

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA,

Plaintiff,

v.

HUGHES TOOL COMPANY and
BAKER INTERNATIONAL CORPORATION,

Defendants.

Civil No. 87-0932

Filed: April 3, 1987

COMPETITIVE IMPACT STATEMENT

The United States, pursuant to Section 2(b) of the Antitrust Procedures and Penalties Act ("APPA"), 15 U.S.C. §§ 16(b)-(h), files this Competitive Impact Statement relating to the proposed Final Judgment submitted for entry in this civil antitrust proceeding.

I.

Nature and Purpose of the Proceeding

On April 3, 1987, the United States filed a civil antitrust Complaint under Section 15 of the Clayton Act, 15 U.S.C. § 25, alleging that the proposed merger of Hughes Tool Company ("Hughes") and Baker International Corporation

("Baker") would constitute a violation of Section 7 of the Clayton Act, 15 U.S.C. § 18. The Complaint alleges that the effect of the merger may be substantially to lessen competition in the manufacture for sale in the United States of tricone rock bits, which Hughes manufactures and sells through its Hughes Tool Division and which Baker manufactures and sells through its wholly-owned subsidiary, Reed Tool Company. The Complaint also alleges that the effect of the merger may be substantially to lessen competition in the manufacture for sale in the United States of electric submersible oilwell pumps, which Hughes manufactures and sells through its Centrilift-Hughes Division and which Baker manufactures and sells through Baker Lift Systems, a division of its wholly-owned subsidiary Baker Oil Tools, Inc. The Complaint seeks, among other relief, an injunction preventing defendants from, in any manner, combining their tricone rock bit or electric submersible oilwell pump businesses.

On April 3, 1987 the United States and defendants filed a stipulation by which they consented to the entry of a proposed Final Judgment designed to eliminate the anticompetitive effects of the merger. Under the proposed Final Judgment, as explained more fully below, defendant Baker would be required to sell, within six (6) months, its tricone rock bit and electric submersible oilwell pump businesses. If it did not do so, a trustee appointed by the Court would be empowered to sell Baker's Reed Tool Company subsidiary and its Baker Lift Systems

division. The United States and defendants have stipulated that the proposed Final Judgment may be entered after compliance with the Antitrust Procedures and Penalties Act. Entry of the proposed Final Judgment would terminate the action, except that the Court would retain jurisdiction to construe, modify, or enforce the provisions of the proposed Final Judgment and to punish violations of the proposed Final Judgment.

II.

Events Giving Rise To The Alleged Violations

Hughes and Baker are both large, diversified oil field services companies, providing a variety of the tools and services needed by companies engaged in exploring for and exploiting oil and gas reserves. Hughes' net sales of all products were approximately \$750 million in 1986. Baker's net sales of all products in 1986 were approximately \$1.5 billion. Both Hughes and Baker manufacture and sell, among other things, tricone rock bits and electric submersible oilwell pumps.

On October 22, 1986, Hughes and Baker entered into an agreement and plan of reorganization which provided for the consolidation of the two companies through a series of stock transactions. As a result of the proposed transactions, Hughes and Baker will both become wholly-owned subsidiaries of a newly formed company to be called "Baker Hughes." All outstanding shares of Hughes and Baker common stock will be converted into

Baker Hughes common stock. The combination would, in effect, merge all of the businesses of Hughes and Baker, including their tricone rock bit businesses and their electric submersible oilwell pump businesses. The tricone rock bit and electric submersible oilwell pump markets are described in greater detail below.

A. Tricone Rock Bits

Tricone rock bits are used in drilling virtually all oil and gas wells in the United States. A tricone rock bit consists, in part, of three cone-shaped cutting devices mounted in such a way that they intermesh and rotate together as the bit drills through the geological formations. Tricone rock bits come in many different sizes and configurations, ranging from 4 to 26 inches. The cutting elements on the cones are either steel teeth that are machined as part of the cone, or tungsten carbide inserts that are pressed into holes machined in the cone surface. The cones are mounted on bearings that may be of either the journal or roller type and may be either sealed or unsealed. Tricone rock bits are attached to the end of a "drill string," which consists of thirty or forty-foot sections of heavy-walled pipe assembled end-to-end leading to the drilling rig at the surface.

