Legalizing Merger to Monopoly and Higher Prices: The Canadian Competition Tribunal Gets It Wrong

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This merger will eliminate our only significant competitor and enable us to raise prices to consumers by 10 percent. By rationalizing our production, we hope to reduce our costs by 1/4 of 1 percent, more than enough to outweigh the allocative inefficiency from the merger. The Canadian Competition Tribunal recognizes that these benefits for our stockholders are more important than higher consumer prices, so it has blessed our merger plans.

CEO of a Hypothetical Acquiring Firm
April 1, 2001

This hypothetical differs only slightly from the facts of a real case pending before the Canadian Federal Court of Appeal. In this case, the Canadian Competition Tribunal concluded that the merger of Canada’s two largest propane distributors would transform Superior Propane into a dominant firm with a 70 percent market share (Decision on ¶ 312) that would be likely to raise prices by “8% or more,” (id. ¶ 252, 261) or at least $43 million per year, primarily to small businesses and lower-income and rural Canadians whose demand for natural gas to heat and cool their homes was relatively inelastic. Since some other Canadians would react to the higher prices by reducing their propane purchases following the merger, the Tribunal also concluded that this merger would also be likely to result in an annual deadweight loss (allocative inefficiency) of $3 million and also to generate perhaps as much as another $3 million in other types of inefficiency losses. Id. ¶¶ 466–67. The Tribunal also predicted that the merger would produce an annual cost savings of roughly $29.2 million. Id. ¶ 380. Adopting a net efficiency standard, the Tribunal decided to permit the merger. While the Tribunal’s decision appears on the surface to be a simple application of the Canadian Competition Act, some of the Tribunal’s basic interpretations have profound implications for merger enforcement in Canada.

In their Point, Counsel for Superior Propane suggest that this decision correctly reflects Canadian law, represents a sound, workable approach to competition policy, and deserves emulation in the United States. We disagree. In our view, the Tribunal decision ignores the statutory purposes of the Canadian law, which, like the Sherman Act, is intended to protect consumers by providing them with competitive prices and product choices. Interpreting merger law to endorse the “total welfare” standard is not necessary to implement a meaningful efficiency defense. The Competition Tribunal could have implemented an efficiency tradeoff by including wealth transfers from consumers to merging firms due to higher prices as an economic harm that efficiency gains must offset, or by adopting the United States standard that requires that efficiencies be sufficient to avoid post-merger price increases. The “total welfare” standard is unsound competition policy for any democratic nation that believes that legislation should benefit most of its citizens, because it tolerates mergers, some with trivial expected efficiency gains, when the market power is so large and the demand for the product so inelastic that there would be little expected “deadweight loss” from consumers shifting to less desirable goods or services. Finally, we believe that a comprehensive estimate of the total welfare effects from a single merger are so complex that there are serious questions whether a comprehensive total welfare inquiry, done in a manner consistent with economic theory, would be administrable. The Canadian courts should therefore reverse the Competition Tribunal, and the antitrust authorities and courts in the United States should not follow the Competition Tribunal’s errors.

Alternative Methods to Implement a Meaningful Efficiency Defense

The legal context of the case is deceptively straightforward. According to Section 1.1 of the Canadian Competition Act, the Act’s purpose is “to maintain and encourage competition in Canada . . . to promote the efficiency and adaptability of the Canadian economy . . . [and] provide consumers with competitive prices and product choices.” Section 92 authorizes the Tribunal to block a merger that “is likely to prevent or lessen competition substantially.” However, Section 96 of the Act contains an exception: “The Tribunal shall not make an order under section 92 if it finds that the merger . . . is likely to bring about gains in efficiency that will be greater than, and will offset, the effects of any prevention or lessening of competition that will result . . . and that the gains in efficiency would not likely be attained if the order were
made.” The controversy concerns whether the statute requires the Tribunal to balance merger-specific efficiency gains only against merger-specific allocative inefficiency losses (which economists call deadweight loss), or whether the Tribunal should also include harm to consumers from supercompetitive prices as an additional anticompetitive effect.

