# DEPARTMENT OF JUSTICE

STRATEGIC ALLIANCES & CONVERGING INDUSTRIES
THE GOVERNMENT'S PERSPECTIVE ON CORPORATE COMBINATIONS

Address by

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It is unusual -- but nevertheless pleasant -- to appear before an audience whose primary interest is not antitrust. Such occasions can provide a useful opportunity for an exchange of views from different backgrounds, perspectives, and disciplines. That is especially true today. Each panel member brings a different perspective to the question posed: what is the government perspective on corporate combinations?

Precisely because you don't spend every waking hour thinking about the Antitrust Division's merger enforcement program, I thought it might be helpful first to give you a general overview of the standards we apply in evaluating mergers, then to summarize the procedures that we follow in conducting merger reviews, and finally to survey briefly some of the major merger cases we have filed in the industries that are the focus of this conference: electricity, gas, telecommunications, and cable.

## I. Merger Enforcement Standards

Unlike the familiar "public interest" standard that many administrative agencies apply in reviewing mergers, the Antitrust Division applies Section 7 of the Clayton Act, which prohibits the acquisition of stock or assets "where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly." Section 7 represents a congressional reaction in 1914 to early decisions by the Supreme Court construing the Sherman Act -- which the government had been using to challenge mergers -- as imposing burdens upon the government that were too onerous. Congress realized that, to be effective, merger enforcement should be able to arrest anticompetitive transactions in their incipiency, to forestall the harm that would otherwise ensue but be difficult to undo. Thus, merger enforcement standards are forward looking and, while we often consider historic performance in an industry, our primary focus is to determine the likely competitive effects of a proposed merger in the future.

The Antitrust Division shares merger enforcement responsibility with the Federal Trade Commission ("FTC"), except in certain industries in which the FTC's jurisdiction is limited by statute. The agencies have developed Merger Guidelines that describe the inquiry they will follow in analyzing mergers. "The unifying theme of the Guidelines is that mergers should not be permitted to create or enhance market power or to facilitate its exercise. Market power to a seller is the ability profitably to maintain prices above competitive levels for a significant period of time." Merger Guidelines 0.1 (footnote omitted).

As suggested by the language of Section 7 itself, we seek to define the relevant product ("line of commerce") and geographic ("section of the country”) markets in which the parties to a merger compete and then determine whether the merger would be likely to lessen competition in those markets.

> “A market is defined as a product or group of products and a geographic area in which it is produced or sold such that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future producer or seller of those products in that area likely would impose at least a ‘small but significant and non- transitory’ increase in price, assuming the terms of sale of all other products are held constant. A relevant market is a group of products and a geographic area that is no bigger than necessary to satisfy this test.”

Merger Guidelines 1.0. In less technical language, the purpose of this inquiry is to ascertain whether, with respect to a product or service offered by the merging parties, there are alternative products and services to which customers could reasonably turn if it were assumed that the merging parties were the only suppliers of the product or service and sought to increase prices. Once relevant markets are defined, we look at various factors in order to determine whether the merger is likely to have an anticompetitive effect.

In performing this analysis, the Antitrust Division and the FTC consider both the post-merger market concentration and the increase in concentration resulting from the merger. We utilize the Herfindahl-

Hirschman Index ("HHI"), which is calculated by summing the squares of the individual market shares of all the participants.  We are likely to challenge a transaction that results in a substantial change in concentration in an industry that is already highly concentrated, although appropriate consideration will be given to other factors, such as the likelihood of entry by new competitors, that could affect whether the merger is likely to create or enhance market power or facilitate its exercise.

## II. Procedures for Reviewing Mergers

Parties to transactions meeting certain size thresholds must provide the Antitrust Division and the FTC with notice of proposed transactions pursuant to the Hart-Scott-Rodino Antitrust Improvements Act of 1976 ("HSR").  They must file a form containing certain basic information, which the Antitrust Division and the FTC use to determine whether more extensive review is appropriate.  If either or both of the agencies wish to pursue the matter, we use a clearance process to work out which one will review it.  While occasionally other factors are used in that process, the primary determinant is agency expertise about the product(s) at issue, so that a merger will usually be reviewed by whichever of the two agencies is most knowledgeable about the relevant product(s).