In the course of drilling an oil or gas well, many different types of geological formations of varying hardness and composition may be encountered. Tricone rock bit manufacturers seek to develop different bits, i.e., bits with

different cutting elements and bearings, to achieve the greatest possible efficiency for drilling each of the different possible geological formations. The major manufacturers of tricone rock bits each offer more than 200 different types and sizes of tricone rock bits.

Oil companies and drilling contractors seek to achieve the lowest "cost-per-foot" when drilling a well. Of the costs used to determine cost-per-foot, the purchase price of the tricone rock bit is a relatively small one. Because securing access to a rig and various other services necessary in the course of drilling a well far exceed the cost of the rock bit itself and because replacing the rock bit can take anywhere from several hours to a full day, tricone rock bit purchasers seek to replace tricone rock bits as infrequently as possible. Accordingly, purchasers select a tricone rock bit based on its durability and reliability, as well as its efficiency in drilling in a particular formation.

There is no reasonable substitute to which a significant number of customers would turn in response to a small but significant and nontransitory price increase in tricone rock bits. The Complaint alleges that the manufacture of tricone rock bits for sale in the United States constitutes a line of commerce and a relevant market (hereinafter "U.S. tricone rock bit market") for antitrust purposes.

Entry into the U.S. tricone rock bit market is difficult and time consuming. To enter the U.S. tricone rock bit market

and gain a significant market share, among other things, a firm must establish a reputation for the efficiency, durability and reliability of its product under actual drilling conditions in a wide variety of different geographic and geological conditions. A firm must also establish and maintain a significant research and development capability, an expert technical service capability, and a sales and service force deployed at locations convenient to drilling sites.

Hughes and Baker are direct competitors in the U.S. tricone rock bit market and are the first and third largest firms in that market. The four largest manufacturers of tricone rock bits account for about 94 percent of total sales in that market. The market is highly concentrated and would become substantially more concentrated as a result of the proposed merger of Hughes and Baker. Based on 1986 sales data, Hughes and Baker have, respectively, about 28 percent and 17 percent of the U.S. tricone rock bit market. The combination of the two firms would create a dominant firm with a market share of 45 percent and would increase the Herfindahl-Hirschmann Index ("HHI"), ^{1/} a measure of market concentration, by about 950 to

^{1/} The Herfindahl-Hirschman Index is a measure of market concentration calculated by squaring the market share of each firm competing in the market and then summing the resulting numbers. For example, for a market consisting of four firms with shares of 30, 30, 20 and 20 percent, the HHI is 2600 (30 squared + 30 squared + 20 squared + 20 squared = 2600). The HHI, which takes into account the relative size and

Footnote Continued

about 3300.

Based upon the foregoing and other facts, the Complaint alleges that the effect of the merger may be substantially to lessen competition in U.S. tricone rock bit market in violation of Section 7 of the Clayton Act.

B. Electric Submersible Oilwell Pumps

Very few oil wells produce enough oil under sufficient pressure to cause the oil to flow to the earth's surface without the aid of some form of man-made pumping device ("artificial lift systems"). Electric submersible oilwell pumps ("ESPs") are one form of artificial lift system used to lift well fluid to the surface. An ESP consists of a multi-stage centrifugal pump connected to an electric motor and encased in a cylindrical steel-alloy casing. ESPs are manufactured in varying sizes according to the depth of the well and volume of fluid for which they are intended. The electric motors are manufactured separately from the pumps themselves so that different combinations of pump sizes and motor sizes can be assembled, depending on the particular

1/ Continued

distribution of the firms in a market, ranges from virtually zero to 10,000. The index approaches zero when a market is occupied by a large number of firms of relatively equal size. The index increases as the number of firms in the market decreases and as the disparity in size between the leading firms and the remaining firms increases.

characteristics and requirements of the well in which the ESP is to be used. Electric motors range from those with a few horsepower to those with 800 horsepower or more. The pumps vary in size according to the barrels per day of fluid they can lift, up to about 20,000 barrels per day or more. Because ESPs may be subjected to severe heat, pressure, and corrosive conditions which typically occur in oil wells, they are precision-crafted to high tolerances and manufactured of special high-grade metal alloys.

