Remarks of Deborah L. Feinstein
Director, Bureau of Competition
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I am pleased to be back at GCR Live New York, having given my first speech as Bureau Director here two years ago at your inaugural event. It’s been a busy year for antitrust litigation, with activity on many fronts, including two merger trials. We are waiting for a decision from the court in our most recent challenge, FTC v. Steris/Synergy Health, and it has been several months since the FTC’s success in Sysco/US Foods. That case provides an opportunity to reflect on how the agency approaches merger review and how courts treat merger challenges. In addition to talking about a variety of substantive issues in the case, I want to talk about the Commission’s decision not to accept the parties’ proposed settlement. That decision required us, as in prior cases, to litigate the likely effects of not only the original transaction but also the parties’ proposed “fix.” I also want to talk about efficiencies, a topic that comes up routinely and arose in Sysco as well.

Product Market Definition and Targeted Customers

In February, following an extensive investigation, the FTC filed an administrative complaint and a preliminary injunction action in the U.S. District Court for the District of Columbia to block the merger of the two largest foodservice distributors in the country, Sysco Corporation and US Foods, Inc. The $231 billion industry supplies food and related products to restaurants, hotels and resorts, hospitals, government agencies, and school and workplace cafeterias. In late June, after an eight-day hearing, the court found that the FTC was likely to succeed in proving, after a full administrative trial, that the proposed acquisition may substantially lessen competition in two relevant markets – broadline foodservice distribution to

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1 The views stated here are my own and do not necessarily reflect the views of the Commission or of any Commissioner.
national customers and broadline foodservice distribution to local customers. The court granted a preliminary injunction and Sysco announced shortly thereafter that it would not pursue the merger.

The court’s decision in 

Sysco

is a worthwhile read for anyone who wants to learn more about U.S. merger analysis. Every element of a Section 7 claim was in dispute: product and geographic market definition, market shares, entry, effects and efficiencies. But as the judge noted, the “primary battlefield” was over market definition, and the court spent nearly 40 pages discussing the evidence bearing on the product dimensions of competition among broadline foodservice distributors. Our view was that Sysco and US Foods were competitors in the market for 

broadline

foodservice distribution, while defendants argued that the market included other foodservice distributors, such as specialty distributors, systems distributors, and cash-and-carry stores. In their view, the combined firm would account for only a 25 percent share of foodservice sales.

What is clear from the court’s decision is that, even after more than 50 years, the Supreme Court’s teachings from 

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

still provide the legal framework for assessing the market in which the merging companies compete. The significance of a decades-old case might be surprising to those who are not steeped in antitrust practice (and seems to vex experienced practitioners who want to relegate 

Brown Shoe
to the history books). Yet 

Brown Shoe’s

statement of the basis for defining a relevant market still has force: “The outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it.” To make this determination, the Court pointed to “such practical indicia as industry or public recognition. . . , the product’s peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors.” That nearly every court returns to this formulation in deciding a Section 7 case is a testament to the analytical soundness of the 

Brown Shoe
Court’s approach to market definition in the merger context. This approach is also consistent with the market definition analysis contained in the Horizontal Merger Guidelines.

In 

Sysco

, we asserted, and the court agreed, that broadline foodservice distribution has a number of distinct characteristics that distinguish it from other types of distribution, such as a wide selection of products, including private label products, next-day delivery, and value-added services, such as menu and nutrition planning. These attributes, in addition to other 

Brown Shoe
indicia such as distinct customers, distinct pricing, and industry recognition, suggested that broadline distributors offer a unique set of products and services that are not interchangeable with product and service offerings from other modes of distribution. The merging parties argued that there must be a broader market because broadline customers also buy from other types of

5 Specialty distributors offer a limited number of products in a category, such as fresh produce, seafood or baked goods. Systems distributors primarily serve chain restaurants with fixed or limited menus. Cash-and-carry stores offer self-service purchasing for customers that transport purchased goods themselves.

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Dep’t. of Justice & Fed. Trade Comm’n, 2010 Horizontal Merger Guidelines [hereinafter Merger Guidelines], § 4 available at http://www.ftc.gov/os/2010/08/100819hmg.pdf (“Market definition focuses solely on demand substitution factors, i.e., on customers’ ability and willingness to substitute away from one product to another in response to a price increase or a corresponding non-price change such as a reduction in product quality or service.”)
distributors. But the district court found that “[t]hough the customers may be varied, . . . the industry, from the perspective of both sellers and buyers, perceives broadline to be a separate mode of food distribution.” The court pointed to other FTC merger cases in which courts found a subset of outlets to be a relevant product market.

