



DEPARTMENT OF JUSTICE

Recent Developments at the Antitrust Division

Address by

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Introduction and Overview

Hello. It is a particular pleasure to be here today at the Milton Handler Annual Antitrust Review. Thank you for the privilege of telling you about the year's developments at the Antitrust Division. Amazing, isn't it, that it takes three speakers to do what one man did?

This past year has been one of the busiest ever at the Antitrust Division. When I look back at our enforcement efforts, what is striking is that they have affected everyday life for consumers across the board. Whether the products are credit cards, health care, vitamins, textbooks, milk, false teeth or waste collection, or more high-tech products like computers, communications services and the Internet, the Division's efforts have affected U.S. consumers dramatically.

As we end this year, and this century, one case certainly stands out--Microsoft. Our case challenged a variety of Microsoft's practices designed to protect Microsoft's monopoly position in the personal computer operating systems market and to monopolize the Internet browser market. The complaint alleged that, among other things, Microsoft illegally bundled its Internet browser with its Windows operating system, attempted to divide markets with its competitors, and imposed exclusionary terms and conditions in its contracts with various customers and vendors in violation of section 1 and 2 of the Sherman Act. The Court consolidated a parallel action of 20 state attorneys general with the federal action, and it also consolidated the trial on the merits with the preliminary injunction hearing. Trial began on October 19, 1998. The Division and Microsoft each submitted direct testimony of 12 witnesses in written form. Cross-examination of these witnesses was heard in open court. On rebuttal, each side presented three witnesses. Judge Jackson's findings of facts, issued two weeks ago, are an important commentary upon the evidence presented. The Court found that Microsoft is a monopolist and that it engaged in massive anticompetitive activity harming innovation and limiting consumer choice. Next the Court will hear arguments on conclusions of law.

You know, at the beginning of the century, the Division was challenging John D. Rockefeller's Standard Oil Company. When you think about our economy then compared to now, the Standard Oil case and the Microsoft case are bookends for the century which speak volumes.

One hundred years ago, antitrust cases involved products created by smoke stack industries; today's cases involve high tech industries, characterized by rapid change and rapid innovation. As much as some things change, they also stay the same; we continue to worry about the illegal exercise of market power that hurts competition and consumers' choices.

Microsoft is only one of a number of civil non-merger cases we've filed this year. We've filed major suits against American Airlines and against Visa and MasterCard, which I'll discuss a little later. In addition to these major cases, we have two other civil non-merger cases in litigation: our *Dentsply* case, where we filed suit against the dominant U.S. manufacturer of false teeth for unlawfully maintaining its monopoly by entering into exclusive dealing arrangements with more than 80 percent of the nation's distributors, thereby depriving its rivals of effective distribution networks, and our case against the Federation of Physicians and Dentists, alleging that the Federation and its member orthopedic surgeons--which include nearly all the orthopedic surgeons in Delaware--agreed that the Federation would handle negotiations with insurance companies and resist Blue Cross/Blue Shield's attempts to reduce fees paid to orthopedic surgeons in Delaware to the level of fees paid to other medical specialists in Delaware and orthopedic surgeons in nearby states. Overall, we filed eight civil non-merger cases, of which five were filed with a consent decree.

The Division has also been extremely busy with merger investigations. Just reviewing the Hart-Scott-Rodino filings has been a challenge. You know, nearly every year since 1995 a new record in the number of filings has been set. In fiscal year 1999, the DOJ and the FTC reviewed a record 4,679 transactions, an increase of nearly 65% since 1995. At the Division, we conducted 229 merger investigations, 66 of them resulting in the issuance of second requests. In this past fiscal year, we had 47 merger wins. A number of cases were abandoned or settled, some with record setting divestitures, such as the SBC/Ameritech merger, where we required a divestiture of \$3.3 billion worth of cellular properties. Another record was set when, as a condition for approving the Fleet Bank/Bank of Boston merger, we required a divestiture of \$13.2 billion in deposits, the largest banking divestiture ever. Major suits were filed against Northwest and Continental Airlines, Aetna and Prudential Healthcare, and Continental Grain and Cargill.

