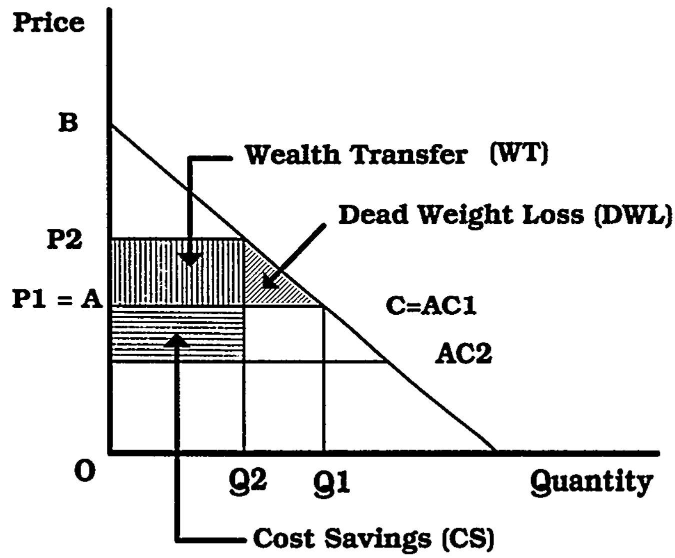

Figure 1: Economic Tradeoffs

According to this model, in a competitive market each firm is a price-taker and thus earning normal profits, not supranormal profits, by choosing the profit-maximizing price and output for which marginal costs equal marginal revenues. At this competitive equilibrium, the market price indicates the level of utility that each consumer derives from purchasing the particular good or service. Economists, however, have suggested that

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12. Oliver E. Williamson, *Economies as an Antitrust Defense: The Welfare Tradeoffs*, 58 AM. ECON. REV. 18 (1968) [hereinafter Williamson (1968)]; Oliver E. Williamson, *Economies as an Antitrust Defense: Correction and Reply*, 58 AM. ECON. REV. 1372 (1968); Oliver E. Williamson, *Allocative Efficiency and the Limits of Antitrust*, AM. ECON. REV. PAPERS & PROC., May 1969, at 105 [hereinafter Williamson (1969)]; Oliver E. Williamson, *Economies as an Antitrust Defense: Reply*, 59 AM. ECON. REV. 954 (1969); and Oliver E. Williamson, *Economics as an Antitrust Defense Revisited*, 125 U. PA. L. REV. 699 (1977) [hereinafter Williamson (1977)].

13. This tradeoff diagram is adapted from Williamson (1968), *supra* note 12.

consumers also derive a surplus utility that is not captured by the price mechanism. Graphically, this consumer surplus is represented by the region under the demand curve and above the competitive price.[14]

If a merger of two firms in a competitive market enables the newly merged entity to exercise a degree of market power,[15] then the price may rise to a new price level (P_2) and the quantity may fall to a new quantity level (Q_2). At this new price and quantity, the economy experiences a dead weight loss (DWL), or an allocative inefficiency.[16] There is also a transfer of wealth from consumers of the good or service to the producer and ultimately its shareholders.[17] Thus the merged entity captures, through a real price increase, the psychic or intangible surplus utility that consumers had gained in competitive equilibrium. If the merger does not render the merged entity capable of exercising market power unilaterally or jointly with other firms, then the merger may be procompetitive, or at least not anticompetitive.

Williamson's insight into this process was to question whether a merger that simultaneously produced cost savings and market power should be regarded as procompetitive. Graphically, this relationship is illustrated by a reduction in the marginal cost curve. Accordingly, Williamson suggested that in determining the overall efficiency effects of the merger, the dead weight loss triangle be compared to the cost savings rectangle (as indicated in

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14. See the triangle marked "ABC" in the tradeoff diagram.

15. *See generally* Thomas G. Krattenmaker et al., *Monopoly Power and Market Power in Antitrust Law*, *in* REVITALIZING ANTITRUST IN ITS SECOND CENTURY, *supra* note 4, at 175, 179. The United States Supreme Court has held that market power is the ability to raise prices above those that would be charged in competitive markets. NCAA v. Board of Regents, 468 U.S. 85 (1984). This is contrasted with the definition of monopoly power as the ability to control prices or exclude competition. See United States v. E.I. du Pont de Nemours & Co., 351 U.S. 377 (1956). In Eastman Kodak Co. v. Image Technical Services, Inc., 112 S.Ct. 2072 (1992), the Supreme Court apparently followed the Krattenmaker proposal that market power be used as in *E.I. du Pont*.

16. See the triangle marked "DWL" in the tradeoff diagram.

17. Consider also the following statement:

> By training, economists might lean to the aggregate efficiency standard, at least initially. After all, economics purports to have little insight into the "proper" distribution of wealth. But simply because economic theory has little to contribute does not mean that society should be indifferent to the distribution, where losers are not compensated for their losses by winners. For example, consider a worker who steals $100 from a capitalist and invests the proceeds at a higher rate of return than the capitalist earned. Would the higher social return justify the involuntary transfer?

Steven C. Salop, *Symposium on Mergers and Antitrust*, 1 J. ECON. PERSP., Fall 1987, at 3, 9 n.7.

Figure 1). Williamson concluded that a merger yielding nontrivial real economies of scale must produce substantial market power and result in relatively large price increases for the net allocative effects to be negative.[18] Economists note that Williamson explicitly disregarded the wealth transfer in his tradeoff analysis.[19] Williamson did recognize, nevertheless, that if the wealth transfer were added together with the dead weight loss, the productive efficiency gain would not be sufficient to outweigh the allocative inefficiency and the negative distributive aspects of the merger.[20]

The microeconomic welfare foundations of the Williamsonian view of the wealth transfer are not beyond question. As discussed above,[21] a "change in the social state that increases the welfare of at least one individual without reducing the welfare of [another is considered to be] a Pareto improvement in social welfare."[22] To the extent that a merger results in a price increase, it should be permitted under the Williamsonian view, so long as the resulting efficiencies are potentially sufficient to compensate consumers for any harm suffered. However, the Pareto principle requires an actual, not just a potential, redistribution; therefore, the Williamsonian expectations may exceed the microeconomic welfare theory upon which they are based.[23]

In theory at least, Williamson did not dismiss entirely the relevance of redistributive issues for policymakers. Rather, he believed that macroeconomic policy instruments such as taxes, transfers, and expenditures were available and superior to

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18. Williamson (1968), *supra* note 12, at 30-31.

19. *See, e.g.*, Michael E. DePrano & Jeffrey B. Nugent, *Economies as an Antitrust Defense: Comment*, 59 AM. ECON. REV. 947, 952 (1969); Alan A. Fisher & Robert H. Lande, *Efficiency Considerations in Merger Enforcement*, 71 CAL. L. REV. 1580 (1983); Alan A. Fisher et al., *Price Effects of Horizontal Mergers*, 77 CAL. L. REV. 777 (1989).

20. Williamson (1968), *supra* note 12, at 28.

21. *See supra* text accompanying note 7.

22. Gary L. Roberts & Steven C. Salop, Efficiency Benefits in Dynamic Merger Analysis 5 (May 10, 1993) (unpublished manuscript, on file with the author).

23. *Id.* at 7. Roberts and Salop argue further that "if the purchasers of a firm's products also own the firm," then a price increasing merger may be Pareto improving. *Id.* at 9. However, they demonstrate that such an income and wealth distribution assumption is unrealistic in the United States. *Id.* at 10. Nonetheless, they argue for "an intermediate welfare standard that places some weight on both consumer surplus and profits." *Id.* at 12.

antitrust in achieving these objectives.[24] Some scholars may protest that we do not reside in such an unrealistic world governed by optimal policies and choices, both social and private. In a world of second-best constraints, however, antitrust may have a role to play in achieving redistributive goals and outcomes.[25] This theme is inescapable; ultimately, it is necessarily part of the philosophy that will influence any analysis of merger efficiencies, even if only at the margins.

Williamson's naive model dealt with the move from a competitive market to a market in which individuals could exercise market power. Possibly, when the market is imperfect to begin with, an even greater productive efficiency gain would be necessary to counteract the allocative inefficiency of a merger.[26]

Williamson's efficiency tradeoff (as originally conceived) contained a clear preference for the static over the dynamic. Williamson concluded that technical progress was most relevant for mergers between relatively small firms, regardless of industry concentration, and mergers involving "lower-middle sized firms."[27] In more modern terms, market power is accompanied by a degree of rent-seeking behavior that leads to "X-Inefficiency."[28] Notwithstanding the tradeoff result, which emphasizes productive efficiency, dynamic efficiency considerations may still suggest tight enforcement in markets lacking sufficient pressure to remain contestable or competitive.[29]

A number of questions spring immediately to mind when one considers further the Williamsonian tradeoff. First, is the tradeoff relevant only in a single market context, or should one make an

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24. *See* Williamson (1968), *supra* note 12, at 28; Williamson (1969), *supra* note 12, at 108.

25. *See* F. M. SCHERER & D. ROSS, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 33-38 (3d ed. 1990).

26. *See* DePrano & Nugent, *supra* note 19, at 952. *See also* David W. Barnes, *Federal and State Philosophies in the Antitrust Law of Mergers*, 56 GEO. WASH. L. REV. 263, 270-71; Paul S. Crampton, *The Efficiency Exception for Mergers: An Assessment of Early Signals from the Competition Tribunal*, 21 CAN. BUS. L.J. 371, 379 (1993).

27. Williamson (1968), *supra* note 12, at 30 (however as discussed below in text accompanying notes 46-47, Williamson modifies this view in Williamson (1977), *supra* note 12).

28. *See* Frederic M. Scherer, *Antitrust, Efficiency and Progress*, *in* COLLABORATIONS AMONG COMPETITORS 33, 35 (Eleanor M. Fox & James T. Halverson eds., 1991); H. Liebenstein, *Allocative Efficiency vs. "X-Inefficiency"*, 56 AM. ECON. REV. 392 (1966). *See also* Steven C. Salop and David T. Scheffman, *Raising Rival's Costs*, AM. ECON. REV. 267-71 (1983) (suggesting that mergers may be undertaken to promote anticompetitive exclusion of rivals by raising competitor's costs and hence allowing the merged entity to gain power over consumer price).

29. *See* 4 PHILLIP AREEDA & DONALD F. TURNER, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION 154-56 (1980).

attempt to consider the net effect on the whole economy?[30] If the latter, how would this be accomplished? Areeda and Turner have concluded that a multimarket balancing approach would: (1) raise issues of equity between groups of product consumers; and (2) prove still more difficult for determining the net welfare effects.[31] Furthermore, it is worth considering whether a multimarket efficiency analysis would promote conglomerate mergers over horizontal mergers.[32] Would this be appropriate, or should antitrust aim at neutrality in the form of corporate organization and focus instead on the competitive outcomes in specific markets?

A second related question arises in the context of increasingly international, if not global, markets.[33] If cost savings can be generated outside of the national borders but still within some relevant product and geographic market, should the same tradeoff analysis obtain? Here the question would seem to be whether, through a process of innovation, emulation, importation, or some combination thereof, the national economy may still benefit in a dynamic sense from the tradeoff.[34]

A similar question also may be raised concerning acquisitions by foreign corporations.[35] The efficiency gains may be transferred immediately outside of the state in the form of interest and dividend payments and, in the extreme, through transfer pricing.[36] It is not clear whether these concerns are within the province of competition law or within some form of

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30. *Id.*

31. *Id.*

32. *See* Sam Peltzman, *Comment by Sam Peltzman in* BROOKINGS PAPERS ON ECONOMIC ACTIVITY: MICROECONOMICS 1990 324, 329 (Martin N. Baily & Clifford Winston eds., 1990) [hereinafter BROOKINGS PAPERS]. However, this assumes that provable and cognizable efficiencies are generated in conglomerate mergers. Accordingly, the answer to this question may depend on whether claims of managerial-related, transaction-based efficiencies are permitted. *See infra* note 47 and accompanying text.

33. *See generally* C. Fred Bergsten & Edward M. Graham, *Needed: New International Rules for Foreign Direct Investment*, 7 INT'L TRADE J., Fall 1992, at 15, 17-23; Alan M. Rugman & Mark A.A. Warner, *Strategies for the Canadian Multinationals*, *in* INTERNATIONAL BUSINESS IN CANADA 200 (Alan M. Rugman ed., 1989).

34. Richard G. Harris, *Strategic Trade Policy, Technology Spillovers and Foreign Investment*, *in* FOREIGN INVESTMENT, TECHNOLOGY AND ECONOMIC GROWTH 1, 11-13 (Donald G. McFetridge ed., 1991). However, as Harris notes, these factors will be most relevant where entry barriers are otherwise low so that the efficiencies can be spread throughout the economy. *Id.*

35. *Id.*

36. *See generally* MULTINATIONALS AND TRANSFER PRICING (Alan M. Rugman & Lorraine Eden eds., 1985).

foreign investment review. The balance of economic opinion, however, supports national treatment for foreign investors as optimal, in the dynamic sense of attracting foreign direct investment into the national economy with the consequent effects of: (1) increased and more efficient intrafirm trade within a multinational enterprise; and (2) technology transfer and other knowledge "spillovers."[37] A third question has been lurking in the shadows of the discussion to this point; namely, why consider the efficiency tradeoff as a separate and distinct element of the overall competitive effects of the merger?[38] It is not clear why efficiency cannot be considered in a manner analogous to entry. If a merger will generate some efficiencies and a degree of market power, then why not analyze the likelihood that the efficiencies will not only inure to the benefit of the whole economy, but also may return a market to a competitive state after some reasonable period of time?[39]

Some commentators have argued that a tradeoff analysis is unworkable; consequently, efficiencies should be considered using an "implicit" approach.[40] Under this scheme, safe harbors would be established by measuring concentration levels that would closely approximate a general judgment about which transactions are likely to lead to nontrivial efficiency gains.[41] Other commentators have called for a variant of this approach;

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37. *See generally* ALAN M. RUGMAN, MULTINATIONALS AND CANADA-UNITED STATES FREE TRADE (1990); Alan M. Rugman & Mark A.A. Warner, *Foreign Ownership, Free Trade, and the Canadian Energy Sector*, 14 J. ENERGY & DEV. 1, 3-4 (1988); EDWARD M. GRAHAM & PAUL R. KRUGMAN, FOREIGN DIRECT INVESTMENT IN THE UNITED STATES 84, ch. 3 (1991).

38. See Franklin M. Fisher, *Horizontal Mergers: Triage and Treatment*, J. ECON. PERSP., Fall 1987, at 23, 26-27, 39, in which Fisher calls for a two-stage merger review procedure. The first stage would rely on safe-harbors. The second would include a more detailed analysis of the "actual likelihood of tacit collusion." *Id.* at 26. As part of this process, efficiencies would be considered but the burden of persuasion would rest on the party asserting that "the merger will create efficiencies to offset any increased risk of anticompetitive behavior." *Id.* at 27. *See also* C. Paul Rogers, *The Limited Case for an Efficiency Defense in Horizontal Mergers*, 58 TUL. L. REV. 503, 520-25, 533 (1983).

39. *See* Brodley, *supra* note 4, at 107-08. Brodley would recognize an efficiencies analysis when: (1) social gain rests on the achievement of significant production or innovation efficiencies; (2) the activity is necessary to achieve the objective, which is not itself achievable by less restrictive means; and (3) the activity does not permanently suppress interfirm rivalry but allows for eventual restoration of competition. *Id.* at 108.

40. *See generally* ROBERT H. BORK, THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF 129 (1978); RICHARD A. POSNER, ANTITRUST LAW: AN ECONOMIC PERSPECTIVE 112-13 (1976); Fisher & Lande, *supra* note 19, at 1624-50.

