Department of Justice

CURRENT ANTITRUST ENFORCEMENT POLICY
AND THE REVISED MERGER GUIDELINES

Remarks by

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You all know the song: "Nobody loves you when you're old and grey." Our two basic antitrust laws are 94 and 70 years old, and some days when I pick up the newspaper I have to wonder whether nobody loves them any more.

A recent _Times_ op-ed piece urged that we should replace our archaic antitrust laws with industrial planning groups. The author agreed that permitting very large mergers would reduce competition but, he argued, "that is precisely why they are needed."

In an earlier _Times_ piece Lester Thurow of MIT complained that the techniques of the 19th Century are not applicable to the 21st and that we cannot afford a legal system that cripples our industrial future.

More recently, another _Times_ op-ed piece by Stuart Eizenstat urged that we simultaneously relax antitrust enforcement and adopt broader government coordination of industrial planning.

Many share the concern of those three authors that the world has changed so radically and the challenges faced by our industries are now so severe that we must take a whole new approach to competition. Indeed, the world has changed radically. For years, American firms dominated foreign markets, and this country had a strong surplus in the trade balance. That surplus has been reversed. Last year, we showed a $38 billion deficit--a deficit that is predicted to grow much larger this year. Twenty years ago about 25 percent of U.S. manufactured goods faced import competition. Today 70 percent do. The surge of high technology imports has been especially great, with enormous increases in such products as electrical and medical instruments, biological products, and computers.

Recent experience may be distorted somewhat by the unusually inflated value of the dollar, but no anticipated adjustment in the dollar's relationship to other currencies will change these facts:

-- American companies face unprecedented and growing competition from foreign firms, and each year American firms dominate fewer and fewer industries.

-- We cannot win the battle for international markets by hiding behind trade barriers; protectionism is self-defeating.

-- And, finally, success or failure in world markets increasingly will turn on the ability to develop high technology products and processes.

These developments do require a probing, thoughtful assessment of all our economic institutions. But such an assessment leads me to the following observations. The challenge to American market dominance has not happened because our economy has declined, but because others' have grown stronger. Our economy is still by far the most productive and most innovative in the world. Our economy became strong and stayed strong because, for the most part, we have allowed free market forces to operate. This free market approach allows our economy to be driven by an enormous diversity of decision makers, permits the most efficient allocation of resources, and results in constant innovation in products, processes, services, and methods of distribution.

The antitrust laws are based on this free market concept and, properly applied, are the antithesis of governmental regulation. Unfortunately, in the past, antitrust enforcers and the courts have ignored these central tenets of antitrust law and have followed rules that:

-- discourage mergers among large firms, particularly vertical mergers and those among non-competing firms, without regard to actual competitive impact;

-- unnecessarily deter joint ventures, especially in the area of joint research and development;

-- limit the ability of patent holders to exploit their technology on the basis of a mistaken assumption that there is a conflict between the patent laws and the antitrust laws; and

-- disallow many kinds of distribution arrangements, even when they are economically efficient.

There is today a broad concensus that we can no longer afford such economically harmful antitrust policy. As Jim Miller, Chairman of the FTC, recently put it: "The rules of antitrust laws as they have developed were undermined by observation of how the world works." What we must do today is create a legal climate that is conducive to aggressive competition and innovation.

To build on the inherent strength of American industry, antitrust enforcers and the courts should operate under one basic premise: antitrust enforcement should not interefere with business decisions at all unless careful economic analysis indicates that the business practice in question can distort market forces and result in the creation or misuse of market power--that is, the power to restrict output and raise prices.

Given that premise, we should act affirmatively to ensure that antitrust and related laws work to encourage competition rather than hinder it. My purpose today is to highlight the Reagan Administration's efforts toward this goal in the area of mergers, research and development, joint ventures, export trade, patent policy, and vertical arrangements.