As important as the qualitative evidence weighing on market definition was the economic evidence. Our expert, Dr. Mark Israel, performed a SSNIP test (also known as the hypothetical monopolist test) using an aggregate diversion analysis. Such an analysis relies on calculations using gross margins to determine the percentage of customers that would need to stay in the market to make a price increase profitable. The defendants disagreed about the appropriate formula to use, the measure of gross margin, and the basis for calculating the diversions. In the end, while the court did not rely on our expert’s precise calculations, it weighed all the evidence and found that our expert’s conclusions were more consistent with the business realities of the food distribution market than were the views of defendants’ experts.

A significant issue in the case was whether the competitive dynamic was different for “national” customers (i.e., large customers that spanned several geographic regions) than for local customers. There is no debate that all food distribution is local in the sense that each customer will be served by a nearby distribution center. But the question was whether there were customers that – because of the size and location of their operations – needed a supplier whose size and location could more closely match their own. We alleged that national customers prefer to contract with a broadline distributor that can service all their locations with consistent products and services, provide centralized ordering and billing, and combine volume discounts for greater savings.

While there was no precise definition of national customers, the court noted that both Sysco and US Foods maintained a dedicated sales group for customers that used multiple distribution centers, and a Sysco consultant described the distinction between “national customers” and local customers. Pointing out that regional broadliners have formed cooperatives to compete against Sysco and US Foods for these customers, the court once again relied on Brown Shoe-style qualitative evidence to conclude that national customers viewed distributors with smaller footprints to be inadequate substitutes for Sysco and US Foods. The court also noted that Dr. Israel performed a SSNIP test that showed there was a separate product

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8 Sysco Opinion at *17.
10 The test asks whether a hypothetical profit-maximizing firm that was the only present and future seller of the products (“hypothetical monopolist”) likely would impose at least a small but significant and non-transitory increase in price (“SSNIP”). Merger Guidelines §4.1.1.
11 Sysco Opinion at *20.
12 As the term was used in the case, a “national customer” did not necessarily have locations throughout the United States. Instead, the term signified only that the customer had locations in multiple regions, even if those regions collectively occupied only a portion of the United States.
13 Sysco Opinion at *26.
14 Sysco Opinion at *23.
market for national customers. The court thus found that the dynamics of competition among broadline food distributors supported a separate relevant product market for broadline foodservice distribution services sold to national customers.

The defendants called this market “contrived.” The court acknowledged that “defining a product market based on the type of customer seems incongruous. After all, one ordinarily thinks of a customer as purchasing a product in the market, and not as the product market itself.” But the court explained: “Broadline distributors must offer a particular kind of ‘product’ – a cluster of goods and services that can be delivered across a broad geographic area – to compete for national customers. In that sense, the customer’s requirements operate to define the product offering itself.”

Indeed, the notion that the competitive effects from a merger may vary for different customers is firmly rooted in the Merger Guidelines. The 2010 revisions to the Guidelines added a new section on Targeted Customers and Price Discrimination, which explains that mergers can differentially affect various groups of customers when sellers can price discriminate, i.e., profitably raise price to certain customers (referred to as “Targeted Customers”) but not others. As explained by Carl Shapiro, one of the principal drafters of the 2010 revisions, there is no general antitrust hostility to price discrimination. Rather, Section 3 of the Merger Guidelines merely reflects that certain customers may face a different competitive set of suppliers or other market conditions than others.

Of course, defining markets based on price discrimination is not new. The analysis can be found in every version of the Horizontal Merger Guidelines dating back to 1982. Indeed, the Commission has obtained divestitures in price discrimination markets based on sales to particular customers in a variety of sectors. For instance, the Commission challenged Ardagh’s acquisition of Saint-Gobain to preserve competition for glass containers sold to beer brewers and spirits distillers. In an acquisition involving information services and databases, the Commission determined that law enforcement customers (such as police forces) have more exacting requirements than other customers, and work only with providers that maintain comprehensive, up-to-date records, and have the ability to do sophisticated analytics. And in a transaction involving truck stops, the Commission determined that although all travel centers provide diesel fuel and amenities to long-haul trucking companies, only a few firms had the scale and scope to meet the over-the-road diesel needs of long-haul trucking companies. Pilot and Flying J—the merging parties—with their extensive networks of travel centers were the first and second choices for a number of such customers. The Commission alleged that the acquisition was likely to result in anticompetitive unilateral effects for those customers and required divestitures.