41. *See* Fisher & Lande, *supra* note 19; Lawrence J. White, *Antitrust and Merger Policy: A Review and Critique*, J. ECON. PERSP., Fall 1987, at 13, 18.

namely, one that employs discrete safe harbors, coupled with a more detailed analysis of other competitive effects, augmented by a tradeoff analysis to serve as a tie breaker.[42]

The case for an efficiencies analysis in assessing the overall competitive effects of a merger, as opposed to a tradeoff defense, may be strengthened depending on which theory of anticompetitive harms is considered relevant. Presumably, if the theory is that mergers monopolize or enable the merged entity to exercise unilateral market power, then it may be easier to assess the allocative inefficiency from the standpoint of increased prices and reduced output. If the theory is that increased risks of collusion result from the reduced number of active firms in the industry, however, then assessing the allocative efficiency may be significantly more difficult.[43] For instance, the reaction functions of other industry participants would have to be factored into the tradeoff calculus. Here, one must inquire whether efficiencies result in different cost structures among firms in a market and the consequent effect on the possibility for successful collusion. Other dynamic factors, such as the diffusion of the cost reduction to and among other market participants through imitation or emulation, also would have to be considered.[44]

Furthermore, consider a merger that could facilitate the merged entity's ability to engage in exclusionary conduct with its upstream suppliers or downstream distributors to raise its rivals' costs. If the merger raises the rivals' costs so that their profit margins drop by more than the increase in profit to the merged entity, then there may be a net social loss.[45] Here again these concerns may belong more properly in an analysis of competitive effects than in a tradeoff calculation.

A fourth question, whether one opts for a competitive effects or tradeoff approach, is what specific types of efficiencies ought to be cognizable by policymakers? In many ways this is the most important question of all. Ultimately, if efficiencies are too difficult or expensive to identify, quantify, and verify ex ante on a case by case basis, then the choice between a competitive effects and tradeoff analysis may be moot.

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42. *See* Fisher, *supra* note 38, at 26-27; Richard Schmalensee, *Horizontal Merger Policy: Problems and Changes*, J. ECON. PERSP., Fall 1987, at 41, 44.

43. *See* Thomas E. Kauper, *The 1982 Horizontal Merger Guidelines: Of Collusion, Efficiency, and Failure*, 71 CAL. L. REV. 497, 522; Fisher & Lande, *supra* note 19, at 1636-38.

44. *See* Roberts & Salop, *supra* note 22, at 34-35.

45. *See* Salop & Scheffman, *supra* note 28, at 268.

The type of efficiency claims recognized may vary with one's view regarding the wealth transfer from the consumers of the relevant product(s) to the shareholders of the merged entity.[46] If, following Williamson, one is not concerned with the wealth transfer, then any reduction in fixed or variable costs representing a real reduction in resource use should be recognized.[47] However, if the concern is price increases, and hence a wealth transfer, then one may not want to recognize fixed costs that are sunk or that otherwise do not affect the merged entity's pricing decisions or, alternately, the entry decisions of potential competitors.[48] All costs are variable in the long run, so the longer the time frame under consideration, the more relevant fixed costs may become, even when one is concerned with the wealth transfer.

Williamson's initial work emphasized production efficiencies over dynamic efficiencies (technological progress and managerial discretion) in the problematic zone of highly concentrated markets.[49] Writing a decade later, however, he concluded that the cost savings attributable to mergers frequently are not from production functions, but instead have transactional origins.[50] While recognizing the inherent difficulties in proof and the inherent tendency for self-serving statements, Williamson still would accept a wide consideration of efficiencies. In keeping with this broad view, this Article will examine possible cognizable production[51] or technical efficiencies.[52] It will then discuss other nontechnical[53] or transactional efficiencies.[54]

With respect to operational efficiencies, Areeda and Turner probably were on the right track in recognizing: (1) plant size;

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46. *See generally* Roberts & Salop, *supra* note 22, at 63-74. In particular, note their discussion of the role of variable costs, fixed costs, power buyer input costs, and rivals' costs under alternate economic welfare standards. *Id.*

47. *Id.* at 63-64.

48. *Id.* at 68-70.

49. *See supra* note 12 and accompanying text.

50. *See* Williamson (1977), *supra* note 12; OLIVER E. WILLIAMSON, *Antitrust Lenses and the Uses of Transaction Cost Economics Reasoning*, *in* ANTITRUST, INNOVATION AND COOPERATION (T. M. Jorde & D. J. Teece eds., 1992) 136, 146-47 [hereinafter INNOVATION AND COOPERATION].

51. *See* AREEDA & TURNER, *supra* note 29; Williamson (1968), *supra* note 12; Robert Pitofsky, *Proposals for Revised United States Merger Enforcement in a Global Economy*, 81 GEO. L. J. 195, 216-17 (1992).

52. *See* Timothy J. Muris, *The Efficiency Defense Under Section 7 of the Clayton Act*, 30 CASE W. RES. L. REV. 381, 418 (1980); Fisher & Lande, *supra* note 19, at 1599-1600.

53. *See* Muris, *supra* note 52; Fisher & Lande, *supra* note 19, at 1599-1600 (using the term "non-operational efficiencies").

54. *See* Williamson (1977), *supra* note 12.

(2) plant specialization (assuming product complementarity); and, to a lesser degree, (3) distribution; (4) research and development; and (5) advertising and promotion.[55] Areeda and Turner concluded that the case for these economies is strongest when: (1) market demand is declining, stable, or expanding very slowly; (2) the potential cost savings are substantial (for example, five percent of total costs); (3) the merging firms have to expand substantially to reach minimum efficient scale; and (4) entry is easy and the market is expanding rapidly.[56]

Areeda and Turner rejected an efficiencies defense for capital costs, procurement, overhead, and management skill.[57] They believed that the risk factor in capital costs would not change materially simply because of increased firm size. Areeda and Turner failed to appreciate, however, that if the merged firm can pool its risks more efficiently, then the risk factor actually may decline. Similarly, the merged entity simply may be able to access a larger sum of capital without having to pay a premium over the interest rate. If either of these can be proved, there is no reason why capital cost efficiency gains should be dismissed a priori. What Areeda and Turner really neglected to address, however, are the other nontechnical or transactional efficiencies. The authors magnified this oversight by permitting only their cognizable efficiencies to be added together to achieve the minimum requisite savings.[58] Admittedly, while transactional efficiencies have a more ethereal quality, they are often substantially more than ephemeral.[59]

This brings us back to the question of whether to distinguish between real and pecuniary efficiencies.[60] The two most common examples cited in reference to this question are tax-driven cost savings and vertical input, supplier-squeezing cost savings. In the case of tax-driven cost savings, one could postulate a merger between one corporation with substantial tax credits, as a result

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55. *See* AREEDA & TURNER, *supra* note 29, at 175.

56. *Id.* at 168.

57. *Id.* at 175, 191-95.

58. *Id.* at 195-96.

59. *See* Scherer, *supra* note 28, at 43. Scherer comments that his studies of multiplant mergers in the 1960s yielded modest efficiency gains provided that the plant was well managed. However, he adds, "[t]he 1960s were a period of rapid economic growth. It is conceivable that in the slow-growth and even retrenchment environment of the 1980s, the overhead and distribution-cost economies potentially realizable through merger have increased." *Id.* But query whether this would apply a fortiori in the "no growth" 1990s.

60. *See* Muris, *supra* note 52, at 417 n.155; Warren-Boulton, *supra* note 4, at 354.

of some otherwise poor financial performance, and another corporation with some outstanding tax liabilities. Putting aside possible operational efficiencies, concentrate instead on the possible offsetting tax savings to the merged entity. Most scholars argue that these gains are strictly pecuniary and redistributive in nature,[61] and hence should not be legally cognizable. The argument hinges on the fact that, if a government has to offset this tax credit with either increased borrowing or taxation, there may occur either a social loss or a redistribution of wealth.

However, if one assumes that a government operates an optimally efficient public finance regime, then presumably the government correctly estimated the demand for tax credits and thus will need no additional borrowing or taxation.[62] Hence there may be no social loss or redistribution of wealth. Instead, the merged entity may obtain a real reduction in marginal costs, assuming that the tax credits are a variable levy and do not represent a fixed cost. In other words, absent grounds of judicial economy,[63] there is no logical reason to dismiss tax-driven cost savings a priori.

Another pecuniary cost saving that has drawn attention occurs when the merged entity is able to squeeze lower prices out of the profit margins of its upstream input suppliers or downstream processors and distributors.[64] As with tax-driven cost savings, however, it may not be so easy to identify and separate pecuniary from real efficiencies. In both cases, if the merger results in the displacement of inefficient managers who

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61. *See* Muris, *supra* note 52, at 417 n.155; Warren-Boulton, *supra* note 4, at 354.

62. While some may find this to be an interminably strong assumption, it really serves to highlight the point that policy should aim "to render unto antitrust that which is antitrust's." If the inefficiency exists in the public finance regime then presumably it ought to be corrected there. Of course, this argument may fail to persuade those who contend that antitrust is a response to the world of second-best solutions. *See* SCHERER & ROSS, *supra* note 25, at 33-38.

63. *See generally* Frank H. Easterbrook, *Ignorance and Antitrust*, *in* INNOVATION AND COOPERATION, *supra* note 50, at 119, 120-21, 130.

64. *See* Warren-Boulton, *supra* note 4, at 354; DUNLOP ET AL., *supra* note 5, at 186. *See also* Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rival's Costs to Achieve Power over Price*, 96 YALE L. J. 209, 277-81 (1986). Krattenmaker and Salop argue that some exclusionary rights agreements may lower the costs of either purchasers or suppliers. *Id.* at 277. Thus, they would recognize an efficiencies justification when: (1) there are standards for quantification; (2) the efficiencies could not be achieved in a less restricted way; (3) the savings are not pecuniary or redistributive between producers and input suppliers; and (4) any resultant price increase to consumers leads to wealth-enhancing innovation and not redistribution between consumers and producers or rent-seeking behavior. *Id.* at 281.

have not bargained competitively or effectively, then what may at first appear as a pecuniary efficiency also may be a real production efficiency.[65] This efficiency can be perceived most readily when the input supplier possesses market power prior to the merger. After the merger, as a result of tougher bargaining by the merged entity, input purchases may increase due to substitution or simply increased output by the merged entity because of lower production costs.[66] Therefore, absent grounds of judicial economy, a rule that prohibits a party from asserting and attempting to prove such efficiency gains may be both socially and privately nonoptimal.

Another interesting question emerges if one accepts the tradeoff analysis of Fisher and other theorists.[67] If one evaluates a tradeoff by comparing the cost savings to the sum of the allocative inefficiency and the wealth transfer, then logic and symmetry would suggest that the efficiencies should be included in the tradeoff calculus even if pecuniary efficiencies were simply redistributive.[68]

Finally, an important remaining issue is the posture of antitrust to various forms of corporate organization. Whether entities are trying to distinguish between real and pecuniary efficiencies or deciding if less restrictive alternatives to a merger exist (such as a joint venture or another contractual form), the entities may consider antitrust laws in their corporate organization and accounting. In some sense, these considerations may represent efficiency losses, if entities devote too much legal or other expert activity to circumventing the antitrust concern.[69] Thus, antitrust law should be as neutral on these issues of corporate organization as possible. Of course, at the margins and in a second-best world there may still be room for these laws to have influence.

The foregoing economic analysis has indicated some of the relevant considerations for merger analysis. First, and most obviously, efficiencies are relevant for merger analysis. Second, choice of market concentration or market share thresholds of review reflects an implicit judgment about the potential efficiency gains from mergers. Third, further analysis of the competitive

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65. *See* Muris, *supra* note 52, at 417-18.

66. *See* Roberts & Salop, *supra* note 22, at 65-67. Note also that this analysis is more readily applicable to costs that are variable, not fixed.

67. *See* sources cited *supra* note 19.

68. *See* Warren-Boulton, *supra* note 4, at 354; Roberts & Salop, *supra* note 22, at 70-71.

69. Peltzman, *supra* note 32, at 329.

effects of a merger may prove that it is not anticompetitive. Fourth, a quick look at efficiencies should be among the criteria used in a competitive effects analysis.[70] Fifth, one should use a further efficiency tradeoff defense to determine whether a given merger should be approved notwithstanding its market power effects. Sixth, one should strictly construe the tradeoff analysis and weigh the efficiency gain against the loss in allocative efficiency and wealth transfer.[71] Seventh, at both stages of analysis, a broad range of production, distribution, and transactional efficiencies ought to be cognizable.

The assessment of the scope for action probably will be influenced by one's prior view of the economic benefits of mergers. Before turning to the case studies from Canada, the United States, and the EC, it is useful to review briefly what economic studies suggest are the effects of merger activity on the economy in general.

In surveying the empirical studies of the effects of mergers, the reader should consider several caveats. First, most of the studies have not been conducted on data dealing exclusively with horizontal mergers. Second, most of the studies test the determinants of merger activity, and hence only indirectly test whether mergers yield substantial efficiencies and result in real wealth creation. As a result, the empirical work may be more useful in providing support for various theoretical positions on the appropriate thresholds for merger review, or for an analysis of how to factor efficiencies into an analysis of competitive effects. These studies are probably less helpful in attempting to operationalize the Williamsonian tradeoff calculus.

The merger-related empirical studies conducted to date have been based on four types of data: (1) stock market data; (2) accounting data; (3) productivity data; and (4) industry concentration and profit margin data.

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70. What I envision here is a procedure somewhat along the lines of the "quick look" at efficiencies in the rule of reason analysis of horizontal restraints endorsed by the United States Supreme Court per Justice Stevens in NCAA v. Board of Regents, 468 U.S. 85, 98-104 (1984).

71. It may not be necessary to consider the whole wealth transfer, however, since from the point of view of the economy as a whole, consumers are also producers and often shareholders. Consider the significant role that pension funds and other large institutions now have in both equity and debt markets. See generally U.S. Equity Market Structure Study, Exchange Act Release No. 30,920 [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,012 (July 16, 1992), which indicates that institutional investors dominate daily equity trading, accounting for 75% to 80% of the average daily volume on the New York Stock Exchange.

The leading proponent of the use of stock market data is Michael Jensen.[72] Essentially, he has argued that the market for corporate control benefits the private interests of shareholders and social welfare by loosening control over vast amounts of resources, thereby enabling them to move to their highest value-added use.[73] The core of Jensen's theory is that changing technological or market conditions require a major restructuring of corporate assets, and new managers make these changes more easily. Takeovers allow new managers to spot the potential efficiencies and capitalize on them. In order to remove inefficient managers, the purchaser often pays a substantial premium over the prebid market price to the shareholders of the target company. Some commentators believe that these transactions either are redistributive or lead to rent-seeking behavior and other X-Inefficiencies that reduce, or perhaps eliminate, any efficiency gains.[74] Nonetheless, Jensen and others have argued that nonredistributive cost savings of about eight percent of the value of both companies historically have been generated.[75] On balance, this empirical evidence[76] provides tentative support for the efficiency-enhancing theories. Because most of the identified gains go to the target shareholders, however, this evidence also provides some support for closer scrutiny when other evidence points to anticompetitive concerns.

Another type of empirical study uses internal accounting data regarding the health of companies at the time of a merger and then ascertains their subsequent profit performance.[77] The

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72. *See generally* Michael C. Jensen, *Takeovers: Their Causes and Consequences*, 2 J. ECON. PERSP., Winter 1988, at 21.

73. *Id.*

74. *See generally* Andrei Schleifer & Robert W. Vishny, *Value Maximization and the Acquisition Process*, J. ECON. PERSP., Winter 1988, at 7; Andrei Schleifer & L.H. Summers, *Breach of Trust in Hostile Takeovers*, *in* CORPORATE TAKEOVERS AND CONSEQUENCES 33 (A. Auerbach ed., 1988); Richard E. Caves, *Effects of Mergers and Acquisitions on the Economy: An Industrial Organization Perspective*, *in* THE MERGER BOOM 149 (L.E. Browne & E.S. Rosengren eds., 1987). However, note that these commentators emphasize hostile takeovers and not mergers generally, although Schleifer and Vishny admit that many takeovers are efficiency-enhancing. Schleifer & Vishny, *supra*, at 17-18.

75. Jensen, *supra* note 72, at 23. *See also* Michael D. Bradley, *Discussion*, *in* THE MERGER BOOM, *supra* note 74, at 169, 170.

76. *See also* Greg A. Jarrell et al., *The Market for Corporate Control: The Empirical Evidence Since 1980*, J. ECON. PERSP., Winter 1988, at 49, 58.

77. *See generally* DAVID J. RAVENSCRAFT & FREDERIC M. SCHERER, MERGERS, SELL-OFFS, AND ECONOMIC EFFICIENCY (1987); Frederic M. Scherer, *Corporate Takeovers: The Efficiency Arguments*, J. ECON. PERSP., Winter 1988, at 69; SCHERER & ROSS, *supra* note 25, at 170-74.