More and more frequently we are going to court to block an entire transaction. In fact, since Joel Klein has been Assistant Attorney General, we've sought to block completely nine separate merger transactions. At the moment, two of these remain in litigation--*Northwest/Continental* and *Compuware/Viasoft*.

Stepping back and looking at the trends on the civil side, one thing is obvious. Increasingly, we are taking our cases to court. I think the fact that we are ready, willing and able to do so will be significant in a couple of ways. First, it is likely to bring about movement in legal doctrine. Second, it is likely to mean that there is more pressure on parties to offer truly effective settlements if they seek to avoid litigation. Which is good news for consumers.

The Division has also been actively prosecuting criminal violations. Our investigation of the *Graphite Electrodes* international cartel led to charges of price fixing and market allocation of graphite electrodes sold in the United States and elsewhere. Graphite electrodes are used in electric arc furnaces in steel mills to generate the intense heat needed to melt steel. The investigation has so far resulted in the filing of eight cases charging that, as a result of the cartel, steel makers, whose products are integral to a variety of business and consumer items, paid noncompetitive, higher prices. These cases have resulted in more than \$300 million in fines.

A second major matter was our investigation of the *Vitamins* cartel. Fourteen cases to date have charged that this cartel was a conspiracy to raise prices and allocate the market shares for certain vitamins sold in the United States and elsewhere. This international cartel is the most pervasive and harmful criminal antitrust conspiracy ever uncovered. Virtually every American has been victimized by it. Everyday necessities such as milk, bread, orange juice, and cereal (all fortified with the vitamins produced by these conspirators) were affected by this conspiracy, while the companies and their co-conspirators reaped hundreds of millions of dollars in additional revenues.

I think Professor Handler would be pleased to know--especially given his work on the landmark *Trenton Potteries* case--that during the last fiscal year, the Division secured over \$1.1

billion in criminal fines, more than we had secured in the first 109 years of Sherman Act enforcement. Among the fines included were a then-record \$135 million fine paid by SGL Carbon AG, which stemmed from the *Graphite Electrodes* investigation. One month later, a German firm, BASF Aktiengesellschaft and a Swiss pharmaceutical giant, F. Hoffmann-La Roche Ltd. agreed to pay \$225 million and \$500 million, respectively for their involvement in the vitamin cartel. The fine paid by F. Hoffmann-La Roche Ltd is the largest antitrust fine ever, as well as the largest fine ever secured in any Justice Department proceeding under any statute.

The past year has also been highly successful in setting new precedents in the level of individual accountability for antitrust violations. Earlier this year, the *Graphite Electrodes* investigation led to a German executive being fined \$10 million, the largest criminal antitrust fine ever imposed on an individual, and two American co-conspirators in that cartel pled guilty and agreed to pay fines of \$1.25 million and \$1 million, as well as to serve prison sentences of 17 and 9 months, respectively, for their crimes. In addition, three former high-ranking Archer Daniels Midland executives, who had been convicted by a Chicago jury in the *Lysine* cartel case, were sentenced to significant prison terms: two are serving 24-month sentences and the third is serving a 30-month sentence. In the *Vitamins* investigation, we also secured precedent-setting agreements with two European executives agreeing to plead guilty and go to jail in the U.S.; one has already begun serving his time in a prison facility in West Virginia. This was the first instance of a European national serving time in a U.S. prison for engaging in cartel activity.

Having hit the high points in each of our major enforcement areas, let me change focus slightly to examine specific competitive concerns and legal theories that have been of particular importance this year in our investigations and cases: innovation competition, monopsony power, potential competition, network effects, and predation.

Innovation

Although the Division's concern about innovation is not new, with advances in economic literature and our increased experience and knowledge in the area over the last couple years, we are taking a much harder look at possible harm to innovation. As our economy shifts to high-technology and emerging growth industries, antitrust enforcement in the innovation area has particular relevance. Obviously, the *Microsoft* case is one example. In that case, we alleged that Microsoft's actions illegally curtailed innovation in products that threaten to erode barriers to entry that protect Microsoft's monopoly in operating systems. The Court made a number of findings that the monopoly affected innovation competition.