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15 Sysco Opinion at *26.
16 Sysco Opinion at *22.
17 Merger Guidelines § 3.
21 See, e.g., Analysis to Aid Public Comments, In re Reed Elsevier NV, et al, Dkt. C-4257 (Sept. 16, 2008) (.
22 In re Pilot Corp., Dkt. C-4293 (Jun. 30, 2010).
Where such price discrimination is feasible, a merger may differentially harm distinct groups of customers depending on the transaction and the market dynamics. For instance, the Commission has examined customer-specific effects in several mergers involving retail pharmacy chains. In 1997, the Commission challenged the merger of CVS and Revco, alleging that the proposed merger would substantially reduce competition in the market for the retail sale of pharmacy services to third-party payors such as insurance carriers and others who pay discounted prices for pharmaceuticals. In 2007, the Commission challenged another retail pharmacy merger, this time alleging anticompetitive effects for a different set of customers—cash customers who are not covered by an insurance plan or otherwise entitled to a discount negotiated for them.

In determining whether price discrimination is feasible, the Guidelines point to two necessary conditions – a seller’s ability to engage in differential pricing and limited opportunities for buyers to equalize such pricing through arbitrage. As the Merger Guidelines explain, differential pricing can occur whenever a seller can offer different prices to different customers based on their observable characteristics. In Sysco, the court found that broadline distributors can price discriminate against customers preferring a national distributor because distributors have substantial information about each customer’s needs “that would allow them to predict which of their customers have inelastic demand and which do not.”

Defendants countered that many of their large customers also purchased from regional suppliers, and that the ability of other customers to do the same (or threaten to do so) would prevent the merged company from targeting national customers with price increases. The court found this point unpersuasive. As it explained, most customers with geographically dispersed operations purchased most of their needs from Sysco or US Foods. Even Performance Food Group, a large regional broadline competitor, admitted that the trend among national customers was in the direction of buying more from a single nationwide provider. Importantly, our market share calculations included all sales by these regional suppliers (and even local suppliers) to broadline customers. In other words, we calculated shares from the perspective of which suppliers national customers used, not by looking only at the sales of national suppliers. Although regionalization would have remained as a competitive alternative for customers who preferred to deal with national broadliners, the merger would have eliminated the next-closest competitor for Sysco and thus would have reduced the ability of such customers to negotiate competitive prices.

23 In re CVS Corp., Dkt. C-3762 (May 29, 1997). The Commission ordered the divestiture of 120 stores to preserve competition in two geographic markets, the state of Virginia and the Binghamton, New York MSA.
24 See Analysis to Aid Public Comment, In re Rite Aid Corp., Dkt. C-4191 (Jun. 4, 2007). The Commission order the divestiture of retail pharmacies in 23 local markets.
25 In Sysco, there was no debate about the infeasibility of arbitrage because customers were not going to buy and transport food supplies for other customers.
26 Merger Guidelines § 3.
27 Sysco Opinion at *28.
28 Sysco Opinion at *29.
Litigating the Fix

In addition to challenging each element of our prima facie case, the parties argued that they had fixed any potential problems created by the merger by entering into a separate agreement to divest assets to a smaller competitor in the market, a standard structural remedy in merger cases. The defendants agreed to sell eleven of US Foods’ 61 distribution centers to Performance Food Group, a regional broadline competitor with 24 distribution centers of its own. The agreement with PFG was signed during the Commission’s investigation in an effort to avoid litigation, but the Commission determined that, even with the divestitures to PFG, Sysco’s acquisition of US Foods would likely result in anticompetitive harm.

