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Out-of-Market Efficiencies in Competition Enforcement – Note by the United States

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1. Introduction

1. This submission focuses solely on out-of-market efficiencies in U.S. merger review, not in other contexts in which questions relating to out-of-market efficiencies might arise.

2. In the United States, if the effect of a merger may be substantially to lessen competition or tend to create a monopoly in any relevant market, it violates Section 7 of the Clayton Act, the principal federal antitrust law governing mergers. Section 7 makes no reference to efficiencies, and the U.S. Supreme Court has stated that efficiencies provide no defense to illegality under that statute. Nonetheless, defendants regularly attempt to justify their transaction by pointing to professed efficiencies. When parties have raised efficiencies as part of a rebuttal, U.S. courts have assessed whether the efficiencies are verifiable, merger-specific, would be passed through to prevent a reduction in competition in the relevant market, and would be of sufficient magnitude and likelihood such that no substantial lessening of competition or tendency to create a monopoly would be threatened in any relevant market.[1] In the experience of the Department of Justice Antitrust Division and Federal Trade Commission (collectively, the "Agencies"), merger efficiencies are often claimed but rarely substantiated.

3. U.S. law does not permit consideration of out-of-market merger efficiencies. The language of Section 7 indicates that potential violations must be evaluated within the confines of a particular relevant market. U.S. courts have rejected consideration of efficiencies outside the market in which the transaction would harm competition. Consistent with the applicable statute and Supreme Court case law, the Agencies as a rule will not consider out-of-market efficiencies when evaluating a proposed merger. Rather, they will seek to prohibit mergers that would harm competition in any relevant market that might be affected by the merger, without engaging in a balancing of harms and purported benefits across different markets. The Agencies follow this practice not only when a merger would affect multiple downstream product or geographic markets, but also, for example, in evaluating the effects of a proposed merger on workers or other upstream suppliers. Stated differently, when the Agencies file a merger challenge under Section 7 of the Clayton Act, defendants cannot be permitted to offset or balance harm in a challenged market by professed benefits in some other market.

[1] *See, e.g.*, *FTC v. Hackensack Meridian Health, Inc.*, 30 F.4th 160, 176 (3d Cir. 2022); *United States v. Anthem, Inc.*, 855 F.3d 345, 354 (D.C. Cir. 2017) (courts have rejected efficiencies claims where "the merging parties had not clearly shown the merger would enhance rather than hinder competition"); *id.* at 369 (Millett, J., concurring) (The proffered efficiencies, even if they are verifiable and merger specific, "must at least neutralize if not outweigh the harm caused by the loss of competition and innovation."); *St. Alphonsus Med. Center-Nampa, Inc. v. St. Luke's Health System Ltd.*, 778 F.3d 775, 791 (9th Cir. 2015) ("It is not enough to show that the merger would allow St. Luke's to better serve patients. The Clayton Act focuses on competition, and the claimed efficiencies therefore must show that the prediction of anticompetitive effects from the prima facia case is inaccurate."); *see also* U.S. Dep't of Justice and Fed. Trade Comm'n, Draft Merger Guidelines § IV.3 (2023) (Draft Merger Guidelines); U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines § 10 (2010) (2010 Horizontal Merger Guidelines) ("Cognizable efficiencies are merger-specific efficiencies that have been verified and do not arise from anticompetitive reductions in output or service.").

4. These practices and policies avoid a complex balancing of harms and benefits across different markets or choosing whether to favor one group affected by a merger over another.