Ravenscraft and Scherer studies, which employ this approach, use a data set from 1950-1976. By Ravenscraft and Scherer's own admission, this data is of limited applicability to horizontal merger evaluation, as most mergers in their data set were conglomerate mergers, and all but very small horizontal mergers were prohibited during the relevant time frame.[78] Ravenscraft and Scherer concluded that mergers initially lead to profitability declines and efficiency losses; however, in subsequent rounds of selloffs of acquired units, mergers did lead to net efficiency gains.[79]

In fact, Scherer himself has noted that the merger wave of the 1980s was more likely to involve the breakup of conglomerates than their creation.[80] This more recent breakup behavior is similar to the older selloffs that created identified gains in efficiency. Consequently, one would expect to see earlier evidence of these gains in recent experience. If anything, Scherer's data supports the conclusions from the stock market studies. Not surprisingly, Scherer argues for tough presumptions against sizable horizontal mergers, which can be rebutted with proof of the likelihood of substantial specific efficiencies.[81]

The third type of study, conducted by Frank Lichtenberg, uses data on productivity to measure the efficiency effects of mergers.[82] Lichtenberg's study spans the period 1972 to 1986. He concludes that changes in ownership are associated with significant improvements in total-factor productivity, which is a direct, if not the purest, measure of productive efficiency.[83] Interestingly, Lichtenberg found significant productivity gains irrespective of whether the merger was generated by management buyouts or by leveraged buyouts, which were so common in the 1980s.[84] While these productivity studies tend to support the results of the other approaches, one should not overstate their import. Assessing the Williamsonian tradeoff requires comparing the gains in productive efficiency with the losses in allocative efficiency to determine a net welfare effect. Notwithstanding this reservation, these productivity estimates could be applied more usefully to an efficiencies consideration in the context of other competitive effects of a merger.

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78. RAVENSCRAFT & SCHERER, *supra* note 77, at 211-12, 224-25.

79. *Id.* at 211-12.

80. Scherer, *supra* note 77, at 76-77.

81. RAVENSCRAFT & SCHERER, *supra* note 77, at 225.

82. *See* FRANK R. LICHTENBERG, CORPORATE TAKEOVERS AND PRODUCTIVITY (1992).

83. *See id.* at 127.

84. *See id.* at 130-31.

A fourth approach to assessing efficiencies employs a comparison of concentration levels with profitability measures such as the price-cost margin.[85] Much of this work is empirically suspect. For instance, Salinger, who uses a data set from 1971 to 1984, initially found a weak relationship between levels of concentration and price-cost margins. He correctly identified the rise of foreign imports as the source of this breakdown. However, he then proceeded to modify the data to remove foreign imports from the United States industrial structure.[86] On the basis of this fundamental misunderstanding of the competitive process, he hypothesized that identified costs and prices increase with concentration. Salinger, therefore, concluded that mergers may not lead to efficiencies and that there exists a role for tough enforcement.[87] He reasoned that cost and price reductions do not occur because the industries start from an oligopoly position.

Salinger's conclusions are also of limited utility because the data set included few horizontal mergers. However, recent work by Stewart and Kim tends to support his conclusions with respect to horizontal mergers over the very limited time period of 1985-1986.[88] In this study, Stewart and Kim found no efficiency gains in highly concentrated industries, minor efficiencies in lowly concentrated industries, and negligible efficiencies in moderately concentrated industries.[89]

The degree of confidence one can give to these results is not clear due to the short-term nature of the data set. Merger-induced efficiencies could be more dynamic or at least long term in nature. Furthermore, when these studies measure net welfare gains, they compare increases of industry profits to the sum of the wealth distribution effect (loss in consumer surplus) and to the allocative efficiency effect (dead weight loss). Therefore, the studies do not address the Williamsonian model. Nonetheless, as Peltzman has observed, these studies still could support a Williamsonian tradeoff argument, provided that a strong burden of proof was imposed on the party asserting the potential efficiency.[90]

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85. *See* John F. Stewart & Sang-Kwon Kim, *Mergers and Social Welfare in U.S. Manufacturing 1985-86*, 59 S. ECON. J. 701 (1993); Michael Salinger, *The Concentration-Margins Relationship Reconsidered*, *in* BROOKINGS PAPERS, *supra* note 32, at 287.

86. *See* Salinger, *supra* note 85, at 306-07.

87. *Id.* at 318-20.

88. *See* Stewart & Kim, *supra* note 85, at 716-18.

89. *Id.*

90. Peltzman, *supra* note 32, at 329.

All of these empirical studies support the view that mergers should be reviewed by applying thresholds based on a prior efficiency theology. Then, efficiencies should be factored into the analysis as part of an assessment of the overall competitive effects of the merger.[91] Because some mergers may lead to real long-term efficiency gains and welfare increases, this analysis should be supplemented by a strictly construed tradeoff analysis as a final step.

The empirical studies generally conclude that the effects of mergers on corporate research and development are negligible or marginally negative.[92] The value of this data should not be overemphasized, as the sample set was not limited to horizontal mergers. However, this does not imply that merging parties should not be allowed to show, subject to a sufficiently strong burden of proof, that the proposed transaction will be efficiency enhancing.

Finally, the empirical studies are also somewhat helpful in the controversial area of tax-driven efficiencies. Using a data set covering the period 1968 to 1983, Auerbach and Reishus[93] found that the tax benefits associated with acquiring a firm's tax losses or unused tax credits exert an insignificant influence on merger activity. However, the acquiror's use of tax losses and credits to offset the income of the target, and the option to step up the basis of the target's assets without paying capital gains tax do tend to have some influence. More importantly, Auerbach and Reishus found that the resulting productive efficiencies could be over 10.5 percent of the target's market value.[94] These are significant cost savings even by Areeda and Turner's standards. Auerbach and Reishus compared these actual gains against potential gains from a set of constructed mergers that did not take place.[95] While this may be useful in suggesting the cause of the merger, the actual

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91. Further support for this view can be found in three case studies of the price effects of FTC-reviewed horizontal mergers. *See* FEDERAL TRADE COMMISSION, CASE STUDIES OF THE PRICE EFFECTS OF HORIZONTAL MERGERS xi-xii, 76-77 & n.64 (Laurence Schumann et al. eds., 1992). This study does not deal with the welfare effects of these mergers except by showing that (1) efficiency gains in mergers in concentrated markets may not lead to price decreases and (2) efficiency gains combined with other competitive factors such as foreign competition may effectively restrain price increases.

92. *See* Bronwyn H. Hall, *The Effects of Takeover Activity on Corporate Research and Development*, *in* CORPORATE TAKEOVERS 69, 93 (Alan J. Auerback ed., 1988); Bronwyn H. Hall, *The Impact of Corporate Restructuring on Industrial Research and Development*, *in* BROOKINGS PAPERS, *supra* note 32, at 85, 121-24.

93. *See* Alan J. Auerbach & David Reishus, *The Effects of Taxation on the Merger Decision*, *in* CORPORATE TAKEOVERS, *supra* note 92, at 157, 178.

94. *Id.* at 171.

95. *Id.* at 158.

gains also are important in indicating the potential for real cost savings, and thereby may be relevant for antitrust analysis.

III. CANADA

A. *Enforcement Framework*

The Competition Act[96] sets out the basic statutory scheme for merger review in Canada. Under the Competition Act, the federal cabinet appoints a Director of Investigation and Research (Director) to investigate conduct regulated by the Competition Act.[97] The Director can initiate an investigation on his own,[98] at the request of the Minister for Industry and Science,[99] or at the request of any six persons residing in Canada.[100] The Director is largely independent of the government, as the Minister of Justice may not require the Director to reach any particular conclusion, although he can request the Director to make further inquiries.[101]

Part VIII of the Competition Act deals with mergers and delineates the matters reviewable by the Competition Tribunal (Tribunal).[102] The Tribunal consists of not more than four judges of the Federal Court-Trial Division, who are appointed by the Minister of Justice, and not more than eight lay members, all of whom are appointed on the recommendation of the Minister for Industry and Science.[103] Every application to the Tribunal is heard by three members, one of whom must be a judge.[104] The Tribunal is a court of record,[105] and its decisions on questions of law can be appealed to the Federal Court of Appeal and ultimately to the Supreme Court of Canada.[106] There is no

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96. Competition Act, R.S.C., ch. C-34 (1985) (Can.).
97. *Id.* § 7.
98. *Id.* § 10(1)(b).
99. *Id.* § 10(1)(c).
100. *Id.* § 9.
101. *Id.* § 22.
102. Competition Tribunal Act, R.S.C., ch. 19, § 3 (2d Supp.), Part I (1985) (Can.).
103. *Id.*
104. *Id.* § 10. This section also provides for sittings by five members, although in practice this has never occurred.
105. *Id.* § 9.
106. *Id.* § 13. This section also applies for appeals on questions of fact with the leave of the Federal Court of Appeals.

private right of action with respect to mergers available in either the Tribunal or the courts.[107] Section 92 of the Competition Act provides that the Director may apply to the Tribunal for an order with respect to a merger that he finds "prevents or lessens, or is likely to prevent or lessen, competition substantially." In practice, under the Director's "compliance approach to enforcement," the Director will not apply to the Tribunal if he can achieve satisfactory undertakings or if he chooses simply to monitor the merger.[108] The Tribunal possesses wide powers to order a dissolution of a completed merger, in whole or in part, or to order that a proposed merger be abandoned in whole or in part.[109] The Director cannot make any order more than three years after a merger has been substantially completed.[110] Section 93 of the Competition Act enumerates the factors that the Tribunal may consider in reviewing a merger. These include: foreign competition (which is probably the most significant factor), business failure, the availability of acceptable substitutes, barriers to entry, including regulatory and trade barriers, the extent of effective competition remaining, and the likelihood of the removal of a vigorous and effective competitor.

More importantly for purposes of this Article, the Competition Act directs the Tribunal to consider: (1) "the nature and extent of change and innovation in a relevant market,"[111]

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107. Competition Act, *supra* note 96, at § 36. The Competition Act does, however, provide a private right of action in respect of: (i) certain other offenses in relation to competition, including conspiracy, bid-rigging, misleading advertising, and resale price maintenance; and (ii) the failure of any person to comply with an order of the Tribunal or another court.

108. For a critical analysis of the Director's use of undertakings and lack of applications to the Tribunal since 1986, see William T. Stanbury, *An Assessment of the Merger Review Process Under the Competition Act*, 20 CAN. BUS. L.J. 422, 427 (1992) ("Moreover, the focus of the merger review process has been in the Director's office rather than in proceedings before the Competition Tribunal.").

109. Competition Act, *supra* note 96, §§ 36, 92(1)(e), (f); *see also* Brodley, *supra* note 4, at 115-18; Frederic M. Scherer, *Comment*, *in* BROOKINGS PAPERS, *supra* note 32, at 327.

110. *See* Competition Act, *supra* note 96, § 97; Brodley, *supra* note 4, at 115-18 (advocating a two stage efficiencies review process: ex ante and ex post); Scherer, *supra* note 109.

111. Competition Act, *supra* note 96, § 93(g). This language is similar to that found in the Treaty Establishing the European Economic Community art. 85(3), Mar. 25, 1957, 298 U.N.T.S. 11 [hereinafter EEC Treaty], which came into force on January 1, 1958. The EEC Treaty provides that in assessing the effect on competition of agreements among undertakings, an agreement shall not be void if it: "contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit." This is generally taken to be the source of the efficiency defense in Article 2(1)(b) Council Regulation 4064/89 of December 21, 1989 on

and (2) "any other factor that is relevant to competition in a market that is or would be affected by the merger or proposed merger."[112] These two factors implicitly permit an analysis of efficiencies in the competitive effects analysis. Furthermore, achieving efficiencies is specifically mentioned in the purpose section of the Competition Act. This is significant because this section is not a preambular statement, but rather is incorporated in the statute, thus avoiding any doubts about its applicability. Section 1.1 of the Competition Act provides:

> The purpose of this Act is to maintain and encourage competition in Canada in order to promote the efficiency and adaptability of the Canadian economy, in order to expand opportunities for Canadian participation in world markets while at the same time recognizing the role of foreign competition in Canada, in order to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy and in order to provide consumers with competitive prices and product choices.

Clearly not all of these goals are vectors possessing a common sign, and this section provides little guidance in weighing the magnitude of each of these purposes. That Section 1.1 clearly envisages a balancing of competing factors, however, suggests that efficiencies should be considered in assessing the competitive effects of a merger. There is some publicly available evidence[113] that this competitive effects efficiencies analysis has

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the Control of Concentrations Between Undertakings [hereinafter Merger Regulation].

112. Competition Act, *supra* note 96, § 93(h).

113. The following news releases and annual report references of the Director all cite efficiencies as a factor in the competitive analysis: 1987 DIR. INVESTIGATION & RES. ANN. REP. (Consumer & Corp. Affairs Can.), Mar. 31, 1987, at 15-16 [Merger of Canadian G.E. Ltd. and Westinghouse Can. Inc. ("efficiency gains may result"); Merger of Rothmans of Paul Mall Ltd. and Benson & Hedges (Can.), Inc. ("substantial efficiency gains in production and distribution would result"); Acquisition by Fletcher Challenge Ltd. of British Columbia Forest Products Ltd. ("a number of production and distribution efficiencies would result . . . due to more effective coordination of inputs and transportation facilities"); Acquisition by George Weston Ltd. of the Chocolate Confectionary Operations of Cadbury Schweppes Can. Inc. ("substantial efficiency gains were expected to result")]; CONSUMER & CORP. AFFAIRS CAN., NEWS RELEASE NO. 88-4, TRAILMOBILE ALLAYS COMPETITION ACT CONCERNS—ACQUISITION OF FRUEHAUF TO PROCEED (Jan. 18, 1988) ("potential for efficiency gains"); CONSUMER & CORP. AFFAIRS CAN., NEWS RELEASE NO. 88-9, DIR ANNOUNCES DECISION ON INTERBAKE ACQUISITION (Feb. 1, 1988) ("efficiencies in relation to the export of products"); CONSUMER & CORP. AFFAIRS CAN., CCAC NO. 189 10062 E 88-02, INFORMATION RESPECTING THE ACQUISITION OF THE ASSETS OF INTERBAKE BY NABISCO AND CULINAR ("efficiencies in the production, sale, marketing and distribution"); 10138 DIR ANNOUNCES DECISION ON DOFASCO