An approach that ably accommodated Parliament’s twin goals of promoting efficiency and maintaining competitive prices would consider the wealth transfer effects of the merger (the higher prices to consumers caused by the merger) to be another negative effect of the transaction, another offset to any merger-specific cost savings from the transaction. Under this approach, the Tribunal would add any expected wealth transfer from consumers to the merging firms as a result of higher prices to the allocative inefficiency losses of the merger.

In Superior Propane, under this approach, the Tribunal would have blocked the acquisition because the expected efficiency gains of $29.2 million would not offset the $49 million in expected undesirable consequences of the merger ($6 million in anticipated inefficiency plus the additional $43 million in anticipated wealth transfers from consumers to the merging firms). If, however, the anticipated merger-specific cost savings had been 68 percent greater (8.4 percent of expected annual sales), the anticipated efficiency gains would have justified the merger. In Superior Propane, this approach would have incorporated an efficiency defense but would have concluded that the anticipated merger-specific efficiency gains were insufficient to offset the anticipated anticompetitive effects.

A second method of reconciling both of Parliament’s concerns would be to require that the anticipated merger-specific efficiency gains be large enough to prevent prices from increasing despite any enhanced market power from the merger. The U.S. Merger Guidelines use this approach. Anticipated efficiency gains too small to be likely to prevent prices from rising would not constitute a valid efficiency defense. Under a price standard, the Tribunal would have blocked this transaction because of its prediction that the merger would raise prices by at least 8 percent.

Although under this approach the required cost savings are significantly larger than those required under a pure efficiency standard, the figures are not unrealistically large and would not effectively eliminate an efficiency defense. For most mergers receiving careful government scrutiny (for example, an increase of even 500 in the HHI in a concentrated oligopoly), the required cost savings necessary to offset the price-increasing harm from the merger is approximately 1.6 to 8.6 percent, depending on elasticity of demand. The required cost savings to invoke a successful efficiency defense are much larger when a merger transforms an industry from oligopoly to monopoly—possibly requiring from 7.7 to 42.9 percent cost savings to justify the merger. But to say that Section 96 would rarely justify a merger to monopoly is hardly to read the section out of the statute. In Superior Propane, the Tribunal found expected cost savings of approximately 5.0 percent—enough to justify an acquisition in many oligopoly situations. So the practical effect of this interpretation of Section 96 would be to limit a winning efficiency defense either to oligopoly situations or to mergers to monopoly with dramatic anticipated efficiency gains. Indeed, a U.S. court recently denied the Federal Trade Commission’s request for a preliminary injunction to stop a merger between the number two and number three baby food manufacturers and permit a merger that would give two firms 98 percent of the sales of baby food in the United States (FTC v. H.J. Heinz Co.). A main reason for this ruling was an expectation that the acquisition would generate a 20.2 percent reduction in variable manufacturing costs for the merging firms. This example shows that the price standard does permit merger to very high market shares in the presence of good evidence of substantial likely efficiency gains. Facey et al. argue that a price standard would read an efficiency defense out of the merger statute. The Heinz decision demonstrates that a price standard can embrace significant expected cost savings, even in a merger to very high concentration.

Parliament Did Not, and Would Not, Adopt a “Total Welfare” Standard

Either of the approaches sketched above would implement the statutory purposes that Parliament established in designing the Competition Act. The “total welfare” standard not only reads the express purpose to provide consumers with competitive prices and product choices out of the Act for purposes of merger analysis, but it also ignores the rest of the statute, most notably the original statutory provision, now codified as Section 45, which condemns agreements that lessen competition by transferring wealth from consumers to the cartel members. If “prevention or lessening of competition” in Section 96 (1) means no more than avoiding any deadweight loss, then the phrase has a significantly different meaning than “restrain or injure competition unduly” in Section 45, which Parliament clearly intended to prevent wealth transfers.

The government that initiated the Competition Act revisions in 1986 would have been unlikely to endorse an approach that would encourage significantly higher consumer prices. Although economists focus on efficiency, a democracy values one person/one vote over the economist’s notion of one dollar/one vote. Parliament’s decision to prevent mergers likely to raise prices implicitly gave consumers a property right to competitively priced goods and services. Any merger likely to raise prices would in effect constitute theft of some consumers’ property without giving them anything in return. In a democracy, each person, wealthy or
poor, has the right not to have his property stolen, no matter how poor the thieves are. The general desire to protect consumers’ property from exploitation applies regardless of the specifics of any particular merger, so the average wealth of the users of propane compared to that of Superior Propane’s shareholders is irrelevant.