2. Out-of-market Merger Efficiencies are not Cognizable under U.S. Law

5. Section 7 of the Clayton Act provides that a merger or acquisition is unlawful if its effect "may be substantially to lessen competition, or to tend to create a monopoly" in "any line of commerce . . . in any section of the country."[2] The U.S. Supreme Court has held that "[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."[3] Following the Supreme Court's guidance, various lower courts have taken a highly skeptical view of whether to consider merging parties' evidence of claimed efficiencies.[4] Where courts have considered claims that efficiencies would counteract a potential loss of competition, they have required that the efficiencies be merger specific (i.e., they could not be achieved without the merger), verifiable, would be passed through to prevent a reduction in competition in the relevant market, and be of sufficient magnitude and likelihood such that no substantial lessening of competition or tendency to create a monopoly would be threatened in any relevant market.[5]

6. The legislative history of Section 7 states: "It is intended that acquisitions which substantially lessen competition, as well as those which tend to create a monopoly, will be unlawful if they have the specified effect in any line of commerce, whether or not that line of commerce is a large part of the business of any of the corporations involved in the acquisition."[6] The Supreme Court further explained this rule in *Brown Shoe Co. v. United States*: "The fact that two merging firms have competed directly on the horizontal level in but a fraction of the geographic markets in which either has operated, does not, in itself, place their merger outside the scope of § 7. That section speaks of 'any . . . section of the country,' and if anticompetitive effects of a merger are probable in 'any' significant market, the merger—at least to that extent—is proscribed."[7]

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[2] 15 U.S.C. § 18.

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

[4] *See, e.g., Anthem*, 855 F.3d at 353 (D.C. Cir. 2017) (stating that it is "not at all clear" that efficiencies "offer a viable defense to illegality under Section 7"); *St. Alphonsus*, 778 F.3d at 790 ("We remain skeptical about the efficiencies defense in general and about its scope in particular."); *FTC v. Penn State Hershey Med. Center*, 838 F.3d 327, 348 (3d Cir. 2016) ("Based on this language [in *Procter & Gamble*] and on the Clayton Act's silence on the issue, we are skeptical that such an efficiencies defense even exists.").

[5] *See, e.g., Hackensack Meridian Health*, 30 F.4th at 176; *Anthem*, 855 F.3d at 354 (courts have rejected efficiencies claims where "the merging parties had not clearly shown the merger would enhance rather than hinder competition"); *id.* at 369 (Millett, J., concurring) (stating that the proffered efficiencies, even if they are verifiable and merger specific, "must at least neutralize if not outweigh the harm caused by the loss of competition and innovation"); *Saint Alphonsus*, 778 F.3d at 791 ("It is not enough to show that the merger would allow St. Luke's to better serve patients. The Clayton Act focuses on competition, and the claimed efficiencies therefore must show that the prediction of anticompetitive effects from the prima facia case is inaccurate.").

[6] S. Rep. No. 81-1775, at 5 (1950), *reprinted in* 1950 U.S.C.C.A.N. 4293, 4297.

[7] 370 U.S. 294, 337 (1962).

7. In view of Section 7's focus on the effect of a transaction on competition within a distinct relevant market, U.S. courts have held that out-of-market efficiencies may not be considered in evaluating whether a proposed merger violates Section 7. The leading decision on this issue is *United States v. Philadelphia National Bank*,[8] in which the Supreme Court rejected the argument that two large Philadelphia-based banks should be allowed to merge notwithstanding a substantial lessening of competition in the market for commercial banking in the Philadelphia area, because on a combined basis the two banks purportedly would be able to compete better with New York banks in making loans to large corporations. According to the Court, "anticompetitive effects in one market [cannot] be justified by procompetitive consequences in another."[9] Lower courts have adhered to this principle.[10]

8. The Agencies follow this same approach. They will seek to prohibit mergers that would violate Section 7 in any relevant market that might be affected by the merger, without engaging in a balancing of harms and purported benefits across different markets. The Agencies evaluate each proposed merger on a case-by-case basis.

9. For example, when a merger involves a multi-sided platform, the Agencies consider competition between platforms, on a platform, and competition to displace a platform.[11] Consistent with the Clayton Act's protection of competition "in any line of commerce," the Agencies will seek to prohibit a merger that harms competition within a relevant market for any product or service offered on a platform to any group of participants—i.e., around one side of the platform."[12] The Agencies will not offset harms to competition found on one side of a multi-sided platform by purported benefits on other sides of the platform.[13]

[8] 374 U.S. 321 (1963).

[9] Philadelphia Nat'l Bank, 374 U.S. at 370.