In the *Visa/MasterCard* case, filed October 7, 1998, we alleged that the defendants violated the antitrust laws by restraining competition in the market for general purpose card network products and services, in violation of Section 1 of the Sherman Act. General purpose cards are payment devices, such as credit cards and charge cards, that enable consumers to make purchases from merchants without immediately accessing or reserving funds. Visa and MasterCard are the two largest general purpose card networks, and together they account for over 75% of all purchases made with general purpose cards in the United States. The complaint alleged that the joint control of both networks by the same group of member banks has limited competition between the networks, which has restricted investment in innovation. For example, Visa and MasterCard have slowed down the development of new card products and technologies such as smart cards, commercial cards, and systems to permit secure card transactions over the Internet. Also, as a result of this joint control, products, services and innovation that could have benefited consumers were not seriously considered or even proposed. The complaint also alleged that the networks have exclusionary rules that impair the ability of other networks to compete with Visa and MasterCard. Loss of competition from other network competitors has hindered development of new and higher quality products. The Department's proposed relief would require that banks governing an association be dedicated to one particular network. The Department also seeks removal of the exclusionary rules.

The key to this case is innovation, but the focus on innovation seems to have confused some of our critics, many of whom argue that strong competition among individual credit card issuers makes antitrust enforcement unnecessary. These criticisms miss the point, however, as our case is about the lack of competition between the different networks and how the ties between them diminished innovation competition between the networks.

On the merger side, the innovation concerns raised in last year's challenge to the \$11.6 billion proposed acquisition of Northrop Grumman by Lockheed Martin--the largest merger ever challenged by the federal government--continues. The main products involved were defense-related military aircraft and electronic systems. Although the complaint alleged significant price effects, I think it's fair to say the principal driver of that challenge was the merger's effect on innovation. As the Attorney General indicated when the case was filed, a loss of innovation can literally have life-and-death implications for our servicemen and women. Innovation was the key for several reasons. First, due to the Pentagon's weapons acquisitions cycle, most of the critical competitive events occur at a very early stage, when costs and prices are extremely uncertain. What is competitively significant is the quality of the design (or the inventiveness of the idea) and the likely success of its implementation. Second, innovation is often achieved in response to external military threats that change rapidly and are unpredictable, requiring that we maintain a number of firms with the capability of innovating to meet future national security challenges. Third, maintaining diversity of firms is also critical, because maintaining our strategically important technological lead over other countries requires, in part, cutting-edge innovations that incumbents are less likely to generate.

Similarly last year's complaint challenging the Halliburton/Dresser transaction, which alleged that the acquisition would decrease competition in the development and improvement of logging-while-drilling ("LWD") tools and services for oil and natural gas drilling implicated innovation competition. LWD services provide information to oil and gas companies about the formations through which the companies are drilling, whether there is oil in the formation, and the ease with which oil can be extracted. Our investigation revealed that only four firms had been able to successfully innovate in the LWD market, and that the different firms had different approaches to

innovation. These different approaches had in the past and would likely in the future result in substantially different types of innovations. Because the merger threatened to eliminate one of these approaches, it would have decreased the chance of successful innovation. It also would have reduced the incentive for the merged firm to innovate and to improve similar, competing tools that the merged firm might deem redundant since it owned both. Our relief specifically addressed innovation. We required Halliburton to sell its entire LWD business, including its manufacturing, research and development, sales, and service capabilities. The divestiture focused on the specialized assets that were required for innovation. By creating a company with these specialized assets--a wide scope of tools with the capability to operate on a worldwide scale--the divestiture allowed another firm to enter the competition for innovation, ensuring competition in this high-tech industry.

Curtailling innovation through mergers or other anticompetitive practices may have serious anticompetitive consequences to consumers over the long run, and may be even more damaging to them than a price increase or a quality decrease, especially in high-tech or high-growth markets. It is also important to note that we are concerned not just with the total amount of innovation as measured by R&D, we are also concerned about the type and nature of innovation likely to develop under different conditions. Even if the rapid pace of change makes analyzing market structure and the competitive dynamics of a market more difficult because of uncertainty, we still need to be vigilant to preserve innovation competition.