Suppose that the only five producers of insulin decided to merge, and suppose that if they doubled the price of insulin after the merger they would lose very few sales. With a minimal reduction in output, the expected allocative inefficiency loss would be very small. Under a the total welfare approach, even a trivial cost savings (such as a small savings in marketing costs) would justify such an acquisition. Similarly, the demand for certain highway construction projects could be almost completely inelastic within a range if the state wanted to have a highway built and would award the contract to the lowest bidder. If the only competing construction companies in an area wanted to join into a single firm, the total welfare approach could generate a favorable decision with only trivial savings in variable costs since such a merger might produce virtually no allocative inefficiency.

Merger of all the construction companies would generate yet another cost saving: the antitrust enforcers would no longer have the cost of investigating or prosecuting bid-rigging conspiracies.

The “Total Welfare” Standard Would Make Effective Merger Enforcement Difficult

Moreover, if there were any doubt over how to interpret the Competition Act, surely decisionmakers should interpret an otherwise ambiguous statute in a manner that rendered it relatively administrable and predictable. In terms of workability and predictability, the price standard has a significant advantage over the Tribunal’s net efficiency approach (which the Point advocates). The price standard would require ascertaining only whether price would be likely to rise, as opposed to the efficiency standard’s requirement that the enforcers ascertain whether price would be likely to increase by more than some amount that the investigators would probably not know until very late in the investigation. The price standard would evaluate anticipated merger-specific efficiency gains by assuming no change in output from the merged firm or its remaining rivals (because there would be no reason to anticipate an increase in price). The efficiency standard, by contrast, requires a confident estimate of such changes in output. It requires calculation of the deadweight loss, which in turn requires a reasonably precise calculation of all firms’ demand and marginal cost curves, both pre- and post-merger, and reactions of all competitors to these changes. Since the initial changes in price and output might not be an equilibrium, the investigators would need to model the industry behavior and work out the interplay of secondary effects. It is difficult enough for agency investigators to predict whether it would be profitable for merging firms to raise prices. It is far more difficult to predict how much consumers would economize and shift their consumption in response to higher prices and how much competitors would change their prices and outputs in response to the merging parties’ changes in prices and outputs. Indeed, the complexity of the cost and price analysis under Section 96 of the Canadian Competition Act may partially explain the reduced level of merger enforcement in Canada compared to that in the United States.

An additional reason not to interpret the statute as embracing the allocative efficiency standard is that this interpretation would make merger enforcement unduly difficult and rare. Did Parliament really intend to order an approach that would be complicated to apply yet make it extremely difficult for the Commissioner to prevail even in mergers to monopoly? Consider Superior Propane. The anticipated allocative inefficiency of approximately $3 million was approximately 0.5 percent of the combined firms’ anticipated annual sales of $585 million. In many situations, courts may look to the literature for guidance on the level of cost savings needed to offset the deadweight loss from increased market power. Professor Williamson projected that cost savings of 0.06 to 0.44 percent would typically compensate for a 5 percent price increase, while 0.26 to 2.0 percent savings would compensate for a price increase of 10 percent. However, expected cost savings of this magnitude are tiny and are often less than reductions companies achieve from routine corporate cost-cutting campaigns. If the prosecution had the burden of showing that the anticipated deadweight loss (allocative inefficiency) would exceed anticipated cost savings of a fraction of a percent of costs, the number of successful enforcement actions would be quite low. The complexity and expense of merger investigations that include evaluation of allocative efficiency and anticipated efficiency gains would quickly use up the government’s antitrust budget with expensive challenges with small prospect of success.