[10] *See Miss. River Corp. v. FTC*, 454 F.2d 1083, 1089 (8th Cir. 1982) ("[T]he anticompetitive effects of an acquisition in one market cannot be justified by procompetitive effects in another market. Honest intentions, business purposes and economic benefits are not a defense to violations of an antimerger law."); *FTC v. Weyerhaeuser Co*., 665 F.2d 1072, 1083 (D.C. Cir. 1981) (projected public benefits from increased employment due to possible construction of new linerboard plant not a cognizable defense where merger would harm competition in separate market for corrugating medium); *United States v. Ivaco, Inc*., 704 F. Supp. 1409, 1427 (W.D. Mich. 1989) ("Procompetitive effects outside the relevant geographic market cannot be used to offset anticompetitive effects in the relevant market."); *United Nuclear Corp. v. Combustion Engineering, Inc.* 302 F. Supp. 539, 554–55 (E.D. Pa. 1969) ("It is simply not legally possible to permit a clear violation of the Clayton Act in one line of commerce in order to strengthen competition in another line of commerce."); *United States v. Bethlehem Steel Corp*., 168 F. Supp. 576, 618 (S.D.N.Y. 1958) ("A merger may have a different impact in different markets—but if the proscribed effect is visited on one or more relevant markets then it matters not what the claimed benefits may be elsewhere."); *see also NCAA v. Alston*, 141 S. Ct. 2141 (2021) (applying Sherman Act to protect workers from an employer-side agreement to limit competition); *Deslandes v. McDonald's USA, LLC*, 81 F.4th 699, 703 (7th Cir. 2023) ("One problem with [the district court's] approach is that it treats benefits to consumers (increased output) as justifying detriments to workers.").

[11] Draft Merger Guidelines § III.10.

[12] *Id.*

[13] In the limited scenario of a "special type of two-sided platform known as a 'transaction' platform," under Section 1 of the Sherman Act, *Ohio v. Am. Express Co.*, 138 S. Ct. 2274, 2280 (2018), a relevant market encompassing both sides of a two-sided platform may be warranted. *Id.* This approach to Section 1 of the Sherman Act is limited to platforms with the "key feature . . . that they

10. Similarly, when a merger involves competing buyers, the Agencies examine whether it may substantially lessen competition or tend to create a monopsony facing workers or other sellers.[14] In determining whether the transaction would violate Section 7 of the Clayton Act, the loss of competition identified in the upstream market is not offset by alleged benefits in a separate downstream product market.[15] Rather, a transaction that would result in a substantial lessening of competition or tend to create a monopsony in an upstream purchasing market would violate Section 7 regardless of its effect in the downstream product market.[16]

11. For example, in *United States v. Bertelsmann SE*, the United States sued to block Penguin Random House, the world's largest book publisher, from buying rival Simon & Schuster. The United States alleged that the acquisition would harm authors by eliminating head-to-head competition between the merging parties to bid for publishing rights for anticipated top-selling books; the complaint did not specifically allege harm to book buyers.[17] Focusing on the upstream labor market, the district court found that the merger would eliminate competition between the merging firms that "benefits authors by increasing advances paid for their books, and industry participants predict that the loss of that competition would be harmful to authors."[18] The court's decision to enjoin the proposed merger reflects that the antitrust laws protect competition for the acquisition of goods and services from workers. *United States v. Bertelsmann* focused on the effects of the merger in the upstream labor market (authors); it was not necessary to consider harm or efficiencies in the downstream product market (books).

3. The single-market focus serves important administrability and policy goals

12. The rule against consideration of out-of-market efficiencies has important administrability and policy benefits. As many courts and commenters have recognized, there are numerous practical impediments to consideration of possible efficiencies even within a single relevant market. For example, it is often difficult for the Agencies and courts to determine whether the claimed efficiencies are sufficiently verifiable and likely to occur to be taken into account, particularly given that merger analysis is necessarily forward looking, and the acquiring firm may not have complete information regarding the

cannot make a sale to one side of the platform without simultaneously making a sale to the other." *Id.*

[14] Note also that lower input prices, e.g., through reduction of wages, achieved through increased monopsony power from a merger are not cognizable efficiencies.