Monopsony

Another notable development this year was that we brought two merger cases, each of which challenged that an acquisition would result in monopsony power--that is, market power as a buyer of goods and services. On July 7, 1999, the Division challenged Cargill's acquisition of Continental Grain Company's Commodity Marketing Group. Cargill was the second largest grain trader and Continental was the fifth largest grain trader in North America. Both operated nationwide distribution networks that annually moved millions of tons of grain and soybeans to customers

throughout the U.S. and around the world. Our investigation focused on the effect of the merger on competition for the purchase of grain and soybeans from farmers and other suppliers. We concluded that the lessening of competition resulting from the merger would likely have led to farmers receiving less money for these crops. The Division reached a settlement with the parties, filed simultaneously with the suit, that required Cargill to divest a number of grain facilities throughout the Midwest and in the West, as well as in the Texas Gulf. Without the required divestitures, the acquisition would have eliminated an important competitor for the purchase of these crops. Our divestitures were designed to address this problem by creating an alternative purchaser in the affected markets.

The other monopsony case was our suit challenging the proposed \$1 billion acquisition by Aetna, Inc of the health care business of the Prudential Insurance Company of America. With the complaint, we simultaneously filed a proposed consent decree which, if approved by the court, would settle the suit. Aetna is a leading provider of health, retirement and financial services benefits worldwide and, through its subsidiary, Aetna U.S. Healthcare, it provides health care benefits to over 15 million plan members throughout the United States. Prudential's subsidiary, Prudential Healthcare, provides health care benefits to approximately five million plan members throughout the United States. The complaint alleged that the proposed transaction would have made Aetna the dominant provider of health maintenance organization ("HMO") plans and HMO-based point of service plans in Houston and Dallas, Texas. The combined market shares which would have resulted from the merger in Houston and Dallas were over 63 percent and 42 percent, respectively. We believed this acquisition would give Aetna the ability in those markets to increase price or lower quality of service for its HMO customers. Second, we believed that the merger would lead to market power in the purchase of doctors' services by Aetna. The decree, which requires Aetna, Inc. to divest its NYLCare Health Maintenance Organization (HMO) businesses in Houston and Dallas-Fort Worth, Texas, addresses both of these issues.

Potential Competition

Another interesting set of cases involved potential competition. One case is our on-going challenge of Northwest Airlines Corporation's acquisition of a controlling stake in Continental Airlines, Inc. Northwest and Continental are the nation's fourth and fifth largest airlines, respectively. The complaint alleged violations of section 7 of the Clayton Act and section 1 of the Sherman Act. Under the parties' proposed agreement, Northwest would purchase the controlling shares of Continental from Air Partners, L.P. This stock represents 14% of the outstanding equity of Continental, but carries 51% of the voting rights. If the nation's fourth largest airline acquires voting control of the nation's fifth largest airline, the incentive for the two of them to compete falls drastically. The result is likely to be higher ticket prices and worse service for millions of passengers. Our complaint alleged that while the acquisition would diminish actual competition on many routes, it would also cause harm by reducing potential competition. That is because, for some routes, Continental is the most likely potential entrant or one of only a few to challenge Northwest's nonstop monopoly.

The second case implicating potential competition was our challenge to the Signature/AMR Combs merger. While the case involved direct competition at two airports (Hartford and Palm Springs), at a third airport (Denver Centennial) Signature had a plan to become the operator of a flight support facility in the year 2000, which would have put it in direct competition with Combs. That potential competition would have been lost without the settlement we obtained.

A third case involving potential competition was our May 1998 challenge to Primestar, Inc.'s acquisition of the direct broadcast satellite ("DBS") assets of News Corporation Limited and MCI, which would have allowed five of the largest cable companies in the U.S., which controlled Primestar, to protect their monopolies and keep out new competitors. DBS is a service that uses orbiting satellites to transmit video programming directly to a subscriber's home. The complaint alleged that the proposed \$1.1 billion acquisition would result in a lessening of competition by possible increases in consumer cable rates. The complaint also alleged that the proposed transaction, as originally structured, would have prevented an independent firm from using the assets to compete directly and vigorously with the Primestar' owners' cable systems and would have eliminated the

cable companies' most significant potential competitor, News Corp.'s ASkyB satellite venture. The parties abandoned the transaction in fiscal year 1999, after the filing of the suit and beginning of discovery.