Although Superior Propane is one of the first cases to crystallize the market power/efficiency tradeoff, this analysis arises in most close merger cases. If the Competition Tribunal were to continue to accept efficiency arguments as uncritically as it did in Superior Propane, and if the courts were to accept an allocative efficiency approach that frequently justified merger to market dominance in exchange for trivial expected cost savings, all merging parties would have a tremendous incentive to generate documents projecting cost savings regardless of how probable. While firms going into a merger normally anticipate some cost savings, these efficiency gains frequently do not arise. Indeed, corporate experience in the United States has many examples where mergers expected to lower costs led to much higher costs. Predicting the extent of cost savings from a given merger is as easy and accurate as the record of a hypothetical econometrician who
While Superior Propane seems on the surface to be a simple decision involving unusual issues, court acceptance of the Tribunal’s decision would have dramatic effects that would make merger enforcement extremely difficult in Canada. The entire premise that generated the Competition Tribunal’s efficiency tradeoff analysis is that Parliament intended to institute an economic efficiency standard in the statute. This standard, which completely ignores consumers’ interests, is inconsistent with the legislative history and with other sections of the statute. For many reasons, we believe that this interpretation is incorrect. We believe that Parliament intended to stop mergers likely to lead to higher prices for consumers and that it did not intend to make it extraordinarily difficult for the government to stop mergers virtually to monopoly.


2 Projected annual sales for the combined firm are $585 million; calculated from Superior Decision ¶ 454. Assume that the $585 million includes the 8% price increase. If so, the combined sales at the original price would be approximately $542 million, and the 8% price increase would be approximately $43 million or more than $43 million in case of a price increase of more than 8%.

3 P. Townley Affidavit at 39.

4 The Tribunal did not describe these inefficiency losses well enough for us to identify their nature.

5 We do not discuss whether the efficiency gains the Tribunal predicted would in fact be realized. We also do not evaluate whether some less anticompetitive method, such as a joint venture or long-term contract, could generate comparable cost savings. Moreover, we have a large number of technical questions relating to the Tribunal’s methodology, such as whether there was preexisting market power, whether there would be any “umbrella effects” (higher prices for other companies in this or related industries), or whether the price and cost changes the Tribunal accepted constituted a sustainable equilibrium. We also do not evaluate whether the Tribunal properly valued non-price competition issues, such as the diminished quality of service common from dominant firms that face minimal competitive pressure. These factors could certainly affect the outcome of the Tribunal’s cost/benefit analysis.

6 Competition Act, R.S.C., ch. C-34, § 1.1 (1985) (Can.). Section 92 and its companion, Section 93, contain additional references to preventing mergers likely to lessen competition.

7 The Point authors repeatedly emphasize that “non-economic” merger effects should be irrelevant to an economic-based merger policy. Indeed, effects such as job losses, plant closings, loss of sovereignty, political goals, protection of small business, and environmental issues are as irrelevant to our analysis as to theirs. The “wealth transfer” effect of higher consumer prices is not a “non-economic” effect however, and is a completely different issue from wealth distribution. We discuss wealth transfers infra; see text accompanying note 24. As we explain infra, wealth distribution is only tangentially relevant. The fact that shareholder wealth is not equally distributed probably explains why Parliament would be concerned about the distributional effects of higher consumer prices as well as efficient resource allocation.

8 This article will neither discuss the wisdom of permitting a case-by-case efficiency defense nor compare a case-by-case approach to the alternative of raising the Merger Guidelines’ threshold levels to capture most efficiency gains, on average. For a discussion of these alternatives, see Alan A. Fisher & Robert H. Lande, Efficiency Considerations In Merger Enforcement, 71 Cal. L. Rev. 1580, 1651–77 (1983).

9 Moreover, the higher payments that flow from consumers to firms with market power are wealth transfers only if one assumes that the merged parties do not face higher costs. With reduced competition, a firm with market power may become complacent and allow costs to rise to use up some of the wealth transfer. Where the government imposes entry restrictions, competition over access to a potential market position frequently uses up a significant proportion of what initially looks like profits. Firms facing weak competition sometimes reduce innovation, the quality of service or variety of choices for consumers. For these reasons, what initially appears to be a wealth transfer of no allocative efficiency significance can become an additional inefficiency cost of increased market power. See Richard A. Posner, The Social Costs of Monopoly and Regulation, 83 J. Pol. Econ. 807 (1975), see also Robert H. Lande, Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenge, 34 Hastings L.J. 65, 77–80 (1982).