The initial waiting period under HSR is usually thirty days. If the reviewing antitrust agency concludes that the merger is not competitively problematic, the HSR waiting period expires or may even be terminated early. The parties are then free to proceed subject, of course, to review by any other agencies with jurisdiction over the transaction.

However, if the reviewing antitrust agency does not resolve its competitive concerns, it can issue a request for additional information, known in our business as a "second request," which defers the ability of the merging parties to consummate the transaction for an additional period of time -- usually twenty days -- after they have provided the reviewing antitrust agency with the requested information. It is not uncommon during this process for the parties to have substantial contact with the reviewing antitrust agency. The process is confidential and, unlike the procedures in some administrative agencies, competitors do not have access to the merging parties' HSR and other submissions. Not infrequently, parties are able to demonstrate that the transaction is not competitively problematic, in which case the waiting period expires or is terminated and, again, the parties may proceed subject to other required approvals.

If the reviewing antitrust agency reaches a different conclusion, however, it is likely that a complaint will be filed -- in federal court if the reviewing agency is the Antitrust Division and an administrative complaint before the FTC if the FTC is the reviewing agency. Sometimes the parties make a proposal to address the competitive concerns that the reviewing antitrust agency has identified; for example, multi-product firms may have a troublesome overlap in a subset of their products, in which case some form of divestiture can solve the problem while still allowing the parties to proceed with the overall merger. There are times, however, when curative relief is not possible, in which case the reviewing antitrust agency is likely to seek a preliminary injunction to prevent consummation of the merger pending completion of judicial or administrative proceedings, depending on the antitrust agency involved.

The last two years have seen an unprecedented number of mergers. The number of transactions reported to the Antitrust Division and the FTC under HSR rose from less than 3,100 in fiscal year 1996 to over 3,700 in fiscal year 1997 and to over 4,600 in fiscal year 1998. Many of these transactions have involved companies with billions of dollars in revenues, offering numerous competing products and services. Unlike many transactions during the 1980s that involved leveraged buy-outs that represented few antitrust problems, today's transactions are more likely to involve strategic competitive considerations as companies endeavor to position themselves as market leaders in preparation for the new millennium.

Despite the obvious burdens that such a pace of merger activity places upon the resources of the Antitrust Division and the FTC, Assistant Attorney General Joel Klein has stated clearly and forcefully that no merger is going to get a “free pass” from appropriate merger review.  During the 1998 fiscal year, we challenged (or indicated that we would challenge) more than 50 transactions.  Two of them illustrate his point; we challenged the  $11.9 billion proposed merger of Lockheed Martin and Northrop Grumman, which, we contended, would have substantially lessened competition in current and next-generation weapons systems, and the $12.5 million transaction between Citicorp and GTECH, which, we contended, would have substantially reduced competition in electronic benefit transfer systems used by states to dispense public assistance benefits.  Competitive problems can arise in very big or very small mergers and in well-known or hardly-known product markets.  The Antitrust Division is committed to identifying such mergers and to see that they are restructured to eliminate  competitive problems or, if that is not possible, that they are blocked altogether.

## III. Application of Antitrust Merger Standards to Energy and Communications Mergers

The focus of this program is on energy, telecommunications, and cable mergers. They all have one element in common: in addition to review under the antitrust laws, they are subject to some form of review by a federal administrative agency. The Antitrust Division has been actively involved in reviewing mergers in all these industries.

### A. Energy Mergers

In energy industries, the Antitrust Division and the Federal Energy Regulatory Commission ("FERC") both have responsibility for merger review. FERC analyzes such transactions under the familiar "public interest" standard but, as the Supreme Court has long made clear, that review does not exempt electricity and natural gas mergers from review by the Antitrust Division. See Otter Tail Power Co. v. United States, 410 U.S. 366, 374-75 (1973) (electricity); California v. FPC, 369 U.S. 482, 489 (1962) (natural gas). Notably, although FERC's public interest inquiry necessarily encompasses competition issues, it is not confined to antitrust principles if strict application of those principles would conflict with its broader regulatory goals. See, e.g., Northeast Utilities Service Co. v. FERC, 993 F.2d 937, 947 (1st Cir. 1993). Thus, FERC and the Antitrust

Division pursue similar but not necessarily identical objectives in reviewing energy mergers.