[15] The Agencies will analyze labor market competition on a case-by-case basis, just as they would when analyzing competition in markets for products and services. Draft Merger Guidelines § III.11.

[16] As a general matter, an exercise in buyer power will often harm downstream customers as well as sellers. *See, e.g.*, C. Scott Hemphill & Nancy L. Rose, *Mergers that Harm Sellers*, 127 Yale Law J. 2078, 2083–87 (2018). But U.S. law does not require a showing that an exercise of monopsony power had demonstrable harmful effects in a downstream market. *See Weyerhaeuser Co. v. Ross-Simmons Hardware Lumber Co.*, 549 U.S. 312, 324–25 (2007) (applying same test to predatory bidding and predatory pricing even though "a predatory-bidding scheme could succeed with little or no effect on consumer prices because a predatory bidder does not necessarily rely on raising prices in the output market to recoup its losses").

[17] *See* Complaint, *United States v. Bertelsmann SE*, U.S. District Court for the District of Columbia, Nov. 2, 2021, available at https://www.justice.gov/media/1184971/dl?inline.

[18] *United States v. Bertelsmann SE*, 2022 WL 16748157, *24 (D.D.C. Nov. 7, 2022).

target firm. Additional challenges include accurately determining the extent to which any efficiencies would be passed through to customers; whether the claimed benefits could be achieved by contract or some other non-merger alternative; whether the efficiencies would merely result from reductions in competition in an adjacent market (e.g., exercise of enhanced buyer power against upstream purchasers); or how the efficiencies interact with the merger's anticompetitive harms to affect customers, workers, or other market participants.[19]

13. The United States' suit challenging the proposed merger between Anthem, Inc. and Cigna Corporation, two large U.S. health insurers, illustrates some of these challenges. Anthem sought to justify the merger on the ground that the purported savings from extending Anthem's lower provider reimbursement rates to Cigna's customers would greatly exceed any harm from the merger. The trial court and the court of appeals rejected this argument, however, holding that Anthem's claimed efficiencies were neither verifiable nor merger specific. Even assuming that the merger would have resulted in lower prices to employers purchasing health care coverage for their employees from the merged firm, Anthem's efficiencies proof suffered from serious shortcomings. For example, Anthem failed to take into account that the merger likely would have degraded Cigna's innovative health insurance product. As the court of appeals held, "that threat to innovation is anticompetitive in its own right."[20] The court also questioned how any sort of numeric balancing of possible benefits and harms could be done without recalculating the claimed benefits after taking into account the various other flaws in Anthem's proof.[21]

14. The FTC's hospital merger cases, in particular, also highlight the challenges that assessing out-of-market efficiencies would entail.[22] In *FTC v. Hackensack Meridian Health, Inc.*, the FTC challenged a proposed merger between two healthcare systems that would have control over three of six general acute care hospitals in Bergen County, New Jersey.[23] The healthcare systems defended the transaction by alleging several efficiencies and procompetitive benefits, including increased hospital bed capacity, improvements to the quality of patient care, expansion of services, and cost savings. In evaluating these claims, the trial court found that they were either too speculative or that they could be achieved independently of the merger. Moreover, to the extent there were cognizable

[19] *See, e.g.*, *Procter & Gamble*, 386 U.S. at 604 (Harlan, J., concurring) ("Economies cannot be premised solely on dollar figures, lest accounting controversies dominate § 7 proceedings."); *St. Alphonsus*, 778 F.3d at 790 ("It is difficult enough in § 7 cases to predict whether a merger will have future anticompetitive effects without also adding to the judicial balance a prediction of future efficiencies.").

[20] *Anthem*, 855 F.3d at 361 ("The fact is, it is widely accepted that customers value the existing Cigna product, and that Cigna is a leading innovator in collaborative patient care." The threatened harm to innovation "is neither answered by Anthem's evidence nor offset by its purported efficiency of offering a degraded Cigna product at a lower rate."); *see also id.* at 370 (Millett, J., concurring) ("[C]ontext matters. Lower rates cannot be trumpeted without first asking what those lower rates will buy.").