10 $68 times $29.2 equals approximately $49 million; expected post-merger total sales were $585 million; see Decision ¶ 454.

11 Since even monopolists take costs into account when they set prices, lower costs can lead to lower prices, even for monopolists. See Alan A. Fisher et al., Price Effects of Horizontal Mergers, 77 Cal. L. Rev. 777, 794–95 (1989).


13 The U.S. Merger Guidelines only consider merger-specific efficiency gains likely to be passed to consumers. This condition requires an expectation that prices would not rise. Id. § 4.

14 See Fisher et al., supra note 11, at 806.

15 Id.

16 $29.2 million is approximately 5.0% of $585 million.

17 No. 1:00 CV 01688, slip op. at 2, 19–20 (D.D.C. Oct. 18, 2000). The Court found that Heinz would be able to reduce Beech Nut’s variable manufacturing costs by 43%. There was no reason to expect a reduction in Heinz’s variable manufacturing costs. Weighting these expected cost savings by each firm’s market shares yields an overall expected cost reduction of 20.2%. See id. The U.S. Court of Appeals for the D.C. Circuit enjoined the merger pending appeal, however, in part because the Supreme Court has not addressed an efficiency defense since the 1960s, the D.C. Circuit has never addressed this defense, and it was unclear whether such a defense should be permitted in a merger with concentration levels as high as in this matter. Because Heinz and Beech-Nut should be able to re-propose the merger if they win on the merits, while it would be impractical to undo the transaction if consummated, and because of uncertainty over which side would prevail, the court granted a preliminary injunction and expedited appeal. FTC v. H.J. Heinz Co., No. 00-5362 (D.C. Cir. Nov. 8, 2000).

18 Although we agree with Facey et al. that Parliament intended Section 96 to play an important role in merger analysis, we cannot accept their reasoning that Parliament must therefore have intended a total welfare test. Parliament enacted the statute in 1986, when the U.S. Merger Guidelines contained an extremely restrictive efficiency test. Moreover, judges and commentators have suggested a variety of other ways that the Tribunal could consider wealth transfers in the context of a viable efficiency defense. For example, it could give more weight to the efficiency arguments the weaker the evidence of anticompetitive effect and the stronger the evidence of efficiency gains. See Canada (Director of Investigation & Research) v. Hillsdown Holdings (Canada) Ltd., (1992) 41 C.R.3d 289 (1992). The Tribunal could also include an explicit balancing of market-power effects in one market against expected cost savings in other markets, and use the expectation of cost savings to offset any expected adverse effects on quality or variety of consumer choice. See Stephen F. Ross, Afterword—Did the Canadian Parliament Really Permit Mergers that Exploit Canadian Consumers So the World Can Be More Efficient? 65 Antitrust L.J. 641, 648–49 (1997). Although the desirability of any of these approaches is beyond the scope of this counterpoint, they and the other approaches discussed in text refute the notion that the Tribunal’s total welfare standard is the only one that can meaningfully implement Parliament’s purposes in adopting Section 96.
King, stated that the “main purpose of this measure is the protection of the consumer.” Id. at 34. Whatever the interpretive differences between the verbs “prevent,” “lessen,” “restrain,” or “injure,” such an implausible statutory construction requires a determination that when Parliament previously used the word “competition” it meant “a market where competitive forces prevent consumer exploitation through higher prices,” but when it used the same word in 1985 it meant “a market where competitive forces and the desire to maximize profit result in an efficient allocation of resources.”

We found no evidence in the legislative history of the Competition Act to suggest that Parliament would have been willing to allow a merger that would produce a monopoly or lead to significantly higher consumer prices. Moreover, Facey et al. have not cited any legislative history to support their reading that this interpretation is what Parliament intended. In contrast, some evidence suggests that Parliament did not want to permit higher prices. During the House of Commons Debates, Michel Coté, the minister responsible for the Amendments, explained the purpose of the Bill as follows: “The fourth but not the least objective is to provide consumers with competitive prices and product choices. As such, this objective becomes the common denominator in what we are trying to achieve. This is the ultimate objective of the Bill.” House of Commons Debates (April 7, 1986), at 11,927. John H. Turner (leader of the Opposition) explained why he favored competition instead of monopolists to gouge consumers with higher prices. I care more about helping consumers than monopolists. Moreover, not even widows and orphans are deserving widows and orphans. However, we have no evidence to suggest that consumers of propane are, on average, wealthier than shareholders of firms with monopoly power. Moreover, not even widows and orphans have the right to steal from propane consumers.