We were thus confronted with the need not only to litigate the initial case presented to us, but also the transaction with the fix. This, of course, is a familiar challenge for the antitrust agencies. The Commission has found itself litigating both the original merger proposal and a modified version in previous matters. On January 14, 2002, the Commission filed for a preliminary injunction to stop the merger of Libbey and Anchor Hocking, two leading suppliers of commercial glassware. One week later, the defendants amended their proposed merger agreement: Libbey would still acquire all of the stock of Anchor Hocking, but Anchor’s parent company, Newell Rubbermaid, would retain certain assets that the defendants alleged would allow it to compete in the market. After acknowledging that it was “[o]perating on what appears to be a clear slate,” the court found that both agreements were subject to scrutiny under Section 7. Upon review of all the evidence, including post-merger HHI’s based on the original deal, the court granted a preliminary injunction: “When considered cumulatively, the FTC’s evidence supports its position that what is now Anchor would be eliminated from the market and that [Newell-Rubbermaid] may not be a viable substitute to replace it.”

Just two years later, the FTC faced a similar issue in challenging the merger of two coal mining companies. In May 2003, Arch Coal proposed to acquire the Triton Coal Company, which operated two mines in the Southern Powder River Basin of Wyoming. During the FTC’s investigation and prior to any litigation, Arch Coal signed a second agreement to sell one of Triton mines to Kiewit, a company operating outside of the market. The Commission filed a motion for a preliminary injunction, and presented evidence in a two-week trial. The court rejected the Commission’s contention that the merger would increase the risk of coordination, relying in part on market shares that assigned the production of the to-be-sold mine to the new owner and crediting that new owner’s plans to expand the mine’s output. The court ultimately denied the Commission’s motion for a preliminary injunction, and the Commission later dismissed its administrative complaint.

The Commission has also faced last-minute changes in business relationships aimed at bolstering the defendants’ rebuttal case during litigation. In FTC v. CCC Holdings, Inc., the Commission alleged that the proposed merger would create a duopoly in two markets with high

30 Id. at 50.
32 Id. at 124-25.
barriers to entry. During the FTC investigation, the defendants signed a new licensing agreement with a third company, Web-Est, that defendants argued would eliminate existing restrictions on Web-Est’s ability to compete and allow it to rapidly replace the competition lost due to the merger. But the court rejected this type of contractual ‘fix’ for the same reasons the Commission prefers structural remedies in merger cases: “Web-Est cannot be considered a truly independent actor because Mitchell will continue to be so involved in its business. In order to be accepted, ‘curative divestitures’ must be made to a new competitor that is ‘in fact . . . a willing, independent competition capable of effective production in the . . . market.’ White Consol. Indus. V. Whirlpool Corp. 781 F.2d 1224, 1228 (6th Cir. 1986) (emphasis added).”

The Commission also routinely rejects promises not to engage in certain conduct as a means of preventing an anticompetitive post-merger exercise of market power, and courts have, too. For instance, in OSF Healthcare System/Rockford Hospital, the defendants filed a proposed stipulation on the eve of trial that they claimed would eliminate the potential for post-merger anticompetitive conduct. Acknowledging that the stipulation addressed some concerns related to the proposed merger, the court nonetheless found that the stipulation did not fully address the potential for harm, because “it does not specifically preclude price increases or otherwise limit the ability of OSF Northern Region to exercise market power in order to achieve higher prices.” Given the Commission’s strong preference for structural remedies in horizontal mergers, courts seem hesitant to rely on contractual promises to prevent post-merger harm as a way to rebut the Commission’s prima facie case.

In Sysco, we argued, and the court agreed, that PFG would have been at a significant disadvantage in competing for national customers because, even after its acquisition of the divested assets, it still would have large geographic gaps in its system and fewer than one-third the number of distribution centers of the combined Sysco/US Foods. The court pointed out that when originally approached about being the divestiture buyer, PFG believed that it needed at least 13 additional distribution centers to compete effectively for national business, but that Sysco determined that it would rather litigate with the FTC than sell more than eleven.

There are a few notable aspects of the court’s review of the proposed fix. First, the judge addressed the impact of the proposed divestitures as a rebuttal argument and only after he had determined that the original deal created a presumption of anticompetitive effects. This two-
step approach is consistent with how the Commission analyzes proposed divestitures.\textsuperscript{42} It addresses the key question in assessing any proposed remedy: does the remedy maintain or restore competition in the markets affected by the merger?\textsuperscript{43}

Second, the court found that the obstacles faced by a post-divestiture PFG created a significant risk that it would not replace the competition lost by the elimination of US Foods as an independent competitor. As the court’s findings make clear, it did not believe that merely creating an additional competitor would be sufficient; rather the court considered whether “PFG will be on equal competitive footing with the merged firm.”\textsuperscript{44} Citing both Libbey and CCC/Mitchell, the court addressed concerns that PFG would face significant competitive disadvantages in competing against the much larger Sysco, and would be dependent on Sysco for several years for transitional services. In light of these concerns, the court was not persuaded that the proposed divestiture would create a truly independent competitor to counter the anticompetitive effects of the merger.