ACQUISITION OF ALGOMA (Sept. 30, 1988) ("efficiencies are expected to arise in relation to capital expansion and operating savings, such as rationalization of product lines and reduced freight costs"); CONSUMER & CORP. AFFAIRS CAN., NEWS RELEASE NO. 11044, DIR ANNOUNCES DECISION ON WOLVERINE ACQUISITION OF NORANDA METAL INDUSTRIES (Nov. 2, 1988) ("significant efficiency gains, thereby becoming a more effective international competitor"); CONSUMER & CORP. AFFAIRS CAN., NEWS RELEASE NO. 10190, DIR'S DECISION ON E.B. EDDY SALE TO SCOTT (Feb. 10, 1989) ("efficiency benefits . . . for example operating savings such as reduced freight costs, which are expected to improve the company's domestic and international competitiveness."); 1988 DIR. INVESTIGATION & RES. ANN. REP. (Consumer & Corp. Affairs Can.), Mar. 31, 1988, at 10 [Merger of C.I.B.C. Securities Inc./Gordon Capital Corp. ("merger would be procompetitive to the extent that the new entity would be well placed to compete in the international market and (provide) benefits resulting from access to a greater capital pool.")]; CONSUMER & CORP. AFFAIRS CAN., NEWS RELEASE NO. 10186, DIR ANNOUNCES DECISION ON ASEA BROWN BOVERI INC. ACQUISITION OF POWER TRANSMISSION AND DISTRIBUTION BUSINESS OF WESTINGHOUSE CANADA, INC. (Feb. 13, 1989) ("efficiency considerations"); CONSUMER & CORP. AFFAIRS CAN., NEWS RELEASE NO. 10188, DIR DECISION ON THE ACQUISITION OF THE ASSETS OF DOMGLAS INC. BY CONSUMERS PACKAGING INC. (Apr. 25, 1989) ("[p]arties expect to achieve $53.9 million annually in efficiency gains which arise from production and operating savings, such as rationalization of excess capacity and reduction of freight costs. The parties will make every effort to implement the claimed efficiencies within three years. This should allow the parties to better meet foreign competition both in Canada and the U.S."); CONSUMER & CORP. AFFAIRS CAN., CCAC No. 189 10224 E 89-04, BACKGROUND INFORMATION ON THE EXAMINATION OF THE ACQUISITION OF THE ASSETS OF DOMGLAS INC. BY CONSUMERS PACKAGING INC. ("The parties claim near-term production and operational efficiency gains of $53.9 million per year, together with other qualitative efficiencies. These savings amount to 10 percent of [their combined sales] in 1988. The parties submit that the need to achieve these gains is essential to the industry's long-term survival in the face of [international and United States] competition. [They] will provide reports to the Director on the implementation of [the] measures and the achievement of these gains."); CONSUMER & CORP. AFFAIRS CAN., NEWS RELEASE NO. 10256, PROPOSED MERGER OF THE BREWING OPERATIONS OF MOLSON AND CARLING O'KEEFE (Jul. 6, 1989) (". . . likely to give rise to substantial gains in efficiency throughout most of Canada, and particularly in Quebec. The Bureau will monitor the parties' efforts to achieve these efficiency gains."); CONSUMER & CORP. AFFAIRS CAN., NEWS RELEASE NO. 10338/90-36, COMPETITION BUREAU WILL MONITOR ACQUISITION OF PALM DAIRIES IN THUNDER BAY (Aug. 28, 1990) (". . . likely to result in substantial efficiency gains that will benefit producers, dairy processors and consumers"); CONSUMER & CORP. AFFAIRS CAN., NEWS RELEASE NO. 10342/90-42, DIRECTOR WILL NOT OPPOSE SALE OF TEXACO CANADA'S ATLANTIC ASSETS (Oct. 5, 1990) (". . . has identified potential efficiencies and synergies between its . . . refinery and the Atlantic assets to enable it to become a lower-cost producer"); 1990 DIR. INVESTIGATION & RES. ANN. REP. (Consumer & Corp. Affairs Can.), Mar. 31, 1990, at 14-15 [Merger of Molson Companies Ltd. and Elders IXL Ltd. ("merged entity would be largest brewer in Canada, number six in North America and number twenty world-wide")]; CONSUMER & CORP. AFFAIRS CAN., CCAC No. 10382 91-05, MAPLE LEAF MILLS LIMITED/OGILVIE MILLS LTD. COMPETITION ANALYSIS ("The parties anticipated that the partnership would yield substantial gains in efficiency related to production, distribution, and administration." However, the Bureau staff reviewed the plan and concluded that "the majority of the claimed gains would likely be attained by been recognized and utilized by the Director and the Bureau of Competition Policy, which the Director heads.[114] In merger decisions, efficiency always emerges as only one of the factors the Director considers; foreign competition also plays a key role.[115]

A careful review of these decisions suggests that the first Director and, to a lesser extent, his immediate successor conducted an implicit competitive effects efficiencies analysis in the merger context. Of the eighteen public references to the successful use of this efficiencies analysis, fourteen appear to have been conducted during the term of the first Director and four in the term of the second, although one of these concerned an amendment to a file opened during the tenure of the first Director. On the basis of publicly available information, it is not possible to determine what proportion this represents of the aggregate turnover in all cases reviewed.[116] A recent decision, *Maple Leaf Mills*, suggests that the second Director primarily applied a tradeoff defense.[117]

The feature of the Competition Act that has received the most attention with regard to efficiencies is not the implicit competitive effects efficiencies analysis, but rather the tradeoff defense in Section 96 of the Competition Act. Section 96(1) provides that the Tribunal shall not make an order when the merger "has brought about or is likely to bring about gains" in efficiency that: (1) "will be greater than, and will offset, the effects of the

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the parties acting independently . . . . As a result, the claimed gains were not found to outweigh the likely anti-competitive effects of the partnership.").

114. When the amended merger provisions came into effect on June 19, 1986, the first Director was Calvin S. Goldman, Q.C., who served until October 30, 1989. He was succeeded by Howard I. Wetston, Q.C., who in turn was succeeded on June 16, 1993 by George N. Addy. *See* CONSUMER & CORP. AFFAIRS CAN., NEWS RELEASE NO. 86-6, APPOINTMENT OF NEW DIRECTOR OF INVESTIGATION AND RESEARCH (Apr. 29, 1986); CONSUMER & CORP. AFFAIRS CAN., NEWS RELEASE NO. 10264, GOLDMAN TO LEAVE COMPETITION BUREAU: NEW DIRECTOR NAMED (Aug. 29, 1989); CONSUMER & CORP. AFFAIRS CAN., NEWS RELEASE NO. 11238\93-22, ACTING APPOINTMENT TO BUREAU OF COMPETITION POLICY (June 21, 1993).

115. *See* R. S. Khemani, *Merger Policy in Small vs Large Economies*, *in* CANADIAN COMPETITION LAW AND POLICY AT THE CENTENARY 205, 213-14, 217 (R. S. Khemani & W. T. Stanbury eds., 1992). Khemani, a former Director of Economics and International Affairs and Senior Policy Advisor in the Bureau of Competition Policy, has said that "[i]n cases where acceptable efficiencies have been identified, other considerations such as effective foreign competition were also relevant in mitigating competition concerns." *Id.* at 217.

116. *See infra* note 147 and accompanying text.

117. Further evidence of this view will be discussed below in reference to a recent decision of the Tribunal in Director of Investigation and Research v. Hillsdown Holdings (Canada) Ltd., 41 C.P.R. 3d 289 (Comp. Trib. 1992). *See infra* notes 139-41 and accompanying text.

prevention or lessening of competition;" and (2) "the gains in efficiency would not likely be obtained" but for the merger. Section 96(2) directs the Tribunal to consider the following factors: (1) will the gains result in a significant increase in the value of real exports; and (2) will they result in a significant substitution of domestic products for foreign products? Finally, Section 96(3) instructs the Tribunal to disregard "gains in efficiency by reason of a redistribution of income between two or more persons."

Apparently, the Competition Act provides a defense in the event that market power is found to result from the merger; it also permits efficiencies to be considered with the other competitive effects of a merger. This raises a number of interesting questions. First, the Canadian Parliament presumably did not intend that the same test be applied in both of these cases. It would make sense, therefore, for the efficiency exception in Section 96 of the Competition Act to be construed more strictly than the efficiency analysis contained in Section 92.[118]

The second question concerns the meaning of the reference to the "effects of the prevention or lessening of competition" in Section 96(1). Do these effects include the redistributive wealth transfer rectangle or just the allocative inefficiency triangle illustrated in Figure 1? As argued above, logic implies that if redistribution is ignored in the calculation of efficiencies, then it also should be ignored in the tradeoff analysis.[119] Under this reading of the statute, it would seem that the relevant effects should not include the redistributive effect.[120] If this view is correct, then there must be some other sense in which the efficiency exception is meant to be more strictly construed than the efficiency analysis. Perhaps the answer lies in the standard of proof or certainty required. Or, perhaps, the Canadian Parliament either did not see the contradiction or did not deem it to be a problem.

Another area of concern raised by Section 96 is the recognition of efficiency gains from export promotion or import substitution. While these gains may be welfare-enhancing from the point of view of the Canadian economy, they easily could be welfare-reducing or simply redistributive in terms of the global

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118. *Contra* Calvin S. Goldman & John D. Bodrug, The Hillsdown and Southam Decisions: The First Round of Contested Mergers Under the Competition Act 15 (Dec. 15, 1992) (unpublished manuscript, on file with the author).

119. *Id. See also* Crampton, *supra* note 26, at 390-94.

120. Goldman & Bodrug, *supra* note 118, at 15.

economy.[121] These measures, however, probably only represent a genuflection to the current state of trading relations and their concomitant second-best solutions.[122] Of the two, export promotion would be less problematic if the market power and efficiency analysis applied to a product and geographic market that crossed the Canada-United States border or some other international configuration.

B. *The Merger Enforcement Guidelines*

The Merger Enforcement Guidelines (Canadian Guidelines),[123] issued by the second Director in March 1991, discuss the subject of efficiency in much greater detail. The Canadian Guidelines generally follow the statutory scheme of the Competition Act. They begin with market definition, turn to evaluative criteria or competitive effects, and then to the efficiency exception. Given the discussion above regarding the use of review thresholds and safe harbors as implicit efficiency judgments, this Article will discuss only briefly market shares and concentration.

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121. The Director, has acknowledged this conundrum outside the merger context with respect to R&D joint ventures, export consortia, production sharing, and specialization agreements, but the analysis clearly fits here as well. *See* Howard I. Wetston, Director of Investigation and Research of the Canadian Bureau of Competition Policy, Notes for an Address to the International Bar Association (Oct. 1, 1991), *in* CONSUMER & CORP. AFFAIRS CAN., SPEECH NO. 10612\91-27, at 7.

122. A staff officer in Canada's Ministry of Foreign Affairs and International Trade has recently written critically of this aspect of Section 96. NICOLAS D. DIMIC, EXTERNAL AFFAIRS & INT'L TRADE CAN., POLICY STAFF PAPER NO. 93/09, MERGER CONTROL UNDER TRADE LIBERALIZATION: CONVERGENCE OR COOPERATION? 35 n.63 (Aug. 1993):

> In the Bureau's view, subsection 96(2) . . . is not intended to expand the class of efficiency gains considered by the Tribunal, but merely draws attention "to the fact that in calculating the merged entities total output for the purpose of arriving at the sum of unit and other savings brought about by the merger, the output that will likely displace imports, and any increased output that is sold abroad, must be taken into account." While such an interpretation renders the subsection meaningless, it is equally true that a positive change in the trade balance is not an efficiency gain in economics either. While the ultimate intent of this subsection remains a mystery, one suspects that legislators confused trade effects with efficiency gains.

Id.

123. DIRECTOR OF INVESTIGATION AND RESEARCH, CONSUMER & CORP. AFFAIRS CAN., INFO. BULLETIN NO. 5, MERGER ENFORCEMENT GUIDELINES (March 1991) [hereinafter CANADIAN GUIDELINES].

Section 4.2.1 of the Canadian Guidelines provides that the Director generally will not challenge a merger on the basis that the merged entity will be able unilaterally to exercise greater market power than in the absence of the merger, when the postmerger market share would be less than thirty-five percent. Similarly, using a theory of the interdependent exercise of market power, the Director generally will not challenge a merger when: (1) the postmerger market share of the four largest firms is less than sixty-five percent; or (2) the postmerger market share of the merged entity would be less than ten percent. Section 4.2.1 indicates that market share and concentration data are necessary, but not sufficient, for the Director to challenge a merger.[124]

The Canadian Guidelines do not indicate how to conduct the competitive effects efficiencies analysis. Section 4.9 describes in general language how to consider change and innovation, and Sections 4.10.1 and 4.10.2 describe, as additional evaluative criteria, market transparency and transaction value and frequency. Part 5 of the Canadian Guidelines, however, does describe how the Director will perform the tradeoff analysis under Section 96 of the Competition Act.

An interesting feature of the Canadian Guidelines is that in some cases efficiencies may be considered that would likely be attained in markets which are not the focus of the investigation.[125] This consideration arises when the nature of the particular efficiencies would prevent their achievement but for the merger.[126] In assessing whether the efficiencies could be achieved otherwise, the Director will consider the market realities of the industry involved. In general, the Director will not exclude the market realities on the basis that the efficiencies "theoretically *could* be attained through internal growth, a joint venture, [or] specialization agreement," if the common industry

124. CANADIAN GUIDELINES, *supra* note 123, § 4.2.1. The market share thresholds are set rather high given the fact that Canada as a small open economy has generally had high levels of industrial concentration and that domestic competition is largely checked by foreign imports. *See* Khemani, *supra* note 115, at 206-14.

125. CANADIAN GUIDELINES, *supra* note 123, § 5.2.

126. *Id.* § 5.2 n.53. This approach contrasts with the United States practice. *See* Howard I. Wetston, *Commentary on "Implications of U.S. Experience with Horizontal Mergers and Takeovers for Canadian Competition Policy," in* THE LAW AND ECONOMICS OF COMPETITION POLICY 369, 372 (Frank Mathewson et al. eds., 1990). Nonetheless, efficiencies should be generally realizable across the entire market. *See* Howard I. Wetston, Director of Investigation and Research of the Canadian Bureau of Competition Policy, Notes for an Address: Canada's Merger Enforcement Guidelines 12 (Aug. 13, 1992).

practice would not incorporate these realities.[127] With respect to less anticompetitive mergers that may produce efficiencies, the Director will only consider "existing alternative merger proposals."[128]

Another interesting feature of the Canadian Guidelines is the treatment of gains that are redistributive in nature. While the Competition Act proscribes consideration of these efficiencies, the Director nevertheless will inquire into whether, for example, increased bargaining leverage that achieves wage concessions or discounts from suppliers is cost justified.[129] As discussed above, this is helpful given the difficulty in distinguishing real and pecuniary efficiencies.[130] Nonetheless, the Canadian Guidelines indicate that tax-related gains, bargaining leverage gains, and gains from reduced output, service, quality, and variety are "generally found" to be redistributive.[131]

In attempting to operationalize the tradeoff calculus, the Director recognizes the largely discretionary and subjective nature of the enterprise. However, the Canadian Guidelines indicate that the Director will make an effort to weigh quantitative efficiency gains against quantitative anticompetitive effects and qualitative gains against other qualitative gains.[132] The Canadian Guidelines indicate in substantial detail that the Director considers production (economies of scale and scope), distribution, and transactional efficiencies as long as these efficiencies reduce the long-run average unit costs. Thus, the Director will consider both real-fixed and variable costs.[133] With respect to dynamic efficiencies, the Director acknowledges that these are qualitative in nature and extremely difficult to measure; hence he focuses on production efficiencies.[134]

The Director makes an effort to account for inflation and to apply a common discount rate to future anticipated

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127. CANADIAN GUIDELINES, *supra* note 123, § 5.2.

128. *Id.*

129. *Id.* § 5.3.

130. *See supra* note 60 and accompanying text.

131. CANADIAN GUIDELINES, *supra* note 123, § 5.3. However, an asset sale that reduces "ongoing expenditures . . . or results in a lower overall cost of capital . . . will ordinarily not be excluded." *Id.*

132. *Id.* § 5.4.

133. *Id.* at App. 2. A consequence of including fixed costs efficiencies is that in Canada, assuming that the concerns of the redistributive nature of tax-related efficiencies can be answered, they will be easier to include.

134. *Id.* at App. A.

efficiencies.[135] The costs of achieving the efficiencies are deducted.[136] What the Canadian Guidelines do not indicate, however, is over what time frame efficiencies must be realized. Is it over two years, as in entry analysis,[137] or is it longer? If so, how much longer, and how is the difference in treatment rationalized?

The Canadian Guidelines indicate that the relevant anticompetitive effects of concern are those that produce allocative inefficiency and not wealth redistribution.[138] On this point, however, the Director recently has been controverted by the Chair of the Tribunal. In *Hillsdown Holdings,*[139] the first Tribunal decision in a contested merger case, the Director asked the Tribunal to order that Hillsdown, which indirectly had acquired a rendering company, divest itself of that business because Hillsdown already operated a similar plant within the relevant market. The Tribunal denied the order on the grounds that competition, although lessened, would not be lessened substantially. Citing *United States v. General Dynamics Corp.,*[140] the Tribunal noted that *Hillsdown Holdings* was a borderline case decided in light of the dynamic changes occurring in the market.[141]

The Tribunal could have stopped there, but it did not, choosing instead to discuss Section 96 of the Competition Act in dicta. After reviewing the textual academic support for the Williamsonian tradeoff, the Chair found that: (1) both the English and French texts of the Competition Act refer to the prevention or lessening of competition; (2) if Parliament had intended this to mean only allocative efficiency effects it would have explicitly said so; (3) the legislative history indicated that Parliament had

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135. *Id.* § 5.7.1. Section 5.7.1 provides that the discounting of gains and losses will be done over intervals of time so as not to discriminate against the stream of value of the gains. *Id.* § 5.7.1. If this were not done, then they may be over-discounted because they begin in the future, but the anticompetitive effect occurs immediately. *See* Crampton, *supra* note 26, at 380.

