DEPARTMENT OF JUSTICE

**INITIATIVES IN MERGER
AND JOINT VENTURE ANALYSIS**

Address by

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It's been less than eight months since we've starting walking the Halls of Justice and in the eight months much has happened. A new wave of mergers, many of which are concentrated in a few key industries, has swept across the business landscape, and, at least from our somewhat egocentric perspective, landed in our office for review. For example, while we were still learning how to get coffee in the main justice building -- no mean feat as those who have ever tried it know -- suddenly almost $100 billion worth of telecommunications mergers were pending before us. We have been told by various industry groups that their industry -- whether it's health care, defense, or high tech -- is in the midst of historic restructuring, and calling into question the relevance of antitrust enforcement, and seeking legislative relief.

How have we responded to these challenges? Rather than use an adjective as some in this audience may be tempted to do, I will discuss some of our thinking and our actions. The specific areas I'd like to discuss are high tech and telecommunications, with some mention of health care and defense.

The question has been raised by some, "Is merger enforcement appropriate in high tech industries?" I don't view that as a tough question. Antitrust enforcement is designed to promote innovation and efficiency. Innovation, whether in the form of improved product quality and variety or of production efficiency that allows lower prices, is a powerful engine for enhanced consumer welfare. By intervening where mergers are likely to mute rivalry or impede entry, antitrust can work to create an economic environment in which the entrepreneurial initiative can flourish.

In analyzing mergers involving high tech industries, we, of course apply the 1992 Horizontal Merger Guidelines. The Guidelines do not dwell on issues of technological change, innovation, or intellectual property. Nevertheless, the Guidelines provide a framework to take them into account in terms of market definition, barriers to entry and competitive effects. And, that's precisely what we've done, for in the long run preserving rivalry in innovation is crucial to consumer welfare.

A good example of the significance of innovation to our analysis is our recent suit against the proposed acquisition of GM's Allison Division by ZF Friedrichshafen, which would have combined their bus and truck automatic transmission businesses. The transaction would have resulted in very high levels of concentration in a few application-specific bus and truck transmission markets in the U.S. (and also in Europe). But our concern over the competitive effects of the proposed acquisition was not limited to those narrow product markets where the two firms presently were alternative sources of supply; we were concerned as well about the effect of combining the assets used for product and process improvements and developments. The combined firm would have controlled most of the assets world-wide necessary for innovation in the production and improvement of heavy duty truck and bus automatic transmissions. Moreover, our investigation uncovered substantial evidence of head-to-head competition in innovation between GM and ZF. In this manner, our complaint captured the scope of the feared anticompetitive effect -- innovation over the entire line of heavy-duty truck and bus transmissions, not just those few product lines that had been the subject of direct sales competition in the past.

As a general matter, we recognize that merger enforcement in markets with rapid technological change raises particular issues. For example, evidence of significant innovation may lead to a prediction of entry by a new firm or product. Such entry may have the effect of deconcentrating the affected market and will lead to a conclusion that a particular transaction presents no competition concerns. Changing market conditions owing to technological development may also suggest that a merger will not lead to the creation or exercise of market power.

Technological change, however, does not always counsel against merger enforcement. Even if technological change makes market structure and dynamics uncertain, it is important to preserve competition in innovation because that competition assures the best outcome for consumers. Antitrust enforcement is not and should not be based on a prediction of precisely where technological change will ultimately lead, but instead focuses on the number of potential innovators, barriers to entry and other factors relevant to competition in innovation. We understand that innovation competition often means duplicating R&D assets but believe that in most circumstances the benefits of competition can outweigh the unavoidable redundancies. Consistent with our allegation in the GM/ZF complaint, we believe that consumer welfare is enhanced when innovative diversity and competition is preserved.

Some have argued that economies of scale and scope are so great in high-tech industries that, as a matter of course, mergers should be allowed even though they contravene normal antitrust standards. Although we reject that argument as a general proposition, in a particular case, it is conceivable that economies of scale or scope may justify allowing a merger that creates market power because the merger is demonstrably necessary to sustain incentives for innovation or to bring the benefits of significant innovation to market more quickly. The Division's antitrust analysis is flexible enough to account for such instances where the special facts required for such an exception can be clearly demonstrated.

Telecommunications presents a good example of a high tech industry subject to rapid change where antitrust enforcement has and will continue to play an important role. There can be little dispute of the importance of the Antitrust Division's challenge to the AT&T monopoly and of the restructuring of the industry obtained through the Modified Final Judgment in settlement of that case. The Division was among the first governmental agencies to recognize that technological advances had materially changed the economic and technological conditions on which prior natural monopoly assumptions were based. We believe that the MFJ helped spur an incredible proliferation of technology and competition in the telecommunications industry that profoundly altered this country's economy. The Division's role in that revolution shoes how the proper application of antitrust enforcement principles can promote innovation and competition by eliminating both private and governmental restrictions.