One of the most important factors affecting the worldwide competitiveness of American industries is the Justice Department's merger enforcement policy. That policy is articulated in the Department's Merger Guidelines, which attempt to reduce the uncertainty associated with merger enforcement by explaining as simply and clearly as possible the circumstances under which the Department is likely to challenge a merger. The current Guidelines, which were issued in 1982, incorporated the most recent legal and economic learning in the area. They are based on the premises that the free movement of assets--a free merger market, if you will--is critical to a healthy, growing economy, and that most mergers do not threaten competition. Mergers facilitate the efficient movement of assets through the economy to their most highly valued uses. Moreover, mergers often may be the most efficient means for American industries to undertake the restructuring that is necessary to compete effectively with foreign firms. Accordingly, the Guidelines provide for a flexible approach that proscribes only those mergers that, on the basis of sound economic and legal analysis, present a clear threat to competition.

As you may be aware, the Department will soon release revisions to its Merger Guidelines. Generally, the revisions are intended to convey the message that the Guidelines are not a set of rigid mathematical formulas that ignore market realities and rely on a static view of the marketplace. To that end, the revisions clarify that the Herfindahl-Hirschman Index ("HHI") thresholds in the Guidelines are not bright-line tests. Although the Guidelines do provide "safe harbors"--that is, levels of concentration resulting from mergers that the Department is not likely to challenge--the Department will consider all of the relevant circumstances, not just concentration and market share data, before deciding to challenge a merger.

Among the additional factors that the Department will consider are factors that suggest that current market share data either understate or overstate the competitive significance of a firm. For example, the fact that a company does not possess important new technology may indicate that it is likely to be a less significant competitor in the future than its historic market share otherwise would indicate. Similarly, a firm that is in poor financial condition may not be able to attract sufficient capital to make investments that are necessary to maintain its facilities or to adopt a new technology that is necessary to maintain its market position. In such a cases, the current market share of the firm may actually decline in the future. These factors, among others, must be considered by the Department in determining whether to challenge a merger.

The revisions also will clarify how the Department treats foreign competition in merger analysis. One of the most important changes in the economy with which merger analysis must deal is the increasing significance of foreign competition in the U.S. marketplace. Although the 1982 Guidelines recognize the importance of foreign competition, they give no real guidance as to how the Department will treat imports and foreign capacity in specific circumstances, especially where imports are subject to quotas and other types of trade restraints. The revisions explain that, generally, the Department will include existing imports in defining markets and calculating the Herfindahl Indices and will consider the effects of such trade restraints as a separate factor in interpreting the significance of market concentration and market share data. Of course, there are other factors, such as excess capacity, that may indicate that the current market shares of foreign firms <u>understate</u> their competitive significance. Under the Guidelines, the Department will also consider such factors in interpreting market share and concentration data.

Finally, one of the most important features of the 1982 Guidelines was the increased freedom they gave to American industries to enhance efficiency through merger. This was a great change from prior policies that seemed to penalize mergers precisely because they would result in increased efficiencies. Despite this great advance, however, the 1982 Guidelines still seemed to take a miserly approach to efficiency claims, indicating that they would be considered only in "extraordinary cases." In fact, however, the Department will in every case consider claims that a proposed merger will generate significant efficiencies that could not be achieved except through merger, and the revisions make this clear.

In addition, recognizing the correlation between research and development ("R&D") and the competitiveness of American industry, this Administration has sought to encourage technological innovation and the translation of such innovation into new products and processes. For example, the Administration has proposed an increase in federal funding of R&D by 17 percent, to $47 billion in 1984. We have also proposed legislation to improve the economic and legal climate for private funding of R&D by making the antitrust, patent, and copyright laws more fully compatible with the efficient creation and development of technology. Congress has responded to this initiative. Most significantly, the Congress is on the verge of passing legislation that will improve the environment for R&D joint ventures, which are increasingly important if American firms are to keep up with their foreign competitors. The Senate Judiciary Committee has reported the Administration's joint R&D bill--the National Productivity and Innovation Act--which will require that courts recognize the competitive benefits of cooperative R&D and will eliminate the threat that treble damages currently pose for such R&D. That legislation now awaits action by the full Senate. The House has already passed, 417 to 0, legislation that is very similar.