136. CANADIAN GUIDELINES, *supra* note 123, § 5.7.2.

137. *Id.* § 4.6.2. However, with respect to entry, the Director has noted in footnote 45 that "[g]iven that section 97 of the Act imposes a three year limitation period in respect of challenges to completed mergers, it is not generally considered to be appropriate to employ a period of longer than two years in this context." *Id.* § 4.6.2 n.45.

138. *Id.* § 5.5. See also footnote 57 which states "[w]hen a dollar is transferred from a buyer to a seller, it cannot be determined *a priori* who is more deserving." *Id.* § 5.5 n.57.

139. Director of Investigation and Research v. Hillsdown Holdings (Canada) Ltd., 41 C.P.R. 3d 289 (Comp. Trib. 1992).

140. 415 U.S. 486 (1974).

141. *Hillsdown Holdings*, 41 C.P.R. 3d at 330-31.

considered earlier bills that would have required a consideration of less than the total effect; (4) one of the traditional purposes of competition law is to protect consumers from higher prices;[142] (5) the purpose section of the Competition Act supports this view by referring to providing consumers with competitive prices; (6) the purpose section does not explicitly indicate that providing competitive pricing for consumers is subordinate to the first enumerated goal, promoting the efficiency and adaptability of the economy; and (7) the legislative history does not contradict this interpretation of the purpose section.[143] Citing to the works of Fisher, Johnson, and Lande,[144] the Chair suggested that the efficiencies should be balanced against the sum of the allocative inefficiency and the wealth transfer.[145]

Practitioners have criticized the Tribunal's decision as being an overly narrow reading of the Competition Act that would render the Section 96 exception a mere "academic possibility."[146] Despite these criticisms, the Tribunal did reach the correct decision under the Competition Act as it is now written. All is not lost, however, for efficiency in Canada. As suggested above, a less obtrusive interpretation of the Competition Act would be to read an initial efficiency analysis into the competitive effects assessment and implicitly into the review thresholds. If this were done, given the difficulties of proof, there is no good reason why the efficiencies exception should not be just that—an exception. The burden of proving efficiencies would be much less stringent when a review indicated that other competitive effects alone, or combined with efficiencies, would assure that effective competition remains in the market. A more onerous standard would be applied if market power concerns became apparent.

Crampton has argued that, as no mergers have ever been approved on the basis of the exception in the six years since it came into force, the Tribunal's reading is too restrictive.[147] This

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142. Interestingly, the Tribunal cited a United Kingdom source for this principle, not a Canadian or United States text. RICHARD WHISH, COMPETITION LAW 12-15 (1985).

143. *Hillsdown Holdings*, 41 C.P.R. 3d at 337-43.

144. *See* Fisher et al., *supra* note 19.

145. *Hillsdown Holdings*, 41 C.P.R. 3d at 347. The Chair also queried whether wealth transfers are always neutral. For instance, she hypothesized a merger between two drug companies that would produce a life-saving drug. *Id.*

146. *See* Goldman & Bodrug, *supra* note 118, at 15; Crampton, *supra* note 26, at 386.

147. Crampton, *supra* note 26, at 387. *See also id.* at 381 n.32 (one merger was provisionally approved on this basis, however, by the time of final decision,

view fails to appreciate that, at least on the basis of the limited publicly available information,[148] the first, as well as perhaps the second, Director has been applying implicitly, if not explicitly, a competitive effects efficiency analysis.[149]

What the new Director must now do is to incorporate explicitly the past, and to some extent the present, implicit practice into the Canadian Guidelines, rather than disregarding the advice of the then Chair of the Tribunal and presiding judicial member in the *Hillsdown Holdings* case.[150] In so doing, the Director should make clear exactly how this competitive effects efficiencies test has been implemented.[151] Reviewing the publicly

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other information about their competitive factors was found that allayed the market power concerns); Khemani, *supra* note 115, at 217.

148. See Stanbury, *supra* note 108, at 428-29, who criticizes the fact that the Director does not provide even redacted information regarding the resolution of merger cases, except for very short statements in annual reports and speeches.

> Finally, information about the standards applied to merger cases is very limited because the direct participants in the merger review process, notably lawyers for the merging parties, their consultants, consultants to the Bureau, and Bureau officials, are reluctant to talk about their experience. They may be concerned that they will dissipate their specialized human capital or are legally barred from talking because they had access to confidential information. In any event, very few individuals are able to obtain direct knowledge of more than a relatively few cases each year.

Id. at 430.

149. See *supra* note 113 and accompanying text. In fact, it is equally plausible that there have been few cases reaching Section 96, because of the "fair, large and liberal construction and interpretation" that is already being given to efficiencies under the Competition Act. Interpretation Act, R.S.C., ch. I-23, § 11 (1991).

150. *See* Howard I. Wetston, Director of Investigation and Research of the Canadian Bureau of Competition Policy, Notes for an Address: Developments and Emerging Challenges in Canadian Competition Law (Oct. 22, 1992), *in* CONSUMER & CORP. AFFAIRS CAN., SPEECH NO. 10882\93-02, at 16; *see* Howard I. Wetston, Director of Investigation and Research of the Canadian Bureau of Competition Policy, Notes for an Address: Decisions and Developments: Competition Law and Policy (June 8, 1992), *in* CONSUMER & CORP. AFFAIRS CAN., SPEECH NO. 10728\92-07, at 5.

151. The Bureau insists that its only efficiencies analysis is found in Section 96 of the Competition Act. This view is contradicted by Khemani, a former Director of International and Economic Affairs at the Bureau, in a study funded by the Bureau and which uses "confidential case files." *See* R. S. Khemani & D. M. Shapiro, *An Empirical Analysis of Canadian Merger Policy*, 41 J. INDUS. ECON. 161, 167 (1993). He concludes that "the decision *not* to challenge particular mergers was further buttressed by the possible existence of efficiencies." *Id.* at 165 n.10. His study of cases between 1986 and 1989 indicates that efficiencies were among factors cited in the assessments of case officers in 27% of cases. *Id.* at 167 (Table I). It is unclear how efficiencies legally could be so considered absent a finding of market power, if the Bureau rejects the statutory

available information on the decisions summarized in footnote 113, it appears that once the Director finds strong import competition, he is prepared to permit mergers in Canada that generate scale economies, which in turn may generate exports. If this is the case, the Director should make this clear.

The Canadian Guidelines do not add much to the interpretation of the export promotion and import substitution efficiency considerations. The Chair of the Tribunal, however, has raised the issue by querying whether a national competition authority should be neutral to wealth transfers in mergers when the efficiencies may be generated to a foreign-owned firm.[152] As discussed above,[153] similar reasoning could apply to mergers between a Canadian firm and a foreign firm. These concerns are not irrelevant, considering that between 1986 and 1992, 64.4 percent of the 5,847 mergers publicly reported in Canada included a foreign-owned or foreign-controlled acquiring company.[154]

As long as the relevant markets are international or global, absent second-best considerations, the reflexive economic answer is that such wealth transfers still should be regarded as neutral. Neutrality simply means that: (1) while some money may be lost to the Canadian economy, Canadian industry ultimately should benefit from the "spillover" effects discussed above; and (2) if capital markets are efficient, the purchase price should include the discounted present value of the future income stream to the acquiring foreign firm.[155] In short, if one finds acceptable efficiencies, then even in the most extreme case, when the merger leads to higher Canadian prices, the wealth transfer is not necessarily lost to the Canadian economy. Thus, even in the tradeoff

interpretation set out herein. As a practical matter, counsel routinely provide evidence of efficiencies in submissions to the Bureau.

152. See *supra* note 121 and accompanying text for a discussion of similar musings by the Director.

153. *See supra* notes 33-37 and accompanying text.

154. These are my own calculations drawn from statistics reported in 1990 DIR. INVESTIGATION & RES. ANN. REP. (Consumer & Corp. Affairs Can.), Mar. 31, 1990, at 5 (Table 1) and 1992 DIR. INVESTIGATION & RES. ANN. REP. (Consumer & Corp. Affairs Can.), Mar. 31, 1992, at 5 (Table 1). A more desirable statistic would involve the aggregate turnover involved but this is not provided by the Director.

155. *See supra* note 37 and accompanying text; *see also* Janus A. Ordover & Alan O. Sykes, *The Antitrust Guidelines for International Operations: An Economic Critique*, *in* 1988 FORDHAM CORP. L. INST. 4-1, 4-9 (Barry E. Hawk ed., 1989); Thomas W. Ross, *Discussant's Comments*, *in* FOREIGN INVESTMENT, TECHNOLOGY AND ECONOMIC GROWTH 28, 30. *But see* Harris, *supra* note 34, at 12-13.

analysis, no distinction may need to be made between foreign and domestic firms.

In conclusion, the Competition Act has two separate efficiency tests that need to be considered in the merger context: one as an implicit part of the competitive effects analysis; and the other as part of a tradeoff analysis. To clarify the nature and application of these two tests, the Director should acknowledge publicly their existence and indicate how the first test is operationalized. Additionally, the second test, the tradeoff, should be construed strictly; this may include aggregating some degree of wealth transfer with the dead weight loss when effecting the tradeoff. From an aggregate global welfare perspective, the protectionist elements of the tradeoff analysis may be nonoptimal. Finally, while Canada properly recognizes a broad range of efficiencies, the Director should clarify the time frame over which these must be realized.

IV. THE EUROPEAN COMMUNITY

The European Economic Community Treaty (EEC Treaty), as recently amended by the Treaty on European Union, represents an attempt to bring twelve sovereign nations together for political and economic reasons, but at the same time allow them to retain their separate identities.[156] Thus, despite the fact that the focus in this Article is on the EC as a whole, a full review of merger-related efficiencies analysis would also have to examine the individual laws of the various Member States.

Article 3(f) of the original EEC Treaty (Article 3(g) of the amended EEC Treaty) states that, in achieving the purposes of the EC, the activities of the EC shall include "the institution of a system ensuring that competition in the common (internal) market is not distorted." Generally speaking, the core of EC competition policy is contained in Articles 85 and 86 of the EEC Treaty, which set out the rules applying to undertakings.

Article 85(1) lists and Article 85(2) prohibits agreements between undertakings "which may affect trade between the Member states and which have as their object or effect the prevention, restriction or distortion of competition within the

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156. *See* EEC Treaty, *supra* note 111, pmbl., arts. 2-3. For a more detailed discussion of the interplay of these objectives and EEC competition law, see SIR LEON BRITTAN, EUROPEAN COMPETITION POLICY: KEEPING THE PLAYING FIELD LEVEL (1992); Eleanor M. Fox, *Merger Control in the EEC: Towards a European Merger Jurisprudence*, *in* COLLABORATIONS AMONG COMPETITORS: ANTITRUST POLICY AND ECONOMICS 297, 298-301 (Eleanor M. Fox and James T. Halverson eds., 1992).

common market." However, Article 85(3) permits a defense that these agreements contribute "to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit."[157] This defense applies only if the agreement imposes restrictions that are indispensable to competition and that do not increase the possibility of eliminating competition in a substantial part of the market. Article 86 addresses abuses of a dominant position and provides for no defenses.

It has not always been (and still may not be) clear how merger regulation fits into the scheme of Articles 85 and 86. Because other authors already have done so,[158] this Article does not trace this relationship in any great detail. Two points regarding merger regulation in the context of Articles 85 and 86, however, are highly relevant to this discussion. In *Continental Can,*[159] the European Court of Justice (ECJ) found "abuse" to exist when "an undertaking in a dominant position strengthens such position in such a way that the degree of dominance reached substantially fetters competition, i.e., that only undertakings remain in the market whose behavior depends on the dominant one."[160] In short, the ECJ found that if Article 86 covered mergers, it would do so only if the mergers resulted in a strengthening of a dominant position. With respect to Article 85, it was not until its dicta in *R.J. Reynolds*[161] that the ECJ indicated that mergers might be reviewable under Article 85, which does permit an efficiencies defense. On the basis of these limited comments, and because the EC Council believed that neither Articles 85 nor Article 86 alone would be adequate to regulate mergers, the EC Council passed the Merger Regulation on December 21, 1989.[162]

Article 2(1) of the Merger Regulation directs the European Commission (Commission) to begin in each case by defining the relevant product and geographic markets. However, prior to even this step, the Commission must first find that the combined "turnover" of the undertakings involved in creating a

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157. *See* discussion *supra* note 111.

158. *See generally* PIERRE BOS ET AL., CONCENTRATION CONTROL IN THE EUROPEAN ECONOMIC COMMUNITY 69-114, ch. 3 (1992).

159. Case 6/72, Europemballage and Continental Can v. Commission, 1973 E.C.R. 215.

160. *Id.* at 245.

161. Joined Cases 142 & 156/84, British American Tobacco Co. and R.J. Reynolds Indus. v. Commission, 1987 E.C.R. 4487, 4578.

162. *See* Merger Regulation, *supra* note 111.

concentration pass certain thresholds set out in Article 1 of the Merger Regulation. One could argue that these thresholds provide an implicit guide to the Commission's judgment about the efficiency properties of mergers, or at least those mergers with a "Community dimension." The standards require that the undertakings have an aggregate worldwide turnover of approximately United States 5.6 billion dollars and an EC-wide turnover of United States 279 million dollars, unless each undertaking has two-thirds of its turnover from one and the same Member State.[163] Below these thresholds, Member States may have differing implicit views of merger-related efficiencies.

Once the Commission has completed its market definition, Article 2(b) sets out the factors to be considered in determining whether a concentration is "compatible with the common market." This is essentially the competitive effects analysis. In their analysis, Commission considers factors such as: market position, economic and financial power, available substitutes upstream and downstream, barriers to entry, demand trends, and the interests of consumers. Additionally, the Commission will consider economic and technical progress, provided that it is to the advantage of consumers and does not form a barrier to competition. This final component of the competitive effects test is narrower than that listed in Article 85(3) of the EEC Treaty itself, which specifically refers to improvements in the production and distribution of goods.[164]

If an efficiencies analysis is taking place, it appears to be in the context of the competitive effects assessment generally and not as part of some Williamsonian tradeoff defense. Indeed, from the consumer benefit language of Article 85(3) of the EEC Treaty or Article 2(b) of the Merger Regulation, it would appear that the EC's approach is more in line with the Canadian Tribunal's decision in *Hillsdown Holdings* than with the Canadian Guidelines. Given the uncertainty regarding the relevancy of Article 85 to mergers and the fact that Article 86 does not provide for any defenses, it is to be expected that the Merger Regulation would not emphasize an efficiency defense in the merger area, which has traditionally focused on market dominance.

Dieter Schwarz of the Directorate-General for Competition (DG-IV) has described this form of analysis as a "structural approach" based on evaluating the effects of a merger on effective

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163. My calculations are based on an ECU/United States exchange rate of 1.115 quoted on January 27, 1994 applied to ECU 5000 million and 250 million respectively. *See Foreign Exchange Markets*, FIN. TIMES, Jan. 27, 1994, at 30.

164. *See* EEC Treaty, *supra* note 111, at art. 85(3).

competition, not just "the efficiency related to a given merger."[165] The Commission's background studies supporting this selective merger policy indicate that: (1) increasing firm size does not always lead to allocative or productive efficiency or innovation; (2) only mergers above a certain threshold of market concentration, which varies from industry to industry, reduce competition;[166] and (3) the oligopolistic structure of EC markets permits sufficiently intense competition, especially when the market is open.[167]

Assuming that the Commission is conducting a competitive effects analysis of mergers,[168] one should be able to review some of the Commission's decisions to see how the efficiencies component of that analysis is being conducted in the embryonic state of EC merger regulation. The starting point for this examination is the Commission's decision in *de Havilland*,[169] which presents its clearest discussion of efficiencies to date. The *de Havilland* case arose in the context of the acquisition of a Canadian subsidiary, de Havilland, of a United States aerospace company, Boeing, by a consortium of a French aerospace company, Aerospatiale SNI, and Alenia-Aeritalia e Selina Spa of Italy. Even under the most generous definitions of product and geographic markets, the merged entity would enjoy a global market share of nearly fifty percent, and a EC market share of sixty-five percent.[170] In reviewing the competitive effects of the merger, having considered all the factors in Article 2(b) of the Merger Regulation, the Commission was concerned that a strengthening of Aerospatiale's dominant position would result were the merger to occur.[171] The Commission concluded that any efficiencies generated would likely give Aerospatiale the

165. *See* Dieter Schwarz, *EEC Merger Policy: Panel Discussion*, *in* 1988 FORDHAM CORP. L. INST., *supra* note 155, at 25-8-25-9; *see also* Dieter Schwarz, *New EEC Regulation on Mergers, Partial Mergers and Joint Ventures*, *in* 1988 FORDHAM CORP. L. INST., *supra* note 155, at 21-1 [hereinafter Schwarz II].