As I discussed in my speech here two years ago,\textsuperscript{45} litigation can be a blunt instrument, especially in a federal injunction case where the merger is either blocked or allowed to proceed in its entirety. Yet it can be necessary. Having conducted an extensive investigation of the proposed merger, Commission staff then fully investigated the feasibility that the proposed divestitures to PFG would alleviate the competitive concerns. In the end, the Commission determined that the proposed divestiture was not sufficient, and litigation ensued. This case is a reminder that an acceptable divestiture—before the Commission or in federal court—must replace the competition that would otherwise be lost as a result of the merger.

Efficiencies

Efficiencies analysis is a topic of perennial interest among antitrust practitioners and perhaps more so after several recent court decisions in which the court examined the defendants’ efficiency claims and found them lacking, as Judge Winmill and the Ninth Circuit did in St. Luke’s\textsuperscript{46} and as Judge Mehta did in Sysco. However, studying only litigated cases for guidance on efficiencies presents a skewed sample set, given the very high levels of concentration involved in most litigated cases, and lingering doubts by some courts about the legal basis for an “efficiencies defense.”

In our investigations prior to litigation, we undertake a careful review of efficiencies claims. Section 10 of the Merger Guidelines sets out the framework we use to examine


\textsuperscript{43} FTC, Statement of the Bureau of Competition on Negotiating Merger Remedies, available at https://www.ftc.gov/tipsadvice/competition-guidance/merger-remedies. See also Ford Motor Co. v. United States, 405 U.S. 562, 573 (1972) (“The relief in an antitrust case must be ‘effective to redress the violations’ and ‘to restore competition.’”).

\textsuperscript{44} Sysco Opinion at *50.


efficiencies claims during the merger review process and incorporates insights from our non-
merger work. That framework was added in 1997 in response to concerns that the Supreme
Court’s stated hostility to an “efficiencies defense” in some older merger cases conflict with
the Court’s recognition of credible efficiencies claims in subsequent non-merger cases such as
NCAA, BMI, and GTE Sylvania. Although the Supreme Court itself has not addressed that
tension since the 1997 version of the Merger Guidelines was issued, lower courts now routinely
consider evidence offered by defendants to show that merger-specific efficiencies are relevant to
the competitive analysis.

Under Section 10 of the Merger Guidelines, efficiencies must meet several criteria to be
credited. First, they must be merger-specific in that they could not likely be accomplished in the
absence of the merger. Second, they must not be vague or speculative. Finally, they must be
cognizable, by which we mean the efficiencies are verified and do not arise from anticompetitive
reductions in output. If merger-specific cognizable efficiencies are substantial enough that the
merger is not likely to be anticompetitive, the Commission is unlikely to challenge the
transaction.

Generally speaking, firms can reduce their costs by combining complementary assets,
eliminating duplicative activities, or achieving scale economies. Cost savings may be generated
from the firm’s variable costs (e.g., raw materials) or fixed costs (e.g., rent on office space).
Variable cost savings are more likely to result in lower prices than efficiencies gained from fixed
cost reductions. There are exceptions to this general rule—for instance, where contract terms
provide for cost-plus pricing or require pass-through of fixed cost savings. Fixed cost savings
may result in lower prices in the long term. As with virtually every aspect of merger analysis,
there is great variation in cost structures and the potential for post-merger efficiencies.

The Merger Guidelines start from the proposition that competition is the primary
motivator for firms to achieve efficiencies internally, and every day, companies act on this
incentive to reduce costs and provide value to their customers. While the desire to reduce costs is
a stated motivation in most mergers we look at, in the final analysis, that desire alone is not
sufficient to save a merger that would also eliminate a significant competitor and result in likely
harm. Even when the proposed merger stands to generate significant efficiencies—and even if
those efficiencies could be achieved more quickly through the merger—the critical question “is
whether the projected savings from the merger is enough to overcome the evidence that tends to
show that possibly greater benefits can be achieved by the public through existing, continued
competition.”