Other types of artificial lift systems include rod-and-beam pumps, hydraulic pumps, and gas lift. In choosing among the various artificial lift systems, customers seek to lift well fluid to the surface in the most economically efficient manner possible. The decision as to which artificial lift system will be used is typically dictated by well conditions and performance requirements. These include such factors as depth of the well, fluid volume and properties, geographic location, surface space limitations, and available sources of power. ESPs are the artificial lift systems used for lifting large volumes of well fluid under certain surface and well conditions.

There is no reasonable substitute to which a significant number of customers would turn in response to a small but significant, nontransitory price increase for ESPs. The complaint alleges that the manufacture of ESPs for sale in the United States constitutes a line of commerce and a relevant market (hereinafter "U.S. ESP market") for antitrust purposes.

To enter the U.S. ESP market and gain a significant market share, among other things, a firm must establish a reputation for the efficiency, durability and reliability of its product. A new entrant must acquire a high degree of technological skill and knowledge, design a line of ESPs, and establish production facilities with precision tooling capabilities and high quality assurance programs. A firm must also establish and maintain a significant research and development capability, an expert technical service and consultation capability, a sales and service force deployed at strategic locations capable of providing prompt maintenance and repair service, and a large inventory of ESP component parts.

Hughes and Baker are direct competitors in the U.S. ESP market and are the second and fourth largest firms in that market. The four largest manufacturers of ESPs account for about 97 percent of total sales in that market. The market is highly concentrated and would become substantially more concentrated as a result of the proposed merger between Hughes and Baker. Based on 1986 sales data, Hughes and Baker have, respectively, about 28 percent and 6 percent of the U.S. ESP market. The combination of the two firms would create a firm with a market share of 34 percent and would increase the HHI by about 300 to about 3350.

Based upon the foregoing and other facts, the Complaint alleges that the effect of the proposed merger may be substantially to lessen competition in the U.S. ESP market in violation of Section 7 of the Clayton Act.

III.

Explanation Of The Proposed Final Judgment

The provisions of the proposed Final Judgment are designed to eliminate the anticompetitive effects of the merger in the U.S. tricone rock bit and U.S. ESP markets by establishing new, independent and economically viable competitors in those markets. The proposed Final Judgment requires defendants, within six months of its filing, to divest the tricone rock bit operations of Reed Tool Company with one limited exception described below, and the electric submersible oilwell pump (ESP) operations of Baker Lift Systems. If defendants cannot accomplish these divestitures within the above period, the proposed Final Judgment provides that, upon application by plaintiff, the Court will appoint a trustee to effect divestiture. The trustee will divest all of the product lines and assets of Reed Tool Company and Baker Lift Systems.

As defined in the proposed Final Judgment, the "tricone rock bit operations of Reed Tool Company" means those tangible and intangible assets, rights and other benefits of Reed Tool Company that are necessary for, or predominantly used in, the development, manufacture, financing, or marketing of tricone rock bits in the United States, including all of Reed Tool Company's interest in its facility located in the Republic of Singapore used to produce tricone rock bits. As defined in the proposed Final Judgment, "Reed Tool Company" means all of defendants' interest in and control over Reed Tool Company, a

subsidiary of defendant Baker that produces and sells, domestically and internationally, natural and artificial diamond bits, coring products and services, and stabilizers, in addition to tricone rock bits. Reed Tool Company includes all of the tangible and intangible assets, rights and other benefits of Reed Tool Company and its parent, defendant Baker, that are used in developing, manufacturing, financing and marketing, domestically and internationally, any of the products produced and sold by Reed Tool Company. The Final Judgment provides, however, that, subject to review and approval by plaintiff in its sole discretion, defendants may be deemed to have satisfied their obligation to divest the tricone rock bit operations of Reed Tool Company if they divest certain assets pursuant to a definitive agreement with Camco, Incorporated attached to the proposed Final Judgment. These assets include most of the assets of Reed Tool Company, but include only an eighteen month lease on the Reed Tool Company Singapore facility with an option to purchase.