166. Schwarz II, *supra* note 165, at 21-4-21-5.

167. *See id.* at 21-7.

168. *See* Fox, *supra* note 156.

169. Commission Decision of October 2, 1991 declaring the incompatability with the Common Market of a Concentration (Case No. IV/M.053-*Aerospatiale-Alenia/de Havilland*) 1991 O.J. (L 334).

170. *Id.* § 26.

171. *Id.* § 72. For the purposes of this paper, I will invoke the *ceteris paribus* assumption in respect to the other competitive effects findings.

power to exclude competition and, in the long run, gain power over consumer prices.[172]

Several important points emerge from the Commission's analysis in *de Havilland*. Putting aside the relative merits of the factual findings in the case, it is clear the Commission has indicated that it may factor efficiencies into a competitive effects analysis. In contrast to the apparent Canadian approach, the apparent understanding of the Commission is that efficiencies are not always procompetitive, especially when generated from imperfect competitive markets.[173]

If efficiency gains cannot be spread throughout the industry or the economy within a reasonable time frame, then they may reinforce other barriers to entry. Although the merged entity may earn supranormal profits, a potential entrant will have to consider that the merged entity's costs are lower and that after entry, the merged firm may profitably set its price below the costs of the entrant. Entry may be deterred even if the merged entity can make a credible threat[174] to potential entrants that it will set prices in this manner. In *de Havilland*, the Commission hinted at this sort of dynamic analysis by examining whether the merged entity would gain long-run market power in the sense of excluding competition. Despite this hint of a new approach, the Commission nevertheless went on to assess the net effects of losses in allocative efficiency against gains in productive efficiency, in keeping with the traditional approach of Fisher and other theorists.[175]

The *de Havilland* case does raise some concerns. One may read the language of the decision to imply that efficiencies are always likely to strengthen a dominant position.[176] Again, as discussed above, this interpretation would be entirely consistent with the legal framework that preceded the Merger Regulation. It

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172. *Id.* § 69. The Commission's theory was that consumers (i.e., airlines) would be "locked in" to purchasing from Aerospatiale over a full product range, and hence Aerospatiale could engage in predatory pricing to exclude competitors in two of the product market ranges. *Id.*

173. *See* DePrano & Nugent, *supra* note 19; Crampton, *supra* note 26 and accompanying text; Schwarz II, *supra* note 165, at 21-2-21-3. *See also* Fox, *supra* note 156, at 316-17; FEDERAL TRADE COMMISSION, *supra* note 91.

174. For a discussion of credible threats in the context of predatory pricing, see generally, Donald G. McFetridge, *Predatory and Discriminatory Pricing*, *in* THE LAW AND ECONOMICS OF COMPETITION POLICY 71, 78-81 (Frank Mathewson et al. eds., 1990).

175. See *Aerospatiale-Alenia/de Havilland*, *supra* note 169, § 70.

176. *Id.* § 69 ("[T]he Commission does not consider that the proposed concentration would contribute to the development of technical and economic progress . . . . Even if [it did] this would not be to the consumer's advantage."). *Id.*

is not clear that an extended dynamic analysis has been made or whether these efficiencies will be deemed to spread through innovation or emulation throughout the industry or the economy.[177] The most compelling evidence that the Commission favors the latter view, however, comes not so much from *de Havilland* but from a range of other Commission decisions.[178]

A more recent decision of the Commission may signal a slight move away from the traditional approach. In *Accor/Wagons-Lits*,[179] after finding that a proposed merger would give the merged entity a dominant position, the Commission stated that: "It is not certain that there would be any improvement in technical and economic progress to the benefit of the consumer. Even if this were not the case, the Commission considers that there are other possible means of achieving it."[180] Admittedly, this is a pretty thin basis for proclaiming a new approach, but at least the Commission assessed the competitive effects of efficiencies without indicating that they significantly impeded effective competition per se. The Commission rejected the proffered efficiencies on the familiar and generally uncontroversial grounds that they were: (1) achievable by "other possible means" (presumably less restrictive); (2) insufficiently detailed; and (3) overly speculative.[181] Yet, the Commission also added the more controversial fourth objection that the efficiencies would not be passed on to consumers.[182]

The question that emerges is whether the competitive effects efficiencies analysis leads to the slippery slope of rejecting all efficiencies. It would be helpful in this regard to have more Canadian information publicly available. If, as argued in this

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177. *See* Frederick Jenny, *EEC Merger Control: Economies as an Antitrust Defence or an Antitrust Attack?*, *in* PROCEEDINGS OF THE NINETEENTH ANNUAL FORDHAM CORPORATE LAW INSTITUTE: INTERNATIONAL ANTITRUST LAW & POLICY 376-79 (1992) (the author is the Vice President of the French Conseil de la Concurrence); Fox, *supra* note 156, at 317.

178. Jenny, *supra* note 177, at 373-75. *See* Commission Decision of January 18, 1991 Notification of AT&T/NCR (Case No. IV/M.050) (the Commission did not challenge the merger); Commission Decision of January 10, 1991 Notification of Matsushita/MCA (Case No. IV/M.037) (a vertical merger case in which the Commission did not challenge the merger); Commission Decision of June 28, 1991 Notification of Drager/IBM/HMP (Case No. MIV/M.101) (the Commission did not challenge the merger).

179. Commission Decision of March 21, 1992 Accor/Wagons-Lits (Case No. MIV/126).

180. *Id.* § 25(4).

181. *Id.* §§ 25(4), 26(2)(a).

182. *Id.* § 25(4); *see also Aerospatiale-Alenia/de Havilland*, *supra* note 169, at § 69.

Article, the Director has applied the competition effects efficiencies analysis, then evidence that this analysis has been employed not only to allow borderline mergers but also to recognize, in appropriate instances, the potential anticompetitive effects of efficiencies would aid in answering this question.

Before concluding this Part, it is useful to examine briefly the kinds of efficiencies that the Commission at least has been prepared to analyze, if not definitively recognize. In *de Havilland*, without prejudicing whether efficiencies were relevant for analysis under Article 2 of the Merger Regulation, the Commission calculated efficiencies from: (1) rationalizing plants (production efficiencies, but no distinction drawn between economies of scale and scope); (2) parts procurement (transactional efficiencies); and (3) marketing[183] and product support (dynamic efficiencies).[184] The Commission did not consider research and development efficiencies per se because the parties did not claim them,[185] although these efficiencies have been recognized in a vertical merger case, *Matsushita/MCA*.[186] The Commission also appears ready to accept evidence of proven synergistic efficiencies, although it is seemingly skeptical that these can be proved with sufficient rigor.[187] Thus far, the Commission does not seem sympathetic to claims of superior management.[188] In *de Havilland*, the Commission stated that such savings are not "a consequence of the concentration *per se*, but are cost savings which could be achieved by [Boeing] or any other potential acquirer."[189]

In *de Havilland*, the Commission considered efficiency losses in markets other than those relevant for its analysis.[190] Logic would imply that efficiency gains also should be considered in secondary markets, although the Commission either did not consider or did not find any evidence to support this view. The Commission, however, seemed at least willing to consider in dicta the possibility that efficiency gains might be realized outside the EC, as long as these were still in the relevant market. Having initially defined a global geographic market, the Commission

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183. *See also Matsushita/MCA*, *supra* note 178, § 11; *AT&T/NCR*, *supra* note 178, § 28.

184. *Aerospatiale-Alenia/de Havilland*, *supra* note 169, § 65.

185. *Id.* § 66.

186. *See Matsushita/MCA*, *supra* note 178, §§ 12-13.

187. *See Matsushita/MCA*, *supra* note 178, § 13; *Drager/IBM/HMP*, *supra* note 178, §§ 18-19; *AT&T/NCR*, *supra* note 178, §§ 28-30.

188. *Aerospatiale-Alienа/de Havilland*, *supra* note 169, §§ 65-67.

189. *Id.* § 65.

190. *Id.* §§ 70, 71. It considered consumers through the effects on regional airlines, and commuters on 100 seat jets. The Commission otherwise primarily focused on aircraft in the 20-70 seat range.

considered, and then rejected as simply redistributive, gains from minimizing currency risk.[191]

In conclusion, the EC treatment of merger-related efficiencies is in a nascent stage. As suggested in Part II of this Article, the EC efficiencies analysis is contained implicitly in review thresholds and explicitly in consideration of the competitive effects of merger. The problem with EC analysis appears to lie in the strict construction that the Commission gives to the efficiencies factor once market dominance has been established. This may change as the Commission develops alternate theories of collusion or interdependent exercise of market power.[192] Accordingly, the Commission may come to appreciate that an efficiency gain may create different cost structures among firms and thus hinder successful collusive agreements. The Commission has cautiously recognized production, transaction, and dynamic efficiencies, although it remains particularly skeptical of management efficiencies. The Commission has not yet indicated whether it will consider marginal or average costs in its analysis.

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191. *Id.* § 68.

192. *See* Commission Decision of July 22, 1992 Nestle/Perrier (Case No. IV/M. 190) 1992 O.J. (L 356) (the Commission found a duopoly); *see also* Re: Italian Flat Glass: Societa Italiano Vetro SpA v. EC Commission, [1992] 5 CMLR 302 (the Article 86 decision).

> There is nothing, in principle, to prevent two or more independent economic entities from being, on a specific market, united by such economic links that, by virtue of that fact, together they hold a dominant position vis-a-vis the other operators on the same market. . . . [E]ven supposing that the circumstances of the present case lend themselves to application of the concept of "collective dominant position" (in the sense of a position of dominance held by a number of independent undertakings), the Commission has not adduced the necessary proof.

Id. See further the views of the former Competition Commissioner, Sir Leon Brittan:

> It is my belief that the concept of dominance in Article 2 of the Regulation covers oligopolistic dominance. If a merger or acquisition creates or reinforces a market structure on which price collusion or price parallelism between companies is highly likely, that concentration should be considered incompatible with the common market.

BRITTAN, *supra* note 156, at 25.

V. THE UNITED STATES

This Part of the Article examines the United States treatment of merger-related efficiencies, focusing on current and even prospective, but not historical, approaches. Avoiding the playground semantics that often surround much of the discussion of the legislative intent behind the antitrust laws,[193] the focus of this Article is on what should be kept and what should be abandoned to adapt United States antitrust law[194] and policy to the realities of the globalization of trade and investment patterns.[195]

No single United States law or policy clearly states the manner in which efficiencies are to be factored into merger analysis; rather, there are several sources to which one must look for guidance. First, there is the policy of the Department of Justice (DOJ) in the exercise of its prosecutorial discretion and the "law" in the form of the administrative practice of the Federal Trade Commission (FTC). Second, there is the "law" of the various states acting as *parens patriae*, enforcing federal antitrust law on behalf of their own citizens in federal court or enforcing their own antitrust law in state court.[196] Third, there is the law qua law of judicial precedent, which may or may not be relied upon by any of the above-named parties or by any private party seeking to enjoin a merger.

The judicial authority supporting either an efficiencies analysis or defense is not promising. Supreme Court precedent from the 1960s alternately supports a view that: (1) efficiencies

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193. *See supra* note 4. For those interested in a front-row seat to this aspect of the debate, see generally, BORK, *supra* note 40; Robert H. Lande, *Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged*, 34 HASTINGS L.J. 67 (1982).

194. The basic statutes of concern here are § 1 of the Sherman Act, 15 U.S.C. § 1 (1989), which prohibits mergers in restraint of trade, § 2 of the Sherman Act, 15 U.S.C. § 2 (1989), which prohibits mergers that form a monopoly, and § 7 of the Clayton Act, 15 U.S.C. § 18 (1989), which prohibits mergers if their effect may be to lessen competition substantially or to tend to create a monopoly.

195. *See generally* Bergsten & Graham, *supra* note 33; Rugman & Warner, *supra* note 33.

196. *National Association of Attorneys General, Horizontal Merger Guidelines*, 64 Antitrust & Trade Reg. Rep. (BNA Special Supp.) (Apr. 1, 1993). I will not examine these guidelines in great detail as I also did not address Member State law in the context of my discusson of the EC. Briefly, however, the states believe that to the extent that efficiency was a concern of the Congress, it was expressed in the legislative finding that less concentration would further that goal. *Id.* at 5-4. Furthermore, the states believe that there is no empirical support for the proposition that mergers in concentrated industries result in substantial efficiencies. *Id.* The states, not surprisingly, reject the Williamsonian tradeoff. Efficiency does not explicitly enter into the states' analysis of competitive effects. *Id.*

actually should count against a merger, not save it;[197] (2) a merger that leads to market power in one market cannot be saved by proof of efficiencies in some other market;[198] and (3) possible efficiencies in one market cannot be used as a defense to market power in the same market.[199]

More recently, the Eleventh Circuit Court of Appeals accepted a competitive effects analysis of efficiencies,[200] without making any reference to earlier judicial decisions rejecting an efficiencies analysis. While the Eleventh Circuit rejected the idea of an efficiencies defense in the Williamsonian sense,[201] the court nevertheless termed its competitive analysis test as a "defense."[202] On grounds of judicial economy and capability, the Eleventh Circuit ruled that it would be too difficult to prove that the efficiencies would be achieved and passed on to consumers.[203] The court therefore concluded that a defendant instead

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

198. United States v. Philadelphia National Bank, 374 U.S. 321, 371 (1963) ("We are clear, however, that a merger the effect of which 'may substantially to lessen competition' is not saved because, on some ultimate reckoning of social or economic debits and credits, it may be deemed beneficial.").

199. F.T.C. v. Procter & Gamble Co., 386 U.S. 568, 580 (1967) ("[P]ossible economies cannot be used as a defense to illegality. Congress was aware that some mergers which lessen competition may also result in economies but it struck the balance in favor of protecting competition.").

200. F.T.C. v. University Health, Inc., 938 F.2d 1206, 1222 (11th Cir. 1991). The court stated:

> It is clear that whether an acquisition would yield significant efficiencies in the relevant market is an important consideration in predicting whether the acquisition would substantially lessen competition. Thus, evidence that a proposed acquisition would create significant efficiencies benefiting consumers is useful in evaluating the ultimate issue—the acquisition's overall effect on competition.

Id.

201. *Id.* at 1222 n.29, citing *Procter & Gamble* and *Philadelphia National Bank* for support ("Of course, once it is determined that a merger *would* substantially lessen competition, expected economies, however great, will not insulate the merger from a Section 7 challenge.").

202. *Id.* at 1222 n.30. Footnote 30 to the competitive effects analysis states that "[i]t is unnecessary for us to define the parameters of this defense now." *Id.* The footnote suggests that this "defense" be limited to proof of significant efficiencies and that they are not attainable by less restrictive means. *Id.*

203. *Id.* at 1223.

would have to prove that these economies "ultimately would benefit competition, and hence consumers."[204]

Other lower courts also have discussed efficiencies.[205] Except in the procedural contexts of a preliminary injunction motion,[206] however, no United States court actually has been persuaded that significant net efficiencies were proven in sufficient quantity to override a finding of anticompetitive effect.