As was the case with interexchange telephone services, technological advances suggest that natural monopoly assumptions about two other markets -- local telephony and cable transmission services -- are questionable. We appear to be at the point where technology for voice, data, and video services are converging. Competitive options may be emerging, but it's not clear when or how the new services will evolve or which ones will succeed. But it is not the function of antitrust enforcers to prescribe the route of the evolving "information superhighway." Instead, our function should be to encourage competition and to insure a competitive marketplace so that the route can emerge from the free play of competitive forces.

Simply stated, our merger policy in the area of telecommunications is to preserve and foster market conditions where innovation and efficiency are maximized through a competitive environment. We must insure that the emerging local transmission competition is not lost to private restraints through the extension of existing market power into other existing or new markets or the creation of new market power, just as it is our obligation to advocate against unnecessary governmental restrictions.

Telecommunications mergers may raise issues of horizontal competitive effects. When they do, we use the 1992 Horizontal Merger Guidelines in a manner familiar to this audience. In our experience, the more difficult questions arise when non-horizontal mergers may have potential anticompetitive effects. We believe that a vertical merger may have such effects and that theories of potential adverse effect are not limited to the discussion of foreclosure in the 1984 Merger Guidelines. A vertical merger may raise the costs of a rival in a downstream or upstream market, resulting in higher prices to consumers. A vertical merger may also cause a competitor to become a supplier as well, and, under certain conditions, chill innovation or lead to coordination of output or prices. We are not ready to make sweeping policy pronouncements, especially in the form of guidelines on vertical mergers, but we are studying vertical effects in specific investigations and will bring a case if we find appropriate circumstances indicating likely competitive harm.

In reviewing telecommunications mergers, it is our responsibility to make sure that no firm can use its existing networks to disadvantage unfairly its competitors, both actual and potential. We are cognizant of the competitive risks associated when local phone companies enter adjacent markets as well as the influence that cable distribution companies may have over consumers and programmers. But if the technological, structural, and legal barriers that give rise to those risks can be alleviated, we cannot ignore the potential competitive benefits of likely new entry and technological convergence. As I've already stated, the goal is to promote conditions that allow competition to flourish, whether its through price, quality, or innovation. With respect to telecommunications, these principles have worked successfully in the past and there is no reason to depart from them now.

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Let me turn to health care and defense. I will discuss these two industries together although the relation between them is not obvious -- unless you have been following the lobbying efforts of certain of their representatives.

It's undeniable that both the health care and defense industries are in a period of dramatic restructuring. Defense procurement is predicted to be slashed by two-thirds in the coming years. Health care reform is a major administration initiative and health care providers are struggling under intense cost containment pressures. These pressures have led to calls for antitrust exemptions or altered levels of scrutiny for these industries.

Let me be as clear as I can: the Antitrust Division flatly rejects exemptions or changed levels of scrutiny for mergers in these industries. Existing policy, especially enforcement of the 1992 Horizontal Guidelines, allows for appropriate treatment of these industries, including full accounting of the sweeping changes they are presently enduring.

We take account of defense downsizing in performing our merger analyses. In the first place, merger analysis asks the question whether the merger is likely to have an adverse effect on competition in the **future**. To answer that question, we must predict what the state of competition in the absence of the merger will be after the expected downsizing. Only then can we assess whether the merger is likely to lessen competition. We also recognize that if significant economies of scale are required in a particular market, then a downsizing in that market may cause that industry restructure with fewer remaining suppliers.

To aid in analysis of the economic effects of defense mergers, the Antitrust Division, along with the Federal Trade Commission, has participated as members of an Advisory Task Force to the Department of Defense. The charter of the task force is to advise the Department of Defense on how it can best assist the antitrust authorities in their evaluation of mergers of defense firms. A report is in preparation and should be released in the next month or so.

Health care reform is a crucial element of Administration policy. We believe that the key to cost containment is the presence of managed care providers which can negotiate contracts with health care service providers. Without competitive alternatives, managed care providers can no more secure favorable prices than can any other customer dealing with a monopolist with no close substitutes. Given that American consumers now spend in excess of 10 percent of the nation's gross national product on health care, we review mergers in this area with great concern. We will intervene in any merger that threatens the ability of managed care providers to contain costs by removing constraining competitive alternatives. While we recognize that certain health care mergers may lead to efficiencies, we remain convinced that competition not consolidation results in the lowest prices and best quality in the long term.

In September of 1993, the Division released jointly with the Federal Trade Commissions six "Statements of Antitrust Enforcement Policy in Health Care." These statements spell out in detail the kinds of activities the antitrust enforcement agencies will not challenge and thus provide some certainty to the health care industry in an uncertain time. These statements, however, do not provide any exemptions or altered levels of scrutiny for health care.

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I have outlined some of our thinking about merger enforcement policy informed by our eight months at the Division. In the coming months, we expect to put this policy into action to discharge our obligation of enforcing the antitrust laws.