As defined in the proposed Final Judgment, the "ESP operations of Baker Lift Systems" means those tangible and intangible assets, rights and other benefits necessary for, or predominantly used in, the development, manufacture, financing or marketing of electric submersible oilwell pumps in the United States by Baker Lift Systems. As defined in the proposed Final Judgment, "Baker Lift Systems" means all of defendants' interest in and control over Baker Lift Systems, an

entity of Baker that produces and sells, domestically and internationally, single stage high pressure surface pumps, and rod pump controllers in addition to ESPs. Baker Lift Systems includes all of the tangible and intangible assets, rights and other benefits of Baker Lift Systems and its parent, defendant Baker, which are used in developing, manufacturing, financing and marketing, domestically and internationally, any of the products produced and sold by Baker Lift Systems.

Defendants are allowed six months following the filing of the proposed Final Judgment to accomplish divestiture of the tricone rock bit operations of Reed Tool Company and the ESP operations of Baker Lift Systems to companies that will operate them as independent, viable competitors. If defendants have not accomplished the required divestitures within that period, plaintiff at its discretion may extend this time period an additional three months, if defendants demonstrate to plaintiff's satisfaction that they are then engaged in negotiations that are likely to result in the required divestitures.

The proposed Final Judgment provides that the tricone rock bit operations of Reed Tool Company and the ESP operations of Baker Lift Systems must be divested in such a way as to satisfy plaintiff that these operations can and will be operated by the purchaser or purchasers as viable, ongoing businesses that can compete effectively in the relevant markets. Similarly, if the divestitures are accomplished by the trustee, Reed Tool Company

and Baker Lift Systems must be divested in such a way as to satisfy plaintiff that these businesses can and will be operated as viable, independent competitors by the purchaser or purchasers. Defendants must take all reasonable steps necessary to accomplish the divestitures and shall cooperate with bona fide prospective purchasers and, if one is appointed, the trustee.

If a trustee is appointed, the proposed Final Judgment provides that the defendants will pay all costs and expenses of the trustee. The trustee's commission will be structured so as to provide an incentive for the trustee based on the price obtained and the speed with which divestiture is accomplished. After its appointment becomes effective, the trustee will file monthly reports with the parties and the Court setting forth the trustee's efforts to accomplish divestiture. At six month intervals, commencing six months after the trustee's appointment and continuing until the trustee has accomplished the divestitures, the trustee and the parties will make recommendations to the Court and the Court shall thereafter enter such orders as it shall deem appropriate in order to carry out the purpose of the trust, including extending the trust or the term of the trustee's appointment.

The proposed Final Judgment provides that, upon completion of the divestitures, defendants may enter into a licensing agreement to continue to use the name "Reed" for a period of eighteen months in connection with the manufacture and sale of

mining equipment by Reed Mining Tools, Inc. and tool joints by Baker Tubular Services, Inc. Also, defendants may enter into a licensing agreement to use the name "Reed" for a period of twelve months following divestiture, in connection with the manufacture and sale outside the United States of Reed Tool Company products by Kobe Argentina, S.A., a subsidiary of Baker that sells tricone rock bits, which is not being divested. If divestiture is accomplished by the sale of less than all of Reed Tool Company, the proposed Final Judgment provides that defendants may enter into a licensing agreement to use the name "Reed" for a period of twelve months in connection with the manufacture and sale of Reed Tool Company products outside the United States and for a period of six months in connection with the retained businesses of Reed Tool Company inside the United States. Other than as described above, defendants may no longer use the name "Reed".

The proposed Final Judgment provides that, notwithstanding the divestiture of the ESP operations of Baker Lift Systems or Baker Lift Systems, defendants shall retain whatever rights they have to use the name "Baker Lift." For a period of eighteen months following the date of divestiture, however, the defendants shall grant a purchaser of the ESP operations of Baker Lift Systems an exclusive license to use the name "Baker Lift" in connection with the manufacture, sale and servicing of the products produced and sold by the business divested. The proposed Final Judgment also provides that for a period of ten

years following the date of entry of the Final Judgment, defendants shall not, under the name "Baker Lift," sell or service electric submersible oilwell pumps in the United States.