On April 2, 1992, the DOJ and the FTC (the Agencies) jointly released their Horizontal Merger Guidelines,[207] which establish a five-part analytical process for determining whether to challenge a merger. This process is structurally similar to both the Canadian and EC approaches,[208] beginning with market definition, turning to market share and concentration thresholds, and then analyzing the competitive effects of the merger. The competitive effects analysis is further broken down into an examination of: (1) the likelihood of the merger lessening competition through either coordinated or unilateral action;[209] (2) the timeliness, likelihood, and sufficiency of entry;[210] (3) potential efficiency gains;[211] and (4) the failure and exiting of assets.[212]

Even though there can be substantial disagreement over defining relevant markets and assigning market shares, it is fair to say that the stage of analysis preceding the competitive effects probably makes an implicit judgment about the efficiency properties of mergers.[213] The Agencies use the Herfindahl-Hirschman Index (HHI)[214] of market concentration to set out the threshold for merger review. In moderately concentrated industries, those with an HHI range between 1000 to 1800,

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204. *Id.* The court cited Section 3.5 of the 1988 DOJ's Merger Guidelines in support of this view, but as with the 1992 Agencies Guidelines, the framework therein is structured as a tradeoff defense.

205. *See* Pitofsky, *supra* note 51, at 212-13 for relevant case cites.

206. *Id.* at 212.

207. 62 Antitrust & Trade Reg. Rep. (BNA Special Supp.) No. 1559 (Apr. 2, 1992) [hereinafter Agencies Guidelines].

208. The first DOJ merger guidelines were issued in 1968 and then went through successive iterations in 1982 and 1984. Not surprisingly, the structure of analysis in other jurisdictions is similar, although the substance may differ.

209. Agencies Guidelines, *supra* note 207, § 2.

210. *Id.* § 3.

211. *Id.* § 4.

212. *Id.* § 5.

213. *See* Robert Pitofsky, *New Definitions of Relevant Market and the Assault on Antitrust*, 90 COLUM. L. REV. 1805 (1990). Pitofsky argues essentially that the Reagan administration enforced at least a 10% SSNIP and not 5%. *Id.* at 1836. This suggests that the guidelines may understate that implicit view.

214. Agencies Guidelines, *supra* note 207, § 1.5. The HHI is calculated by summing the squares of the market shares of the firms in the market.

mergers resulting in an HHI increase of more than 100 points are said to raise "significant competitive concerns" that require further analysis of competitive effects.[215] In highly concentrated industries, where HHI is greater than 1800, mergers resulting in an HHI increase of between 50 and 100 points also require further analysis. If, however, the increase is greater than 100 points, then the merger may succeed only upon proof of all the competitive effects factors and efficiencies, or that the assets would exit the market without the merger.[216]

The competitive effects analysis requires the Agencies to determine whether the postmerger market conditions are conducive to reaching terms of coordination, detecting deviations, and punishing such deviations.[217] The focus, then, is on determining whether a merger will lead to the collusion or the "incipient" exercise of market power.[218] The role of efficiencies should be explicitly included in this inquiry as part of the first stage of the formal efficiencies analysis. For instance, when industries contain firms with different cost curves or structures, it may be more difficult to agree to price and output restraints and to police them.

The Agencies subsequent entry analysis also seemingly reads efficiencies against a merger. For example, if one firm is a very low cost producer and other barriers to entry are otherwise high (due, for example, to high up-front costs), unless entry would be profitable and likely in two years,[219] the merger will be prohibited.[220] However, the efficiency gain that would result from the merger possibly may reduce costs over time throughout the industry and may, through emulation, adaptation, or further innovation, increase competition. Thus, in some cases, concentrating on the ability of these efficiency gains to produce scale economies and thereby to increase the minimum viable scale may

215. *Id.* § 1.51(b).

216. *Id.* § 1.51(c).

217. *Id.* § 2.1.

218. *Id.* § 2.11.

219. *Id.* § 3.2. The Agencies do acknowledge that a longer time frame may be used when *demand* conditions are such as to permit consumers to extend the life of their durable goods.

220. Long entry lags may indicate that high sunk costs which cannot be recovered in the event of failure may cause minimum efficient scale to be high relative to market demand. *See* John C. Hilke & Philip B. Nelson, *The Economics of Entry Lags: A Theoretical and Empirical Overview*, 61 ANTITRUST L.J. 365, 371-72 (1993).

actually deter more long-term entry.[221] Essentially, entry analysis and efficiencies analysis, at least with respect to timing, become blurred.[222] The point here is not that the Agencies are wrong in their analysis, but that the positive effects of efficiencies likewise deserve explicit weighing at this stage.

Assuming that the Agencies are not yet convinced about the desirability of a merger, the next step is to look at the actual efficiencies section of the Agencies Guidelines. These guidelines state that some mergers which might otherwise be challenged "may be reasonably necessary to achieve significant net efficiencies." The Agencies impose only two conditions on the use of this defense: (1) equivalent or comparable savings must not be reasonably achievable by the parties through other means; and (2) the expected net efficiencies must be greater the more significant are the competitive effects and the risks identified in the earlier entry analysis.[223]

With all due respect, this section of the Agencies Guidelines is of little use in addressing the difficult questions raised in Part II of this paper. First, "net" efficiencies would seem to include not only cost savings in the relevant market but in secondary markets as well. Yet this proposition is not clearly stated in the Guidelines. Furthermore, one would expect that net efficiencies would also extend to economies of scale realized outside the United States. As discussed above, as long as the relevant market is international or global, this treatment would be procompetitive, not anticompetitive. The DOJ's International Guidelines, however, which were issued in 1988 and have been

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221. One way that these efficiency gains might increase competition is by changing the relevant geographic market. Consider a geographic market as the whole or part of the United States. If a United States firm that could not previously export into another market because of its cost structure can now export, it may attract a foreign company to enter the United States market through trade or investment in order to recoup its lost sales and profits at home. The mere presence of the United States firm in its home market may drive emulation or further innovation and increased exports to reduce its lost sales and profits at home. *See generally* Edward M. Graham, *Strategic Management and Transnational Firm Behaviour: A Formal Approach*, *in* THE NATURE OF THE TRANSNATIONAL FIRM 155 (Christos N. Pitselis & Roger Sugden eds., 1991); Edward M. Graham, *Transatlantic Investment by Multinational Firms: A Rivalistic Phenomenon?*, 1 J. POST KEYNESIAN ECON. 82 (1978).

222. See the remarks of a former Deputy Assistant Attorney General (Economics) JANUS A. ORDOVER & M. E. GUERIN-CALVERT, BANK MERGER ANALYSIS AND THE NEW MERGER GUIDELINES: THE VIEW FROM THE DEPARTMENT OF JUSTICE 30-31 (1992) (". . . if we can conclude entry is easy, then we also implicitly conclude that efficiencies are [sic] *raison d'etre* for the merger.").

223. Agencies Guidelines, *supra* note 207, § 4.

neither repudiated nor amended on this point, suggest that these efficiencies would not be factored into the analysis.[224]

The principal competitive risk identified in Sections 1 to 3 of the Agencies Guidelines is that a merger will facilitate collusion and the exercise of market power with the accompanying ability to raise prices to consumers. Does this mean that the Agencies have adopted a wealth transfer calculus in the tradeoff, or have they adopted the Williamsonian model? Consistent with the argument of this Article, a strictly construed wealth transfer model would not provide a good analytical tool, unless the positive and negative aspects of efficiencies were more clearly emphasized in the competitive effects analysis.[225]

To some extent, the Agencies have attempted to respond to these questions through speeches made by their officials. Both the DOJ[226] and the FTC[227] have indicated that there is, in fact, a two-part test for efficiencies of the kind this Article recommends. But the revised Agencies Guidelines, issued in April 1992, did not explicitly incorporate this test, for reasons that are not made clear.

In public comments, the DOJ has qualified the definition of net efficiencies to mean only those that will occur in the relevant market.[228] This view is consistent with the International Guidelines. The DOJ seems prepared, however, to recognize that

224. *Department of Justice, Antitrust Enforcement Guidelines for International Operations (Nov. 10, 1988)*, 55 Antitrust & Trade Reg. Rep. (BNA) (Nov. 17, 1988). See Illustrative Case 1 at 5-25-5-27 involving a merger between a foreign and United States firm. The DOJ states that they would focus on the merger's "likely competitive effects in the U.S.," and efficiencies would be weighed against that harm. *Id.* at 5-25, 5-27.

225. This is consistent with the view expressed by Fisher that if evidence that efficiencies would make the merged enterprise "a tougher competitor" were not allowed, he would not accept a strictly construed efficiencies defense. Fisher, *supra* note 38, at 39.

226. *See* Judy Whalley, *in After the Herfindahls are Counted: Assessment of Entry and Efficiencies in Merger Enforcement by the Department of Justice*, Remarks of the 29th Annual Antitrust Seminar, PLI 19-20 (1989). Whalley is a former Deputy Assistant Attorney General. *See also* ORDOVER & GUERIN-CALVERT, *supra* note 222, at 20-21.

227. See Kevin J. Arquit, *Merger Analysis in the '90's: The Guidelines and Beyond*, 61 ANTITRUST L.J. 119, 134 (1992). Arquit is a former Director of the Bureau of Competition Policy.

228. *See* Whalley, *supra* note 226, at 21, 23. *See also* Memorandum on Efficiencies in Support of United States' Motion for a Preliminary Injunction, at 6; United States v. IVACO, Inc., 704 F. Supp. 1409 (W. D. Mich. 1989) (on file with the author) [hereinafter IVACO Brief].

there may be situations in which other markets may be inextricably intertwined with the relevant market.[229]

On the related question of whether the efficiencies must inure directly to the benefit of consumers in the relevant market, the Agencies seem hesitant to say no. In other words, they are reluctant to actually operationalize the Williamsonian tradeoff. The Agencies still want to weigh the efficiency gain against the loss in allocative efficiency and the wealth transfer.

In the recent decision of *Honickman*,[230] the FTC[231] considered whether a major soft drink bottler could acquire certain additional soft drink franchises in New York and New Jersey.[232] The FTC found that the substantial net efficiencies in New York would not outweigh the anticompetitive effects in New York, but would do so in New Jersey.[233] The FTC's letter, however, fails to indicate whether Honickman had argued that the gains in New Jersey could overcome the anticompetitive effects in that state. Furthermore, the FTC held that, even if these gains were sufficient, they would not be passed on to consumers.[234] Even Commissioner Yao, while finding in his dissent that there were significant marketing and distribution efficiencies, did not question this efficiencies framework.[235]

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229. Whalley, *supra* note 226, at 23 ("i.e. they share common production facilities").

230. Harold Honickman, F.T.C. Docket No. 9233, Trade Reg. Rep. ¶ 23,286, ¶ 22,957 (Nov. 16, 1992).

231. The decision was written by Commissioners Azcuenaga and Starek with Commissioner Owen concurring in part and dissenting in part and Commissioner Yao dissenting. *Id.* ¶ 22,967.

232. *Id.* ¶ 22,957.

233. *Id.* ¶ 22,965.

234. *Id.* ¶ 22,965 n.26 ("Even if the net efficiencies appear to outweigh the anticompetitive risks, there may be no benefit to consumers. Such a consumer benefit is necessary to save an otherwise anticompetitive acquisition.").

235. *Id.* ¶ 22,969 ("Moreover, I am convinced that there are efficiencies to be gained from Honickman's proposed acquisitions in the New York counties, and that such efficiencies will be passed on to consumers."). Commissioner Yao's decision turned on a competitive effects analysis of efficiencies, and thus he may not have addressed this question squarely. The FTC's position may not be upheld by the enforcement staff either. Arquit, *supra* note 227, at 137.

> It may further be the case that market power, but not scale economies, can be achieved instantly upon consummation of the merger. Where this is so, it may be appropriate to decline taking enforcement action where it is clear that any price increase will be quickly offset by lower costs resulting from the attainment of scale economies. Needless to say, this course of action rapidly becomes less attractive as the time frame for achieving the efficiency moves outward, and as the probability of attainment declines.

Id.

The DOJ is slightly more willing to permit a merger when efficiencies outweigh the allocative inefficiency. When some short-term wealth transfer may result, however, the range of acceptable efficiencies seems limited to large production efficiencies such as economies of scale and "other fixed cost saving."[236] Once the matter gets to court, the DOJ's position is the same as that of the FTC.[237]

Before turning to the future, one should review briefly the types of efficiencies that the Agencies have recognized. The Agencies Guidelines indicate that production, distribution, and transactional efficiencies are relevant, specifically listing economies of scale and scope, distribution advantages, and synergies.[238] The Agencies will consider managerial efficiencies only when they are linked to some specific operation in the firm.[239] As in Canada, the costs of achieving these efficiencies are deducted.[240]

In looking to the future, one should begin by returning to Justice Harlan's concurrence in *F.T.C. v. Procter & Gamble*,[241] in

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236. James F. Rill, 60 Minutes with the Honorable James F. Rill, Assistant Attorney General, Antitrust Division, U.S. Department of Justice, *in* 61 ANTITRUST L.J. 217, 241 (1992).

237. IVACO Brief, *supra* note 228, at 8:

> The antitrust laws should not be used to deprive consumers of the benefits of a merger that would result in greater output and lower prices. This is the underlying rationale for permitting the introduction of efficiencies that more than offset any anticompetitive potential. The rationale requires, however, that efficiencies not be considered in the absence of evidence that the alleged cost savings and other benefits will be passed on to the consumers who would otherwise have to bear the brunt of an anticompetitive combination.

Id.

238. *See* Agencies Guidelines, *supra* note 207, § 4.

239. *Id.*

240. F.T.C. v. Alliant Techsystems Inc., 1992 Trade Cas. (CCH) ¶¶ 69,047; 69,169; 69,175 (D.D.C. Nov. 23, 1992).

241. Justice Harlan stated:

> If it is conceded, as it must be, that Congress had 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 effects on competitors must be distinguished from adverse effects on competition. . . . Economies achieved by one firm may stimulate matching innovation by others, the very essence of competition. They always allow the total output to be delivered to the consumer with an expenditure of fewer resources. Thus when the case against a conglomerate or product-extension merger rests on a market-structure demonstration that the likelihood of anticompetitive

which he clearly enunciated the rationale for an efficiencies element of a competitive effects test. The Agencies even might consider quoting from the language of this concurrence in the next iteration of their guidelines. More to the point, courts that want to begin to rationalize the divergence between economic thinking, agency practice, and judicial precedent could rely upon Justice Harlan's statement. This is in fact exactly what the Eleventh Circuit did, albeit imperfectly, in *F.T.C. v. University Health.*[242]

Once this competitive effects test is more clearly established, it should be possible to fashion a second-stage procedure under which some kind of Williamsonian tradeoff analysis can be attempted. The Canadian model offers a good starting point for accomplishing this objective. An additional feature of the Canadian system ought to be considered, however, when looking to it for guidance. In Canada, as discussed above,[243] the Director has three years in which to challenge a merger before the Tribunal or to monitor the competitive effects of a merger. While one can debate whether the Director's use of this authority has always been optimal, in theory at least the Director is permitted in borderline cases to take a wait and see approach to assessing efficiencies. If analogous authority were to exist in the United States, still fewer cases invoking Williamsonian-type considerations would reach the judiciary. As recommended above in the Canadian context, there is no reason why at this ultimate stage some measure of the redistributive losses should not be factored explicitly into the tradeoff calculus.

> consequences has been substantially increased, the responsible agency should then move to examine and weigh possible efficiencies arising from the merger in order to determine whether, on balance, competition has been substantially lessened. Where detriments to competition are apt to be "highly speculative" it seems wisest to conclude that "possibilities of adverse effects on competitive behavior are worth worrying about only when the merger does not involve substantial economies. . . ." The Court must proceed with caution in this area lest its decision "over the long run deter new market entry and tend to stifle the very competition it seeks to foster."

F.T.C. v. Procter & Gamble, 386 U.S. 568, 597-98 (1967) (citations and footnotes omitted).

242. F.T.C. v. University Health, Inc., 938 F.2d 1206, 1223 (11th Cir. 1991); *see also* United States v. Wilson Sporting Goods Co., 288 F. Supp. 543 (N.D. Ill. 1968).

243. See *supra* note 110 and accompanying text. However, unlike Pitofsky, I would prefer that the procedure be broadly based on all competitive effects (as in Canada) and not just proof of efficiencies. *See* Pitofsky, *supra* note 51, at 227.