Network Effects

Another issue we continue to be concerned about is network effects. Network effects occur when the value to a customer of a product increases with the number of people using that same product or a complementary product. This was a key concern in our earlier investigation of the merger of MCI and WorldCom. We thought the merged firm would obtain such a dominant position in the Internet backbone market that it would, through network effects, have an incentive to tip the market through inferior or more costly interconnection, resulting in market power. Because entry was not going to constrain a dominant MCI/WorldCom, any remedy had to create a viable competitor that would replace MCI as a principal player in the national Internet backbone market. The only way this was possible was through the divestiture of MCI's entire Internet backbone business. This relief was important to ensure that competition for Internet backbone services is maintained, competition which to date has ensured that innovation flourishes as the Internet grows and changes almost daily. Allowing one player to achieve dominance through acquisition could have had an irreversible impact on this market and could have stifled competition at a critical stage in the development of the industry.

Predation

Finally, in our first predation case in over twenty years, we filed suit against American Airlines on May 18, 1999. The complaint alleged the defendants had monopolized and attempted to monopolize airline passenger service to and from the Dallas/Ft. Worth International airport ("DFW") in violation of Section 2 of the Sherman Act. According to the complaint, American--the

second largest airline in the United States--sought to drive small, start-up airlines out of DFW by adding flights and cutting fares. After driving out, American re-instituted its high fares and reduced its service. Though predation cases are not brought often, we are convinced that, under the facts of this case, we will prevail in court.

Enforcement Actions

Although some people have claimed that, with all this work, we've been too busy to focus on enforcing our past decrees or investigating only the largest violations, let me disabuse you of such notions. The evidence from the past year demonstrates that we continue to be extremely aggressive and vigilant about enforcing our decrees. We filed two contempt cases for decree violations; one against Interstate Bakeries Corporation, and one against Smith International and Schlumberger. The *Smith/Schlumberger* suit is the first criminal antitrust contempt case involving a merger decree in more than 15 years.

As to the nature and types of case we bring, we have also made conscious decisions to seek enforcement actions where there is likely to be significant harm, no matter what the industry or size of market. Our challenge involving Suiza's acquisition of Broughton involving school milk in Lexington, Kentucky, and our billboard advertising cases are good examples.

In addition, I'd like to comment on the fact that lately there has been an increase in the number and nature of misrepresentations made to the Antitrust Division. In particular, there have been instances of attorneys or clients misrepresenting facts when dealing with us, as well as assertions of the attorney/client privilege that are clearly too broad. I just want you--and your clients--to understand that there are consequences for such actions. Reputation and trust are crucial in our business. If we develop a lack of trust in you or your client, that will mean longer and more intensive investigations. For instance, we will insist on taking more depositions or requiring broader document production. A lack of trust could also result in a

more stringent consent decree, such as one where we insist upon the immediate appointment of trustee for divestitures, or a requirement that the divestiture be completed before the consummation of the merger. All of which means that deals will take longer and cost more to get through than they otherwise would.

Conclusion

We continue to be aggressive, but selective, in our enforcement. In addition, we will closely scrutinize all industries, including those that are high tech, and our thinking will continue to evolve as we gain more information and new tools. We are committed to doing whatever it takes to protect the American consumer. Finally, I'd like to leave you with the words of Professor Handler upon receiving The John Sherman Award on May 21, 1998, which I think are very insightful about antitrust enforcement, both as we close out this century and as we enter the next one:

[A]ntitrust is here to stay. It will be applied to the globalized economy of this country as well as the new industries which will flower in the next millennium. That they will add new dimensions to our economy does not mean that they need not comply with antitrust requirements. To paraphrase Scripture, a good doctrine has been given us which we must not forsake. Antitrust is the foundation of our free enterprise system, its philosophy has been adapted by many countries, it has advanced the public interest at home and abroad, and I venture to believe that it will continue to do so in the years ahead.