Department of Justice

MERGER ENFORCEMENT POLICY: PROTECTING THE CONSUMER

REMARKS OF

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I appreciate the opportunity to share with you the perspective of the Department of Justice on merger enforcement.

Introduction

Apparently, some observers have misinterpreted the emphasis I place on criminal enforcement -- and there is no question that is my number one priority -- as implying a lesser commitment to merger enforcement. They are simply wrong. It is true that current merger analysis employed by the courts and enforcers has changed significantly over the last twenty years. Today's merger analysis is more sensitive to the economic benefits of mergers and to the various factors that determine whether a merger truly threatens competition. Nonetheless, that analysis also serves to identify those mergers that are anticompetitive and that therefore violate the law.

I may never convince all the skeptics that the analysis we employ is entirely correct. No one should doubt, however, that whenever that analysis indicates that a merger is, in fact, anticompetitive, we will try to stop it -- or at least to ensure that its anticompetitive aspects are eliminated.

In the five-month period during late 1986 and early 1987, for example, the Antitrust Division challenged five transactions. 1/ As a result of our opposition, the parties abandoned two of the deals and agreed to divestitures in the remaining three. Although you would never know it if you relied on the press for information, just this week we announced that the Division will challenge a merger between the number one and number two billboard advertising companies in the Atlanta area. 2/

I intend to ensure that the Division continues to have sufficient resources to carry out its responsibilities under the Hart-Scott-Rodino Act. This is particularly important as the courts -- correctly, in my opinion -- have restricted the classes of private parties that have standing to challenge mergers. The public has a right to be confident that federal antitrust enforcers are protecting consumers from anticompetitive mergers.

Today, I would like to discuss our merger enforcement policy in general -- to explain the goals it should seek to achieve, and those it should not. Next, I would like to discuss two specific issues that recur in our analysis of

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1/ United States v. Mac Andrews, and Forbes Group. et al., Civ. No. 86-8055 JMI (C.D. Ca., filed Dec. 10, 1986); United States v. Rheem Manufacturing, Civ. No. G87-40CA1 (W.D. Mich., filed Jan. 16, 1987); United States v. Domtar, Inc., Civ. No. C87-0689 RFP (N.D. Ca., filed Feb. 25, 1987); United States v. Hughes Tool, Company and Baker Int'l Corp., Civ. No. 87-0932 (D.D.C., filed April 3, 1987); United States v. Dow Chemical, Civ. No. 87-C-4280 (N.D. Il., filed May 11, 1987).

2/ Turner Outdoor Advertising, Ltd./Patrick Media Group of Atlanta, Inc.

mergers -- ease of entry and our "fix-it first" policy. Finally, I will provide some suggestions as to how best to represent merging parties before the Division.

Focus on Consumer Welfare and Efficiency

It is obvious to anyone who is familiar with developments in the enforcement and interpretation of Section 7 of the Clayton Act that the law has changed dramatically during the last twenty years. I do not intend to recount that history today, but I do want to describe and defend the one factor that is chiefly responsible for the change.

More than for any other reason, merger analysis has undergone dramatic change as the result of the near consensus among the courts and academia that the only defensible standard for a merger enforcement policy is consumer welfare. Despite the complaints of critics on the fringe, it is today well established that the only ill addressed by Section 7 is power over price. The courts today are guided by the goal of consumer welfare because they realize that it is the only guideline that allows them to achieve consistent results. Other legitimate societal concerns are best addressed by legislative bodies, not by the Antitrust Division, and not by the courts in applying the antitrust laws.

NAAG "Alternative" Merger Guidelines

Of course, critics who are on the fringe or who really have little experience with or understanding of Section 7 have chastized us for focusing exclusively on economic effects and for not evaluating the social and political effects of mergers. Indeed, almost one-third of the so-called alternative merger guidelines of the National Association of Attorneys General (NAAG) are devoted to such criticism. However, the remaining two-thirds of those guidelines serve to illustrate the pointlessness of this criticism -- it is practically impossible to develop an analytical framework explicitly incorporating social and political objectives. In fact, the NAAG's alternative guidelines start out by adopting the general analysis of the Department's Merger Guidelines, and then make what appear to be random, unjustified changes to that analysis. Nowhere do the NAAG's guidelines explain what social and political objectives these changes advance, or how those changes advance those goals. While such an explanation is probably impossible, the danger when enforcement agencies use Section 7 to address unspecified social and political values is clear.

It has been suggested that some state attorneys general view merger enforcement as a tool that can be manipulated to promote the parochial economic interests of their states at the expense of national economic welfare. The suggestion is that threatened enforcement can be used to obstruct mergers that may affect some narrow special interest in the state without regard to the benefits, such as increased efficiency, lower unemployment and lower prices, that the rest of the nation loses when the merger is blocked.