To be successful in the United States context, the nature of the private right of action, of course, would have to be altered in suits brought by competitors. It is not enough to argue that this "is only a variation on risks that firms already must take."[244] The United States also must find the political will either to limit suits brought by noncompetitors[245] or to require a party seeking to assert that right to first obtain the consent of the Attorney General. I would extend the Snyder and Kauper proposal, permitting the Federal government to collect judgments in the former cases, to the latter category of cases as well.[246] At the end of the day, the most satisfactory results probably could be achieved by de-trebling damages for all merger cases brought by private parties, either alone or in combination with the other suggestions.[247]

The biggest caveat to this proposal, however, is the fear that the Agencies will not have the budget to actually monitor these efficiencies. In a time of fiscal restraint and budget cutting, would this proposal represent an attempt to turn the Agencies into active regulators? The Agencies probably could rely on a system of private complaints to determine which conditionally approved mergers warranted closer secondary scrutiny over time. In Canada, this private-party filtering system has not proven problematic, but this hardly provides a basis for concluding it would work in the United States. The United States has a different legal and social culture, which is seemingly attracted to litigation. Lawyers simply may flood the Agencies with both offensive and defensive requests for review. One way to handle this flood of requests might be to place a heavy burden of proof on the complaining party at this early stage or to make the losing party bear the costs of bringing the action.[248]

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244. Pitofsky, *supra* note 51, at 226.

245. See William Breit & Kenneth G. Elzinga, *Antitrust Enforcement and Economic Efficiency: The Uneasy Case for Treble Damages*, 17 J.L. & ECON. 329, 355 (1974) and Edward A. Snyder & Thomas E. Kauper, *Misuse of the Antitrust Laws: The Competitor Plaintiff*, 90 MICH. L. REV. 551 (1991) for the same recommendation on the grounds that these suits are often anticompetitive.

246. Breit & Elzinga, *supra* note 245, at 597.

247. This is already the case with respect to certain notified research and production joint ventures. *See National Cooperative Research Act of 1984*, 15 U.S.C. § 4304 (1984), *amended by National Cooperative Production Amendments of 1993*, Pub. L. No. 103-42, 107 Stat. 117 (1993). *See generally* Mark A.A. Warner and Alan M. Rugman, *Competitiveness: An Emerging Strategy of Discrimination in U.S. Antitrust and R & D Policy*, 25 LAW & POL'Y INT'L BUS. (forthcoming Apr. 1994).

248. *See, e.g.*, 15 U.S.C. §§ 4303-04. The substantially prevailing party in an antitrust action involving a notified research and production joint venture can recover its legal costs including reasonable attorney's fees and prejudgment

This Part has reviewed the various sources of authority with respect to the analysis of efficiencies in merger cases. Analysis has indicated that the Agencies and courts need to use explicitly a two-stage competitive effects test of efficiencies, which can capture both the negative and positive aspects of any potential merger. Second, this Part has suggested supplementing this test with a tradeoff analysis that includes some measure of wealth distribution in the calculus.[249] Third, this analysis has suggested institutional change as a necessary correlation, including the conditional approval of some borderline mergers and amended use of the private right of action.

VI. IMPLICATIONS FOR HARMONIZATION AND CONVERGENCE

Part II of this Article reviewed the economics of efficiency in the context of mergers and the empirical evidence on efficiency gains from mergers. It concluded that mergers generally lead to efficiency gains, but not always and not by as much as is often claimed. Efficiency gains are more likely to be found and to be substantial in moderately concentrated industries. Accordingly, this Article has argued that, as a first step in the analytical process, efficiencies of mergers should be evaluated along with the overall competitive effects of mergers. There should then be an explicit, strictly construed balancing test employed by the relevant reviewing body. This test would weigh a very wide variety of provable and cognizable productive, dynamic, and transactional efficiency gains against allocative efficiency losses and some degree of wealth transfer from consumers to producers. In the case studies of Canada, the EC, and the United States that

interest "if the claim, or the claimant's conduct during the litigation of the claim, was frivolous, unreasonable, without foundation, or in bad faith." *Id.* § 4304.

249. A similar approach is advocated by Professor Steven C. Salop of Georgetown University Law Center:

> What needs to be done is that policymakers have to take income distribution concern into account explicitly and come up with a social welfare function that balances the interests of consumer surplus with the interests of producer surplus. . . . If this is done, one can formulate a dynamic efficiencies analysis based on a chosen social welfare function and that analysis can be put into evaluating overall competitive effects of the merger.

64 Antitrust & Trade Reg. Rep. (BNA) No. 1609, at 387 (Apr. 8, 1993) (quoting Professor Steven C. Salop). My tradeoff defense, and not my competitive effects analysis, would correspond to Salop's proposal.

Boeing."[255] In that case, the Director's view of the competitive nature of the market may have been correct and the Commission's view wrong.

This Article cannot resolve this dispute. It does highlight, however, the problem of international merger regulation and the myriad conflicts that may arise as different national authorities try at various times to maximize one or all of the possible productive, allocative, or dynamic efficiency objectives in their home jurisdictions. The ongoing trade dispute between the EC and the United States over which is the most egregious subsidizer or protector of their respective civilian aircraft industries is well known.[256] One should consider also the real world competitive concerns faced by a small producer in a small state caught in this kind of internecine trade war.

Originally a subsidiary of a British company, de Havilland grew during World War II to take advantage of the benefits of a Canada-United States preferential defense procurement agreement.[257] Over time, and with the support and encouragement of the Canadian government, the Canadian de Havilland wrested a degree of managerial and innovative independence from its parent company.[258] Its expertise in small aircraft, especially short take-off and landing aircraft (STOL), eventually brought de Havilland into competition with its British parent.[259] Canadian de Havilland was forced by its parent to cease production; as a result, de Havilland financially deteriorated to the point that the Canadian government acquired the company in an attempt to resuscitate it.[260] These efforts proved largely unsuccessful because de Havilland needed to be part of a larger marketing and distribution network; so it was sold to Boeing subject to certain performance requirements.[261] In the end, unable to obtain efficiencies from the rationalization of

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255. Commission Decision of October 2, 1991 declaring the incompatability with the Common Market of a Concentration (Case No. IV/M.053-*Aerospatiale-Alenia/de Havilland*) 1991 O.J. (L 334), § 71.

256. *See generally* TYSON, *supra* note 2.

257. Chris DeBresson et al., *Technological Linkages and Foreign Ownership in the Canadian Aircraft Industry*, *in* FOREIGN INVESTMENT, TECHNOLOGY AND ECONOMIC GROWTH, *supra* note 34, at 317, 319. *See generally* MARK A.A. WARNER, A HISTORY OF UNITED STATES-CANADA TRADE AND INVESTMENT RELATIONS IN MULTINATIONALS AND CANADA-UNITED STATES FREE TRADE 16, 20-21.

258. DeBresson et al., *supra* note 257, at 323-26.

259. *Id.* at 334-35.

260. *Id.* This experience was common in Canada as Canada tried to develop a niche in the highly supported aerospace market. *Id.*

261. *Id.* at 335.

followed, the Article looked for support for this view and suggested ways of operationalizing it at the national level.

Along the way, this Article pointed out potential areas for international conflict in merger regulation arising out of the use of efficiencies analysis. This Article will examine these potential conflicts in greater detail to suggest institutional prerequisites to merger analysis as first, second, and third-best solutions.

A good starting point is *de Havilland*, in which the Commission pointed to the intersection of competition policy and industrial policy. The parties did not claim research and development efficiencies, because these activities on the part of de Havilland were the subject of performance requirements imposed by the Canadian government.[250] In September 1991, the Director indicated that the acquisition raised "insufficient competition concerns in Canada."[251] A number of commentators have suggested that Canada was engaging in industrial policy in this case.[252] The Director did not cite efficiencies in reaching his decision not to challenge the acquisition; however, based on the record described above, it is likely that they were a factor.[253]

It is equally plausible that the Director, while probably finding a global geographic market, also found a single civilian product airplane market, not the smaller twenty to seventy seat market determined by the Commission.[254] As the Commission itself noted, in the larger product market, the United Kingdom and German competitors (British Aerospace and Fokker, respectively) were "already facing strong competition from

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250. Commission Decision of October 2, 1991 declaring the incompatability with the Common Market of a Concentration (Case No. IV/M.053-*Aerospatiale-Alenia/de Havilland*) 1991 O.J. (L 334), at 66.

251. *See* 1992 DIR. INVESTIGATION & RES. ANN. REP., *supra* note 154, at 7.

252. *See* BOS ET AL., *supra* note 158, at 230 ("the Commission included industrial policy concerns in its decision but not in favor of the markets directly concerned . . . but rather in favor of a neighboring market."); *see also id.* at 230, n.122 ("It may be that the Canadian authorities themselves apparently have been pursuing industrial policy objectives."); Fox, *supra* note 156, at 318.

253. *See* Derek Ireland et al., *Globalization, the Canadian Competition Act, and the Future Policy Agenda* 5 (May 1993) (a recent discussion paper prepared by the Canadian Bureau of Competition Policy) ("The Canadian Bureau decided not to challenge the merger because of the efficiency gains in Canada, the limited competitive effects on the small Canadian market for commuter aircraft, and because of the potential that de Havilland was a failing firm.").

254. *See supra* note 190. Here I am not dealing with the three smaller markets actually found by the Commission, but rather the Commission's best case scenario.

production in the United States because of these requirements, Boeing tried to sell de Havilland to Aerospatiale.[262]

This brief history points to the key question: What is the correct posture (from the point of view of national welfare) of national antitrust authorities toward efficiencies analysis in a world of second-best solutions? Former EC Competition Commissioner Sir Leon Brittan[263] and Fox,[264] both praise the *de Havilland* decision for not using the efficiencies analysis to promote national champions or other industrial policy goals. As discussed above, however, this view assumes that the Commission, and not the Canadian Director, correctly viewed the relevant product market.[265] To find a partial answer to this question, one can look for insights from the "New" or "Strategic" Trade Theory.[266]

New Trade Theory represents an attempt to integrate some of the recent game theory insights of industrial organization economics into the older tradition of the economics of international trade.[267] New Trade Theory emphasizes: (1) the realities of imperfect competition; (2) industries that display increasing and not constant returns to scale; and (3) the possibility of external economies or the spillover of the kinds of efficiencies discussed in this Article between a firm, an industry, and other firms and other industries.[268] Paul Krugman distinguishes between two distinct branches in this economic literature.

The older branch emphasizes the strategic use of industrial policy, aimed at identifying industries possessing economic rents as a result of imperfect competition. Once these industries are identified, this approach recommends trying to choose national

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262. *Id.* De Havilland eventually was purchased from Boeing; 51% by Bombardier Inc., a Montreal-based transportation company, and 49% by the Government of the Province of Ontario. *See* 1992 DIR. INVESTIGATION & RES. ANN. REP., *supra* note 154, at 7.

263. *See* BRITTAN, *supra* note 156, at 7.

264. *See* Fox, *supra* note 156, at 315, 325.

265. *See supra* notes 254-55 and accompanying text.

266. *See generally* Paul R. Krugman, *Does the New Trade Theory Require a New Trade Policy?*, 15 WORLD ECON. 423 (July 1992) [hereinafter Krugman 1992]; Paul R. Krugman, *The Narrow and Broad Arguments For Free Trade*, 83 AM. ECON. REV. PAPERS & PROC. 362 (May 1993); J.D. Richardson, *"New" Trade Theory and Policy A Decade Old: Assessment in a Pacific Context*, National Bureau of Economic Research Working Paper 4042 (Apr. 1992); Ordover & Sykes, *supra* note 155.

267. *See* Krugman 1992, *supra* note 266, at 424-27 (citing Avinash K. Dixit & Joseph E. Stiglitz, *Monopolistic Competition and Optimum Product Diversity*, 67 AM. ECON. REV. 297 (1977)).

268. Krugman 1992, *supra* note 266, at 425-27.

policies to dominate those industries and to capture the economic rents for the national economy.[269] However, Krugman surveys the empirical evidence and concludes that while these policies may be export-enhancing, they are often national welfare-reducing.[270]

The more recent branch of the literature, in contrast, emphasizes the external economies justification for strategic industrial policy. In essence, this branch aims: (1) to capture the gains from exploiting economies from increasing returns to scale in large international markets of tradeable goods; and (2) to then capture these economies in some national nontradeable good and service, such as labor.[271] Krugman suggests that it may be theoretically possible for a "clever" national government systematically to "slice" off sectors from other states, through temporary subsidy or protection that lasts just long enough to change the pattern of comparative advantage between and among states.[272] Krugman acknowledges the dangers to which these policies might give way: costly rent-seeking and other X-Inefficiencies that ultimately might prove to be national welfare-reducing.[273] Nonetheless, Krugman reluctantly adopts what he terms a "cautious activist" approach and, by implication, would seem to favor an efficiencies analysis for antitrust purposes that would not prima facie abandon industrial policy concerns.

To be sure, this view would attract critics in antitrust circles.[274] These critics would argue that competition policy is as much cultural as it is economic, or that the cultural component is a key component of the economic. Accordingly, these critics are leery that increased market power at home, even if some of the costs of that market power are not borne by domestic consumers,[275] ultimately may be aggregate welfare-reducing from a national perspective.

It is still true, however, that these New Trade Theory insights are likely to be at best redistributive and at worst welfare-reducing in terms of aggregate world welfare. In fact, Krugman

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269. *Id.* at 431-33.

270. *Id.* at 435.

271. *Id.* at 435-36.

272. *Id.* at 437.

273. *Id.* at 439-40.

274. *See generally* BRITTAN, *supra* note 156, at 3, 21, 25; FOX, *supra* note 156, at 325; Eleanor M. Fox, *Federalism, Standards and Common Market Merger Control*, 1988 FORDHAM CORP. L. INST., *supra* note 155, at 23-1 to 23-9.

275. *See* Ordover & Sykes, *supra* note 155, at 4-6 to 4-10. However, while these authors recognize the problem, they believe that antitrust analysis should make some effort at netting out the efficiency and welfare effects of a merger. *Id.* *See also* Harris, *supra* note 34.

has suggested that if many states attempt to pursue similar policies, the results may lead to the classic Prisoners' Dilemma, the net effect of which may be to reduce national, as well as global, welfare.[276]

Reconsidering the much vaunted Canadian treatment of efficiencies in merger analysis, the question still remains whether the policy of seeking export promotion efficiencies really has been or ultimately will prove to be national welfare-enhancing? Ultimately, the resolution of that question is an empirical matter. However, this analysis seems to argue for a more sophisticated competitive effects efficiencies merger standard that is fully capable of accommodating these rich new economic insights. If the EC was correct in its market definition in *de Havilland*, then perhaps there is some merit in the more cautious European and United States approaches to recognizing efficiencies.

VII. CONCLUSIONS

This Article's analysis points to the need for a priority list of approaches to efficiencies that address the international realities of merger review. Boddez and Trebilcock have proposed such a scheme in the context of dumping and predatory price discrimination under the proposed North American Free Trade Agreement.[277]

Borrowing from their approach, this Article offers the following three-part classification solution. The best regime would be some appropriately constituted institutional mechanism to review mergers with some sufficiently high "international dimension" (to borrow from the EC model).[278] That would seem the only institution capable of sorting through the competing claims and interests of efficiency-based merger analysis.

A second-best solution would consist of continued attempts to harmonize international standards and increase ties between national authorities, with the hope that these ties might reduce the incentives to resort to rent-seeking efficiencies analyses of

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276. Krugman 1992, *supra* note 266, at 437-38.

277. THOMAS M. BODDEZ & MICHAEL J. TREBILCOCK, UNFINISHED BUSINESS: REFORMING TRADE REMEDY LAWS IN NORTH AMERICA 203-58 (1992).

278. Richardson, *supra* note 266, at 28-29. I have discussed elsewhere the appropriate institutional prerequisites to a supra-national competition authority in the context of the North American Free Trade Agreement. *See* Edward M. Graham & Mark A.A. Warner, *Multinationals and Competition Policy in North America*, *in* MULTINATIONALS IN NORTH AMERICA (Lorraine Eden ed., 1994).

mergers.[279] The basic standard for this analysis would be the one this Article consistently has argued; that is, merger-related efficiencies should be evaluated along with the overall competitive effects of mergers, followed by a strictly construed tradeoff analysis.

As a third-best solution, each national competition authority could attempt to implement on its own the kind of competitive effects efficiencies analysis of mergers that the Article has advocated. This analysis could be further supplemented by a fairly strict exception or tradeoff defense.

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279. BRITTAN, *supra* note 156, at 108; Bergsten & Graham, *supra* note 33, at 39-40.