In reality, with complex regulation of medicine and the widespread use of health insurance, the price and wealth-transfer effects of this hypothetical merger would be difficult to ascertain. The exact product in this example, however, is irrelevant. One instead may use any product likely to face a low elasticity of demand. Normally, any profit-maximizing firm facing an elasticity of demand with an absolute value of less than 1.0 would find it profitable to raise price. However, in a non-collusive multi-firm market, competition can keep the market elasticity of demand less than an absolute value of 1.0. In these markets, the wealth transfer tends to be very large in comparison to the allocative inefficiency (deadweight loss) from a price increase.

If output would not decrease, at least within a range, the merger would produce no allocative inefficiency. A variant would inquire whether price would be likely to rise by a “significant” amount.

In oligopoly, there are many complexities in measuring the tradeoff. For example, the authors approach. A candidate running against anyone voting for such legislation would argue as follows in the next election: “My opponent wants to allow mergers to monopoly and higher prices. But I want to protect consumers from higher prices. I care more about helping consumers than monopolists. I shall therefore introduce legislation to prevent mergers that will enable monopolists to gouge consumers with higher prices.” See also Ross, supra note 18.

The Point’s authors imply that some shareholders of Superior Propane surely are deserving widows and orphans. However, we have no evidence to suggest that consumers of propane are, on average, wealthier than shareholders of firms with monopoly power. More so, even widows and orphans have the right to steal from propane consumers.

In reviewing documents from merger filings, we have frequently seen instances in which the acquiring firm’s managers have directed staff to find additional synergies to justify a higher than expected final purchase price. The ease with which the staff return with additional anticipated cost savings shows how easy it is to generate documents projecting anticipated efficiency gains, especially to meet a hurdle of a fraction of a percent decrease in costs. It is often difficult to know how much of the value which firms would be likely to have merger-specific savings in variable costs? These considerations are critical to understanding whether predicted effects would constitute a stable (equilibrium) condition or lead to further changes and thus different results from the initial calculations. For more such complexities, see Fisher et al., supra note 11, at 792–809.

Moreover, the predictability of the total welfare standard is especially low because a full analysis also requires consideration of whether the merger imposes inefficiency losses on competitors, customers, or suppliers. Since the total welfare standard generates changes in prices and outputs, it imposes changes in welfare on more of the economy than does the price standard. We thank Professor Steven Salop for this observation.

See Margaret Sanderson, Efficiency Analysis in Canadian Merger Cases, 65 Antitrust L.J. 623, 629–31, 636–37 (1997), to appreciate the complexity of the balancing under Section 96.

See Oliver E. Williamson, Economies as an Antitrust Defense Revisited, 125 U. Pa. L. Rev. 699, 709 (1977). Professor Muris’s required efficiency gains are smaller, sometimes substantially so, than those of Professor Williamson. See Timothy J. Muris, The Efficiency Defense Under Section 7 of the Clayton Act, 30 Case W. Res. L. Rev. 381, 387 (1980). These calculations may be unreliable, however, because they do not consider whether the resulting prices and outputs are sustainable given the reactions of competitors. The estimates assume that all firms, both merging and not merging, have the same changes in prices and costs. Reliable calculation of the tradeoff is enormously complex and beyond the scope of this paper. See Fisher & Lande, supra note 8, at 1624–51; Fisher et al., supra note 11, at 792–809. For an analysis of many complexities of Williamson’s approach in the Canadian context, see Mark A.A. Warner, Efficiencies and Merger Review in Canada, the European Community, and the United States: Implications for Convergence and Harmonization, 26 Vand. J. Transnat’l L. 1059, 1079–92 (1994).

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