No one is a more ardent federalist than I am, but such state protectionism would clearly be an affront to our Constitution, under which states have ceded part of their sovereignty to ensure a national common market. Whether or not NAAG's Guidelines are used foolishly to promote parochial concerns, the threat inherent in those guidelines illustrates that the incantation of "social and political values" can conceivably be used to pervert antitrust analysis to achieve ends -- such as the economic balkanization of the United States -- that are clearly at odds with the laws themselves.

<u>The Consequences of an Economic Focus</u>

Contrary to the claims of critics, changes in merger analysis have not harmed the economy nor society as a whole. It is true there have been more mergers during the last several years than during the 1970s. However, it is clear that changes in the antitrust laws are not what has motivated these mergers; rather, they have been motivated by, among other things, technological changes, changes in the tax law, and changes in exchange rates.

While antitrust enforcement has not prompted mergers, reform has lowered the cost of at least some mergers. The Justice Department's 1982 Merger Guidelines, which spelled out our analysis of mergers, and the subsequent revision of the Guidelines in 1984, have greatly clarified our merger enforcement policy. Now, business people can determine with much greater certainty when a merger will or will not likely violate the antitrust laws. Businesses can merge or acquire assets in response to changes in the marketplace in a way that steers clear of harm to consumers, and so of government interference.

The cumulative effect of the change in merger enforcement is both a more dynamic economy and domestic industries that have a fighting chance in a competitive world economy. American consumers -- as well as workers and stockholders -- are better off as a result.

Not surprisingly, our critics are reduced to attacking our enforcement policy generally and by innuendo. I challenge those critics to point to one merger that we cleared that subsequently has resulted in higher prices to consumers.

And do not point to airline mergers. The Justice Department opposed, among other deals involving airlines, the mergers of Northwest-Republic and TWA-Ozark. We argued to the Department of Transportation that the elimination of competition at "hub" cities, such as Minneapolis and St. Louis, would result in higher fares on some routes to and from those hubs. DOT disagreed, and allowed the mergers to proceed in the belief that airline markets are contestable -- that is, that they are subject to "hit and run" entry by airlines not currently serving the markets.

Now it appears DOT may recognize that not all airline markets are contestable. Nevertheless, any problem of higher fares and poorer service on some routes did not result from a failure by the Justice Department to oppose those mergers. The real problem is Congress' failure to change the law to treat airline mergers like mergers in any other industry. If the law had been changed in 1984 to make Section 7 of the Clayton Act applicable to airlines, I believe the airline industry would be different from, and more competitive than, it is today.

Airlines aside, I simply do not believe that the critics, if forced to back up their demogoguery with fact, can point to a single merger that passed muster under the current enforcement policy but that, nonetheless, increased prices to consumers.

Nor have social and political values suffered from the current, more sensible antitrust approach to mergers. By focusing on consumer welfare, current merger policy implicitly promotes the social and political values upon which our nation was built. The dynamic economy promoted by current merger policy poses the greatest possible threat to economically entrenched special interests. Moreover, such an economy is the greatest ally of small business, the inventor-innovator and the economically disadvantaged.

The evidence also belies the charge that current enforcement policy has led to the aggregation of corporate wealth that critics claim threatens to undermine our social and political institutions. The facts are that:

- More than one-third of recent mergers and acquisitions have involved divestitures that reduced aggregate economic concentration.

- The percentage of assets held by the top 100 and top 200 U.S. corporations remains below 1970 levels, and has been relatively stable over the last seven years.
- At the same time, the percentage of the nation's employment accounted for by the country's top 100 and top 200 corporations has been declining.
- According to a January 21, 1987 Wall Street Journal article, the number of U.S. corporations had grown to nearly three million in 1983 (the latest year for which data is available), an increase of 80 percent since 1970. Nearly all of that increase was attributable to firms with sales of less than $1 million.

And these statistics ignore the dramatically increased presence of foreign competitors in U.S. markets during the last ten years. In short, the facts simply do not support the critics' attacks on our merger enforcement policy.

<u>Excessive Regulation of Takeovers</u>

Perhaps sensing the weakness of their case on antitrust grounds, some critics have thrown in their lots with those trying to impede mergers and acquisitions by increasing federal securities regulation of takeovers. But the goal of anyone who is truly concerned about consumers and shareholders should be to reduce costly regulation of the market for corporate control, not to increase it.

The interest of incumbent management in increasing the cost of takeovers is clear and, while unappealing, certainly understandable. Corporate management seeks protection from competition and from having to account for the failure to manage efficiently their company's assets.

But the interest of so-called consumerists in increasing takeover costs is less clear. Increasing the cost of takeovers harms shareholders: One survey has concluded that target company shareholders in successful tender offer acquisitions gain, on average, a premium of approximately 30 percent over the pre-offer market share price. Shareholders of bidding firms experience increases in their share value of about three or four percent. 3/ Virtually everyone in this country is a shareholder, if not directly, then indirectly, through participation in a pension fund.