[21] These included, for example, Anthem's failure to prove a "realistic pass-through rate" or what portion of the claimed efficiencies was attributable to the relevant market. *Anthem*, 855 F.3d at 364.

[22] *See, e.g.*, *Saint Alphonsus*, 778 F.3d at 791 ("It is not enough to show that the merger would allow St. Luke's to better serve patients. The Clayton Act focuses on competition, and the claimed efficiencies therefore must show that the prediction of anticompetitive effects from the prima facia case is inaccurate.").

[23] *Hackensack Meridian Health*, 30 F.4th at 175–78.

benefits, they were not significant enough to offset the harm to "the patients in Bergen County."[24]

15. These challenges would be greatly magnified if the Agencies and courts were to consider not only in-market efficiencies but also potential efficiencies in other markets with different sets of buyers and sellers and different competitive conditions.[25] Furthermore, the Agencies' practice of evaluating whether a merger would substantially lessen competition or tend to create a monopoly within a single market recognizes that groups such as workers or upstream sellers are entitled to the protection of the antitrust laws if they would be harmed by the effects of a proposed merger, irrespective of claimed efficiencies in other markets.[26]

16. Section 7 simply does not authorize the Agencies and courts to disregard competitive harm within a well-defined market to serve some other interest. In *Philadelphia National Bank*, the Supreme Court rejected the argument that Philadelphia needed a larger bank to stimulate economic development, explaining: "We are clear, however, that a merger the effect of which 'may be substantially to lessen competition' is not saved because, on some ultimate reckoning of social or economic debits and credits, it may be deemed beneficial. A value choice of such magnitude is beyond the ordinary limits of judicial competence, and in any event has been made for us already, by Congress when it enacted the amended § 7."[27]

[24] *Id.* at 177.

[25] Nancy L. Rose & Jonathan Sallet, *The Dichotomous Treatment of Efficiencies in Horizontal Mergers: Too Much? Too Little? Getting It Right*, 168 U. Pa. L. Rev. 1941, 1978–79 (2020) ("The likely impact of an 'out-of-market' test would thus be to tremendously complicate antitrust enforcement by requiring agencies that have already proven harm in one market to take on a full analysis of other markets."); Laura Alexander & Steven C. Salop, *Antitrust Worker Protections*, 90 U. Chi. L. Rev. 273, 295 (2023) ("The balancing of in-market harms to workers and out-of-market benefits to downstream purchasers would be exceedingly resource intensive and prone to error. The harms and benefits may not simply be financial but may involve various factors that are not directly commensurable, such as price, quality, safety, and so on.")

[26] As the Supreme Court stated with regard to the Sherman Act, the Act "does not confine its protection to consumers, or to purchasers, or to competitors, or to sellers . . . . The Act is comprehensive in its terms and coverage, protecting all who are made victims of the forbidden practices by whomever they may be perpetrated." *Mandeville Island Farms, Inc. v. Am. Crystal Sugar Co.*, 334 U.S. 219, 235–36 (1948); *see also NCAA v. Alston*, 141 S. Ct. 2141 (2021) (applying Sherman Act to protect workers from an employer-side agreement to limit competition); *Deslandes*, 81 F.4th at 703 (Treating "benefits to consumers (increased output) as justifying detriments to workers (monopsony pricing)" is "not right; it is equivalent to saying that antitrust law is unconcerned with competition in the markets for inputs, and *Alston* establishes otherwise."); Alexander & Salop, *supra* note 25, at 295 ("[A]llowing workers to suffer the adverse consequences of anticompetitive conduct because it benefits downstream consumers is analogous to robbing Peter to pay Paul. It would deprive workers of the benefits of competition to which they are entitled in the name of enriching others. Perhaps this is just a principle of basic fairness.").

[27] *See* 374 U.S. at 371.