47 See FTC v. Procter & Gamble Co., 386 U.S. 568 (1967); Brown Shoe, 370 U.S. at 344.
analysis in various iterations of the Merger Guidelines, see the FTC staff report, Anticipating the 21st Century:
Competition Policy in the New High-Tech, Global Marketplace (May 1996), Chapter 2, available at
https://www.ftc.gov/system/files/documents/reports/anticipating-21st-century-competition-policy-new-high-tech-
The challenges of mounting a successful efficiencies claim are well-known. As the Merger Guidelines explain, “[e]fficiencies are difficult to verify and quantify, in part because much of the information relating to efficiencies is uniquely in the possession of the merging firms.” Thus, courts have rejected efficiencies claims for lack of independent verification, or because the projected savings are too speculative or too far into the future to offset the merger’s likely harm. Failure to meet projected savings targets in prior acquisitions can also raise concerns about the credibility of current savings projections. In the end, efficiencies claims—like claims of probable competitive harm—involves projections and estimates. But just as the elements of a *prima facie* merger claim are informed by reference to information from a variety of sources, so too must efficiency claims be put to the test.

The agencies routinely examine efficiency claims made by the parties during the investigative stage. But at any stage, we are looking for verification, specificity and cognizability. In *Sysco*, we evaluated the parties’ claims during our investigation and found that many were not merger-specific, verifiable or cognizable—and in any event, did not outweigh the harms. In the litigation, the court indicated that the parties had initially claimed over $1 billion in efficiencies but the parties reduced that amount to about $600 million when accounting for the divestiture to PFG, unforeseen complications, and the like. One of Sysco’s economic experts, Dr. Jerry Hausman, further reduced the claims to $490 million, but the court was not clear as to what independent analysis he did to arrive at that figure. Even as to that figure, the court was not convinced that the full amount of the cost savings were merger-specific; it found that Sysco was undertaking programs before the merger that could have led to the cost savings that appeared to be included in the merger savings numbers. The court concluded that even if it credited the full amount that Dr. Hausman claimed and assuming complete pass-through, “even a modest increase in price could offset any cost savings generated by the efficiencies.”

If verified, efficiencies claims can persuade the agency not to oppose a merger, especially where the potential for anticompetitive harm is limited. For example, in a recent initial phase investigation involving food products, staff was able to conduct a fairly rigorous pricing analysis which indicated that the proposed merger was likely to produce a modest price increase. At the same time, staff also had information that the acquired firm was capacity-constrained, and the acquiring firm had cost advantages that would likely generate variable cost savings in excess of the possible price increase. Staff projected revenue synergies from increasing the acquired firm’s sales, as well as variable cost savings of varying sorts, including reduced freight costs, lower input costs and elimination of duplicative facilities. The investigation was closed because staff concluded that at least some of the asserted efficiencies were likely cognizable and sufficient to

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55 *FTC, Statement of the Commission, In the Matter of Ardagh Group S.A.*, File No. 131-0087 (Apr. 11, 2014) (“Both competitive effects and efficiencies analyses involve some degree of estimation. This is a necessary consequence of the Clayton Act’s role as an incipiency statute. In addition, while competitive effects data and information tends to be available from a variety of sources, the data and information feeding efficiencies calculations come almost entirely from the merging parties. . . . The need for independent verification of this party data animates the requirement that, to be cognizable, efficiencies must be substantiated and verifiable.”)
56 *Sysco Opinion* at *58.
57 *Sysco Opinion* at *59.
offset any plausible price increase.\textsuperscript{58} But as the potential for anticompetitive effects rises, the magnitude of efficiencies required to offset the harm rises, as does the degree to which those cost savings must be passed through to customers.\textsuperscript{59}

I also want to address how we think about efficiencies in a few particular situations.

First, there is a question of how we analyze the likelihood that efficiencies will be passed through. In bid markets, economics teaches us that costs savings are not likely to be passed through if the first and second bidders merge because the merged firm can still win the bid at the higher price. Even where the parties are not the first and second, there may be limited pass-through depending on the circumstances. In other cases, to determine whether cost reductions are likely to be passed through, we may look at empirical studies of the effect of cost savings (or sometimes cost increases) in an industry or whether prior cost reductions have led to price reductions to customers. For example, the district court in Staples found that Staples and Office Depot had a proven track record of achieving cost savings through efficiencies and then passing those savings on to consumers in the form of lower prices, but found that the companies’ projected pass-through as a result of the merger was unrealistic—because the projections were four times the historical rate.\textsuperscript{60}