Moreover, takeovers generally increase the competitive vigor of the targets. As a recent article in the Wall Street Journal put it: "Liquidity and mobility are the

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3/ Jensen & Ruback, The Market for Corporate Control: The Scientific Evidence, 11 J. Fin. Econ. 5, 7 (1983).

modern advantages; massive amounts of sedentary capital tend to rust and rot." 4/

Finally, hostile takeovers are least likely to result in higher prices to consumers. If a takeover promises to create market power, then managers can be bought off (or allowed to keep their jobs), and the acquiror can still profit from the monopoly price increases.

Selected Issues in Merger Enforcement

Having talked at length on merger enforcement in general, I should now provide you with some information that you can actually use. While the Department's Merger Guidelines are generally well understood, some elaboration may be helpful in two areas -- ease of entry and our "fix-it first" policy.

Ease of Entry

How we evaluate ease of entry has been perhaps the most persistently misunderstood aspect of our merger analysis. Specifically, let me correct two misperceptions: First, the Merger Guidelines' consideration of entry does not begin and end with a search for so-called Stiglerian "barriers to entry;" Second, the answer to whether entry is easy must be based on facts, not on an economist's or a lawyer's unsubstantiated theory that entry should be possible.

4/ Dale Jahr, "Corporate Wealth: More for the Little Guys," Wall Street Journal (Jan. 21, 1987).

Entry is not a "yes" or "no" proposition. Entry conditions can range from "extremely easy" to "extremely difficult." It is rarely, if ever, the case that entry is impossible; it is perhaps only slightly more frequent that a market is truly contestable.

For competition purposes, the <u>time</u> it takes to enter effectively is at least as important as the <u>fact</u> that entry can occur. As I am fond of saying, given enough time, market forces will overcome even the strongest cartel -- if you doubt me, you need look only as far as OPEC. On the other hand, the costs to the world's economy have been enormous during the time it has taken to erode OPEC's power. The Merger Guidelines, of course, take the position that if entry will not occur within two years, then it can not be relied on to eliminate the threat posed by an otherwise anticompetitive merger.

Nor is "ease of entry" a talismanic incantation to bless otherwise anticompetitive mergers, without regard to the facts. The Department will assess entry on a case-by-case basis, utilizing the best evidence available to us. We will examine, among other things, the perceptions of the most likely entrants, the cost of entry relative to likely annual revenues, previous attempts to enter the market, ease of exit, the importance of the reputation of incumbent firms, and the strategies used by incumbent firms to deter entry.

It is important that you supply us with evidence to support your entry contentions. It does no good to come in and tell us that "anybody" could enter the relevant market within two years if we have been told by the alleged prospective entrants themselves that entry is unlikely, or if the only recent history of new entry is of failed entry. In some cases, "anecdotal" evidence may weigh far greater than the hypotheses of lawyers and economists not in the business.

Moreover, the mere fact that some entry has occurred in the past, or that some aspects of a business are easily replicated, does not by itself indicate that entry is easy within the meaning of the Guidelines. A merger we would otherwise challenge will pass muster on ease of entry grounds only if entry would occur sufficiently quickly, and be of sufficient magnitude, to prevent the post-merger exercise of market power.

"Fix-It First" Policy

Often, only a part -- perhaps a small part -- of a proposed transaction is troublesome. The Division will not block an entire transaction where only a portion raises competitive concerns if those concerns can be cured -- say through an asset spin-off. This is known as our "fix-it first" policy.

Generally, we will require a competitive problem to be fixed before a merger is consummated. But where it would be impossible to meet this requirement, we may agree to allow the merger to close if the parties enter into a binding consent decree requiring them to cure the problem within a specified period -- generally six months or less -- after the merger closes. If a sale has not been made at the end of that time, the assets go to a government-appointed trustee who will sell the assets at the best available price.

We require the assets to be held separate during the "shop" for a buyer. This can be a very complicated or a relatively simple requirement for the parties, depending on whether the "fix" involves a single plant, a product line or an entire division. The goal is to preserve the competitive viability of the assets.

During the initial shop period, the buyer must be approved by the Department. We will only approve a buyer that we believe will be an effective competitor. It obviously is not a cure if a proposed buyer could not offer effective competition to the merged company. Once assets move to the control of a trustee, a buyer will have to be approved either by us or by the court.

When there is a dispute as to which or how many assets must be spun off to help establish "replacement" competition, we let the market be our judge. For example, we may give the parties a period of time to sell off a single plant of a division. But if a suitable buyer is not found within that time, then the entire division would have to be sold.