By the terms of a Hold Separate Stipulation of the Parties and Order Thereon, incorporated by reference into the proposed Final Judgment, defendants must take certain steps to ensure that, until the required divestitures have been accomplished, Reed Tool Company and Baker Lift Systems will be held separate and apart from defendants' other assets and businesses. Defendants must, until the required divestitures are accomplished, preserve and maintain Reed Tool Company and Baker Lift Systems as saleable and economically viable ongoing businesses.

IV.

Remedies Available to Potential Private Litigants

Section 4 of the Clayton Act (15 U.S.C. § 15) provides that any person who has been injured as a result of conduct prohibited by the antitrust laws may bring suit in federal court to recover three times the damages the person has suffered, as well as costs and reasonable attorneys' fees. Entry of the proposed Final Judgment will neither impair nor assist the bringing of any private antitrust damage action. Under the provisions of Section 5(a) of the Clayton Act (15 U.S.C. § 16(a)), the proposed Final Judgment has no prima facie

effect in any subsequent private lawsuit that may be brought against defendants.

V.

Procedure Available for Modification
of the Proposed Final Judgment

The United States and defendants have stipulated that the proposed Final Judgment may be entered by the Court after compliance with the provisions of the Antitrust Procedures and Penalties Act, provided that the United States has not withdrawn its consent. The Act conditions entry upon the Court's determination that the proposed Final Judgment is in the public interest.

The Act provides a period of at least 60 days preceding the effective date of the proposed Final Judgment within which any person may submit to the United States written comments regarding the proposed Final Judgment. Any person who wishes to comment should do so within sixty (60) days of the date of publication of this Competitive Impact Statement in the Federal Register. The United States will evaluate the comments, determine whether it should withdraw its consent, and respond to the comments. The comments and the response of the United States will be filed with the Court and published in the Federal Register.

Written comments should be submitted to:

James R. Weiss,
Chief, Transportation, Energy
and Agriculture Section
Antitrust Division
United States Department of Justice
Room 9403
Judiciary Center Building
555 4th Street, N.W.
Washington, D.C. 20001

VI.

Alternatives to the Proposed Final Judgment

The proposed final judgment not only relates to the tricone rock bit assets of Reed Tool Company that are located in the United States, but also to its facilities in Singapore. The Singapore plant is highly efficient and produces, at a comparatively low cost tricone rock bits for sale in the United States. The United States concluded that inclusion of the Singapore plant in the divestiture of tricone rock bit assets likely was crucial to assuring that the divestiture produced a viable and effective competitor in the U.S. tricone rock bit market. As a result, the proposed final judgment obligates defendants, with one possible exception, to divest the Singapore plant. The sole exception relates to the possible sale of the tricone rock bit assets to Camco, Incorporated ("Camco").

The United States considered, as an alternative to the proposed final judgment, eliminating this one possible exception, but decided against it. Prior to entry of the final judgment, Baker had entered into negotiations with Camco

concerning Camco's possible purchase of the tricone rock bit assets of Reed Tool Company from Baker. Camco was offered a package of assets that included the Singapore plant. Camco was not certain, however, that it needed the Singapore plant, in part because it has other efficient foreign facilities. Consequently, Camco requested a lease for the Singapore plant with an option to purchase it, rather than on an immediate acquisition, in order to have additional time to determine if it needed the facility. Ultimately, Baker signed a definitive agreement (attached to the proposed final judgment) to sell Camco the tricone rock bit assets of the Reed Tool Company, which included an eighteen (18) month lease on the Singapore plant, property and equipment with an option to purchase the Singapore plant at a fixed price for a twelve month period. During the last six (6) months of the lease, defendants would be able to offer the plant to alternate purchasers, subject to Camco's right of first refusal. Even if Camco does not ultimately purchase the Singapore plant, under its agreement with Baker, Camco will retain all of the tools, dies and drawings related to tricone rock bits manufactured in that plant.