A second situation involves a case where we can predict that prices will go up post-merger but there are some merger-specific cognizable qualitative efficiencies. As I discussed in a health care speech last year,\textsuperscript{61} parties in hospital mergers often claim that their combination will produce significant efficiencies, such as improved quality of care, avoidance of capital expenditures, consolidation of jobs and services, and reduction in operational costs, such as purchasing and accounting costs. In assessing these arguments, we examine a variety of evidence. We look at the comparative quality of the hospitals merging. If the acquired hospital already has strong quality measurements comparable to those of the acquiring hospital, we may question the ability of the acquiring hospital to improve those metrics. If the acquiring hospital has made prior acquisitions, we will want to see whether those mergers resulted in quality improvements. The parties must explain more than just the processes and practices that the acquiring hospital system can transfer to an additional hospital; they need to address the specifics

\textsuperscript{58} In 2006, the Agencies published a Commentary on the Merger Guidelines that contains other examples of mergers (in some cases masking the identity of the companies involved) in which the reviewing agency accepted the efficiencies claims of the parties, leading to a decision not to challenge. U.S. Dep’t of Justice & Fed. Trade Comm’n, Commentary on the Horizontal Merger Guidelines (2006), available at https://www.ftc.gov/sites/default/files/attachments/merger-review/commentaryonthehorizontalmergerguidelinesmarch2006.pdf.

\textsuperscript{59} “To make the requisite determination, the Agencies consider whether cognizable efficiencies likely would be sufficient to reverse the merger’s potential to harm customers in the relevant market, e.g., by preventing price increases in the market. In conducting this analysis, the Agencies will not simply compare the magnitude of the cognizable efficiencies with the magnitude of the likely harm to competition absent efficiencies. The greater the potential adverse competitive effect of a merger, the greater must be the cognizable efficiencies, and the more they must be passed through to customers, for the Agencies to conclude that the merger will not have an anticompetitive effect in the relevant market.” Merger Guidelines §10 (footnote omitted).

\textsuperscript{60} FTC v. Staples, Inc., 970 F. Supp. at 1090.

of how those processes and practices will benefit patients through improved care. In addition, we want to understand why the acquired hospital could not improve its quality without a merger with this particular acquirer. Ultimately, given that competition spurs competitors to innovate, we will want to understand why a reduction in competition will enhance rather than diminish those incentives.

Another question can arise over how to balance the possibility and magnitude of a price increase against the possibility and magnitude of qualitative efficiencies. To date, however, that is not something we have found necessary to do. In the handful of transactions we have challenged, we have determined that the quality improvements were speculative, unsubstantiated, non-merger-specific, or some combination of the three. But if the asserted quality improvements are substantiated, non-speculative, and merger-specific, we would attempt to determine the likelihood that quality-adjusted prices would increase.

A third special case involves out-of-market efficiencies. The Merger Guidelines state that as a general rule, the agencies will assess competition in each market independently, but that we may consider efficiencies not strictly generated in the relevant market under review if they are so inextricably linked with that market that a partial divestiture or other remedy could not feasibly eliminate the anticompetitive effect in the relevant market without sacrificing the efficiencies that the merger would generate in other markets. The caveat here is that inextricably linked efficiencies are most likely to make a difference when they are great and the anticompetitive effect in the relevant market is small.62 Again, we have not been presented precisely with this scenario, and in most cases, the Commission is able to fashion a partial divestiture that preserves competition without sacrificing efficiencies in related markets. But it is an issue we are alert to.

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Every merger decision contains lessons, and the Sysco decision is no exception. Every facet of the market analysis was contested, with the additional challenge of assessing the impact of the proposed divestitures to PFG. But in many ways, the decision represents no great leap forward on any particular point of law or economic analysis. Rather, it is another example of applying time-tested standards for market definition set out more than 50 years ago in Brown Shoe to a particular set of facts to determine whether the proposed merger was likely harm competition. Merger analysis continues to evolve, mainly through the development of modern economic tools that can provide additional information bearing on the ultimate question of whether a merger is likely to substantially lessen competition. And the court relied extensively on the work of our economic expert, who performed a SSNIP test using an aggregate diversion analysis. But sometimes, old-school tools like Brown Shoe practical indicia still help get the job done.

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