The current legal and regulatory environment presents interesting challenges for the Antitrust Division in this field. Historically, FERC (and the Federal Power Commission before it) played the major role in reviewing energy mergers, in large part because pervasive regulation limited the ability of energy companies to compete against one another. With substantial deregulation of these industries, however, antitrust issues have become increasingly important -- a phenomenon that is likely to continue -- and the Antitrust Division's role in merger review has expanded significantly.

That is not to say that this role has come easily. This situation presents a challenge to the Antitrust Division because, although the Antitrust Division must determine whether a merger may tend substantially to lessen competition in the future, there is usually a history of competitive behavior in an industry and some prior transactions that inform the Antitrust Division's predictive judgment. In an industry transitioning from pervasive regulation to substantial deregulation, those benchmarks are often lacking, which can make the Antitrust Division's job more difficult and more important at the same time.

FERC, too, has modified its merger review process to take account of the changes wrought by deregulation. FERC has adopted merger guidelines, patterned on the DOJ-FTC Horizontal Merger Guidelines, to advise parties of the way in which it will evaluate competitive issues. Yet, differences between the Antitrust Division and FERC remain. Not only does FERC's mandate allow for consideration of other issues in determining the public interest, but it also places the burden of showing that the merger is consistent with the public interest on the parties to the deal, unlike the burden placed on the Antitrust Division in challenges it brings in court. Also, FERC is specifically authorized by statute to condition mergers and to exercise continuing jurisdiction over merged entities, while the Antitrust Division ordinarily seeks to resolve its competitive concerns about mergers through structural remedies, i.e. divestitures, that do not require continued prosecutorial or judicial oversight.

As a practical matter, antitrust review by the Antitrust Division and administrative review by FERC are likely to proceed along parallel tracks, although there are important differences in process that should be noted. The HSR process is confidential, and the Antitrust Division has statutory powers to compel production of documents, answers to interrogatories, and investigatory depositions not only from the merging parties, but also from third parties. The FERC process has many of the advantages -- and disadvantages -- associated with a traditional administrative hearing, including dependence on parties' discovery, public hearings, and issuance of a decision based on the administrative record that is subject to deferential judicial review.

Despite these differences, the Antitrust Division and FERC have rarely reached conflicting decisions. Competitive concerns can be addressed by consent decree with the Antitrust Division and/or undertakings accomplished through the FERC review process. One recent case illustrates both the changing nature of energy industries and the significant role that the Antitrust Division is taking to ensure that the consuming public is not ill-served by consolidation.

In United States v. Enova, an electric company sought to merge with a natural gas pipeline owner. Enova is a major provider of electricity in southern California, selling electricity from plants that use coal, gas, nuclear power, and hydropower. Pacific Enterprises ("PE") is virtually the sole provider of natural gas transportation and storage services to plants in southern California that use natural gas to produce electricity. Because gas-fired plants generally are the most costly power plants to operate, they are the last plants to be used to meet consumer demand for electricity. They operate primarily during periods of high demand for electricity and, by state power pool regulations, their costs determine the price for all electricity sold during these peak periods in California.

The Antitrust Division was concerned that PE/Enova would have had the incentive and ability during periods of high demand for electricity to use its natural gas monopoly to limit the supply of natural gas to utilities, which would increase the operating costs of gas-fired electric generating plants and the resultant price determined by the pool. As the operator of lower-cost generating facilities, PE/Enova would stand to benefit from higher prices for electricity. Of course, that would mean higher prices for consumers. Accordingly, the Antitrust Division filed suit under Section 7 of the Clayton Act, and the parties entered into a consent decree pursuant to which the merger was permitted after Enova divested specified generating facilities to a purchaser acceptable to the Antitrust Division, in order to protect competition in California's electricity market. <u>See</u> Competitive Impact Statement, 63 Fed. Reg. 33396 (June 18, 1998). FERC approved the transaction soon thereafter.

There have been, as you know, a number of proposed energy mergers that are still under review at the Antitrust Division and at FERC.

While I am reluctant to discuss the specifics of any pending transaction, I can assure you that the Antitrust Division is reviewing them carefully and is prepared to take any appropriate enforcement action.