We have been tough in demanding a real solution to competitive problems. In some cases, where a suitable solution could not be found, or was not palatable to the parties, deals have collapsed. I don't like to see that, but once we are convinced that a proposed transaction poses a substantial threat of harm to consumers, I have no choice.

Obviously, a curative divestiture may effect the price of your deal, or even whether you have a deal at all. The moral is: If you think your transaction raises antitrust concerns, consider restructuring the deal to cure the problem before you come to the Justice Department.

Appearing Before the Department

Let me turn now from a general analysis of the Guidelines to a few practical suggestions as to how you, as counsel for merging parties, can best present your case when you do come to the Department.

The Antitrust Division's process is designed to ensure the fairest, most accurate evaluation of a merger. Lawyers who treat the Division as nothing more than a way station on the road to litigation do a disservice to their clients. They are foregoing an opportunity to save their clients' time and money.

Our job is not to bring cases, even ones we can win by clever lawyering. Rather, our job is to stop only those mergers, or portions of mergers, that we conclude threaten to harm consumer welfare.

If a merger does not threaten consumer welfare but we nevertheless seek to stop it, then we have disserved the public

-- both by denying society the benefits of the merger and by forcing the parties, the courts and the government to endure the cost and inconvenience of litigation. If the Department concludes after thorough analysis that a merger does threaten consumer welfare, we will challenge it <u>even if</u> we run the risk of losing in court. I do not believe your clients can find a fairer, sounder approach to analyzing their merger.

<u>Cooperation</u>

The three most important suggestions I can make with respect to representing before the Division parties to a merger are cooperate, cooperate, and cooperate. First, cooperate with the staff as soon as you make your Hart-Scott-Rodino filing -- or even before. If you are totally candid about the competitive issues raised by your merger, and you address those issues directly and immediately, you often can avoid a second request. After all, we will identify the relevant issues eventually -- either as a result of your candor, or after a costly, time-consuming second request.

Second, cooperate with the staff in responding to second request letters. It is, of course, inevitable that in some cases, no matter how much you cooperate initially, we will need to send out a second request. As many of you know, our requests have increased in length and complexity over the years, and some of you may feel they are overly burdensome. I am aware of that concern, and we are reevaluating our standard requests to ensure that they create no more burden than is necessary to obtain the needed information.

In the meantime (and even after we revise the format, if we do), all second requests and CIDs invite counsel to negotiate production. If production of some material is burdensome, and you really believe it is unnecessary, tell the staff. Again, cooperating with the staff to help them answer their questions can relieve your client's burden.

Third, cooperate with the staff as they are reaching their conclusions. Remember, the vast majority of merger investigations are closed by the staff, not me. If you think you can withhold your strongest arguments until you get to the Operations Office, the Deputy, or me, think again. Your chances of success before the Division decline dramatically as each successive level of review recommends a case.

<u>Just the Facts</u>

When making presentations to the staff or to the front office, focus on the facts. Of course, you will want to put them in the context of some competitive model. Nevertheless, the most unpersuasive presentations involve outside lawyers and economists who spend their time lecturing Division officials on theory. It is almost invariably true that by the time a case gets to my desk, someone in the Division has articulated and analyzed every theoretical argument you can think of, and then some. At that point, we must determine which theory the <u>facts</u> best fit. You have the best access to the facts, and your best hope for success lies with favorable facts, not with your ability to confect novel theories.

Business Officials

Good lawyers and good economists, of course, can make a difference for the prospects of a merger under investigation. Ultimately, though, the most persuasive aspect of a presentation generally is provided not by lawyers or economists, but by those who know the business on the basis of their personal experience. They are almost always your greatest resource because they know the facts -- and, again, fact is more important than theory.

Plan Ahead, but Be Responsive

When making a presentation to the Division, plan ahead and deal with the points upon which the staff has focused. During the presentation, listen to the questions and deal with them, because that is likely to be where the decision will turn.

One More Time, Cooperate

Finally, cooperate throughout the process. If the staff gets the impression you are in a litigation mode, they are likely to shift to a litigation mode. The result is a more contentious investigation with reduced chances for an expeditious conclusion.

If the Division asks for additional time, try to accommodate us. I have never -- repeat never -- asked for more time simply to gain a litigation advantage, and I never will. On the other hand, we tend to view a refusal to grant a reasonable request for a limited extension of time as a lack of confidence in the merits of your client's case.

These suggestions are not exclusive; there are others, such as to read the Department's Merger Guidelines carefully (you would be surprised how often lawyers display a lack of familiarity with them). However, the preceding are the most important.

Let me state for the record that we in the Division also recognize that we have an obligation to cooperate with you. In the final analysis, we realize that we possess a great deal of power -- power that can be abused. We try to live by the highest standards to ensure that we exercise that power responsibly. We are human, and we sometimes fall short. But bear with us, we'll keep trying.

Thank you for your patience. In the time remaining I will answer some questions.