The United States concluded that it was reasonably possible that a divestiture to Camco under the definitive agreement would produce a viable competitor. The lease of the Singapore plant to Camco for a significant period of time would provide Camco an opportunity to evaluate its particular need for the

Singapore facility. Moreover, because negotiations between Baker and Camco were essentially complete, the proposed divestiture to Camco would have the benefit of quickly putting the assets in the hands of a new, independent competitor. In this context, the United States decided to include an exception that at least potentially would permit divestiture to Camco. Significantly, however, the exception does not automatically authorize the divestiture to Camco. Instead, the United States retains the absolute right to disapprove a sale to Camco. The United States will conduct an investigation and will approve the sale only if it concludes that Camco would be a viable competitor. In the event that the sale to Camco is not approved, defendants must proceed with divestiture to another entity and must include in the divested assets all interests in the Singapore plant.

Another alternative to the proposed final judgment that the United States considered related to the provision authorizing defendants to divest the alternative package of assets within six months. The United States considered permitting the defendants only three months to divest the tricone rock bit operations of Reed Tool Company and the ESP operations of Baker Lift Systems. If those divestitures were not accomplished within three months, defendants would have been obligated to divest Reed Tool Company and Baker Lift Systems within the succeeding three months. Ultimately, the United States concluded that allowing defendants the full six months to

divest either package of assets would not in any way compromise the ultimate aim of creating a new viable competitor.

In formulating relief the United States also considered proposal made by Smith International, Inc. ("Smith"), one of defendants' principal competitors in the U.S. tricone rock bit market. Smith proposed that the United States require defendants to delay their merger pending resolution of defendant Hughes' claim as a judgment creditor in the Chapter 11 reorganization proceeding in which Smith is currently involved, or, at the very minimum, until the relief proposed in the proposed Final Judgment is approved by the Court. Smith contended that Hughes had engaged in a series of anticompetitive actions during the reorganization proceeding ^{2/} and that the relief it proposed was necessary to preserve Smith as a significant competitor in the tricone rock bit industry.

The United States rejected Smith's proposals because it concluded that there was not a sufficient nexus between the

^{2/} Prior to the proposed merger, Defendant Hughes obtained a judgment against Smith for \$205 million for Smith's alleged infringement of Hughes' O-Ring seal patent used in tricone rock bits. As a result of Hughes' judgment against it, Smith entered Chapter 11 reorganization proceedings, in which Hughes participates as an unsecured judgment creditor. Smith maintained that the conduct of Hughes in the Chapter 11 proceeding and other various practices were designed to liquidate Smith or otherwise eliminate it as a competitor in the tricone rock bit market. These included baseless or overly litigious conduct toward Smith within the context of the reorganization proceeding and predatory discounting targeted at Smith in the tricone rock bit market.

relief sought by Smith and the anticompetitive effects that formed the basis of our challenge to the merger. The allegations of the Complaint are based solely on the likely competitive effects of the proposed merger between Baker and Hughes. The United States concluded that it was appropriate to seek only that relief which is necessary to address the competitive problems upon which the complaint is based. Because the relief in the proposed Final Judgment will restore the status quo ante in the U.S. tricone rock bit industry by creating a new, independent and economically viable competitor in that market, the United States determined that, with respect to the subject matter of the action pending before the Court, no further relief is required. 3/

Litigation is, of course, always an alternative to a consent decree in a Section 7 case. The United States is satisfied, however, that the proposed Final Judgment provides substantially all the relief requested by the United States in its complaint and that the United States could have no better relief had it litigated the case in a full trial on the merits.

3/ To the extent that Hughes' alleged conduct would constitute a separate violation of the antitrust laws, the proposed Final Judgment prevents neither Smith nor, if appropriate, the United States from instituting further legal proceedings.

VII.

Determinative Documents

The United States considered determinative in formulating this proposed Final Judgment the proposed agreement between Baker and Camco summarized above and attached to the proposed Final Judgment. There are no other determinative materials or documents.

Respectfully submitted,


Donald A. Kaplan


Patricia G. Chick


Donna N. Kooperstein


Philip J. Thompson

Attorneys
U. S. Department of Justice
Antitrust Division
Judiciary Center Building
Room 9822
555 Fourth Street, N. W.
Washington, D. C. 20001
(202) 724-6464

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