### B. Telecommunications and Cable

For telecommunications and cable, the Federal Communications Commission ("FCC") is our colleague in reviewing mergers. The FCC is charged, through its authority to review license transfers, with ensuring that mergers are consistent with the public interest. Here, too, the Supreme Court has determined an administrative agency's application of that standard does not exempt such mergers from antitrust scrutiny and, if necessary, enforcement action by the Antitrust Division. See United States v. Radio Corporation of America, 358 U.S. 334, 346 (1959). Again, the Antitrust Division utilizes the HSR process to conduct merger reviews, and the FCC utilizes administrative proceedings.

These are not the only similarities between review of energy and communications mergers. Like electricity, various forms of deregulation and technological advances -- from fiber optic cable to increased spectrum space to DBS -- have created whole new opportunities and means of competition. These developments pose substantial challenges to the Antitrust Division and the FCC.

Review by the Antitrust Division and the FCC usually proceed simultaneously. Often, the Antitrust Division has been able to complete its review before the FCC issues its decision. The Antitrust Division has filed a number of complaints and consent decrees with respect to telecommunications and cable mergers, and the FCC has therefore been able to take into account the relief obtained by the Antitrust Division in reaching its public interest determination.

With the Telecommunications Act of 1996 opening local telephone markets to competition for the first time, the FCC has had the opportunity to take a fresh and vigorous look at how it will evaluate mergers. In the Bell Atlantic-Nynex merger, the first RBOC transaction, the FCC discussed the manner in which it would evaluate mergers in light of the 1996 Act. In general, the FCC relied -- and continues to do so -- on principles underlying the DOJ-FTC Horizontal Guidelines although, unlike FERC, it has not formally adopted any official merger guidelines. Those sound principles also have application to transactions involving cable companies.

The Antitrust Division and the FCC share an interest in ensuring that competition in telecommunications and cable markets is not threatened by mergers. Recent examples of efforts in these areas are illustrative.

1. In United States v. Primestar, Inc., Civil Action No. 1:98CV01193 (D.D.C. May 12, 1998), the Antitrust Division successfully challenged an effort by five of the nations's largest cable companies, acting through their joint venture Primestar, to acquire one of only three orbital slots available to provide high-power direct broadcast satellite ("DBS") service. Cable television companies for many years have dominated markets for the distribution of multichannel video programming. In recent years, firms using new technology to distribute programming through high-powered satellites have emerged as a competitive threat to cable companies. The Antitrust Division was concerned that this joint venture, which would have allowed cable companies to exert control over a DBS service, threatened this alternative. The defendants abandoned this acquisition after suit was filed but before the FCC had completed its review. Subsequently, EchoStar -- the smallest of the DBS firms -- sought approval from the FCC to purchase the News Corp. and MCI DBS assets. The Antitrust Division filed comments with the FCC urging approval of that transaction; the FCC proceeding is pending.

2. The Antitrust Division also had competitive concerns about the recent AT&T-TCI merger. The merger combined the nation's largest long distance carrier and second largest cable services provider. The avowed

purpose of the merger was to allow AT&T to enter the residential telephone market through cable telephony. In this respect, the transaction offered the prospect of increased competition for local telephone service.

However, the transaction raised significant issues with respect to wireless service. TCI owned a 20+ percent interest in Sprint PCS, which competed with AT&T in a number of markets for mobile wireless services. The Antitrust Division concluded that allowing AT&T to acquire this interest in its competitor might tend substantially to lessen competition and therefore permitted the merger to proceed only after insisting on a consent decree requiring the defendants to divest TCI's holding of Sprint PCS stock. See Competitive Impact Statement, 64 Fed. Reg. 2506 (Jan. 14, 1999). The FCC subsequently approved the merger.

Of course, there have been other significant telecommunications mergers, and a number of very important ones are pending either at the Antitrust Division, the FCC, or both agencies. The Antitrust Division is working on a number of fronts to advance the policies underlying the Telecommunications Act of 1996 and will play a significant role with respect to mergers involving communications companies.

## IV. Conclusion

The next decade will be a critical one for energy and communications companies. The decisions that antitrust and regulatory agencies make with respect to proposed mergers in those industries may well determine not only the prices that consumers will pay for these essential services but also the reliability of products and services and even the pace of innovation. It is not an overstatement to suggest that these industries hold the key to our country's economic prospects. It therefore is important that antitrust and regulatory agencies "get it right." I hope that today's panel discussion will help move us in that direction.