Another manifestation of this Administration's commitment to promote American technological innovation is our position that patent license restrictions should not be barred under per se antitrust rules, but should be judged on their demonstrable competitive effects. While the creation of new technologies is very important, technology does our economy little good if it is not brought to the market. Patent license restrictions may be the best, and perhaps only, means of developing and exploiting new technologies. To improve the legal climate for patents and patent licensing, I am hopeful that Congress will act on other parts of our legislative package concerning (1) patent licensing under the antitrust laws; (2) the misuse defense to infringement actions; and (3) increased protection for U.S. process patent holders.

We are also taking steps to enable private firms to exploit patent rights on inventions resulting from government-funded research, subject only to normal antitrust rules. Under existing laws, businesses face a myriad of conflicting policies in the various federal agencies, and far too often valuable inventions end up never reaching the marketplace. President Reagan addressed this problem by an Executive Order issued on February 18, 1983. The Order provides that, to the extent permitted by law, all federal agencies are to adopt uniform policies that generally will grant title in a patent to the government contractor that discovered the invention. This policy recognizes that private enterprise, not the government, is best able to get technology to the marketplace, where it can benefit us all. The Order and supporting legislation both anticipate that the United States will be able to use the patented invention for its own purposes at no cost and ensure that the contractor will not receive title to the patent if the result would be anticompetitive and, therefore, harmful to consumers.

As for distribution arrangements in general--so-called non-price vertical restraints--flexibility is critical, especially for smaller and middle-sized manufacturers. Except in highly-concentrated markets, non-price vertical restraints are almost always at best procompetitive and at worst competitively neutral. The courts are increasingly receptive to this notion. We plan to issue enforcement guidelines in this area by the end of the year, which we hope will assist the sensible trends in recent court rulings.

American companies also can improve their competitiveness worldwide by entering into international joint ventures. Such ventures, which are increasingly common, provide opportunities for firms to combine diverse resources on large projects or to take advantage of complementary strengths in planning, development, production, or marketing. Perhaps above all, international joint ventures can provide American firms access to new markets and new technology.

In the past, joint ventures sometimes have been viewed quite harshly by antitrust authorities, but in recent years antitrust analysis has become more sophisticated and clear-headed, recognizing the potential of joint ventures for improving competition. As I mentioned, the Department has actively supported legislation to encourage R&D joint ventures. Although that legislation is limited to R&D, the Department recognizes the importance of all types of joint ventures. The Department does not condemn joint ventures as <u>per se</u> illegal, or object to them on the basis of their size alone. Rather, we base our analysis on economic reality: we examine all of the surrounding facts and circumstances, including whether the venture members would enter the market independently. We then determine whether, on balance, the competitive benefits that are likely to result from the venture outweigh any potential reduction in competition. Joint ventures will be challenged only when they threaten to reduce competition significantly in either the market in which the joint venture operates or in other markets where the venture partners either compete or might compete.

Parties to a joint venture or any other agreement, for that matter, can obtain increased antitrust certainty through the Department's business review procedure. Under this procedure, parties can determine in advance whether a proposed venture presents antitrust concerns. Last fall, for example, we issued a favorable business review to a joint venture between Pratt & Whitney and Rolls-Royce, two of the three companies in the non-communist world generally thought to be capable of producing an advanced technology jet engine.

We know of no instance in which a private plaintiff has successfully challenged conduct for which we issued a favorable business review letter. Thus, a favorable business review can provide substantial antitrust comfort for the firms involved. Moreover, where we conclude that a joint venture does present antitrust problems, we will work with the parties to structure the transaction in a way that fulfills their needs while satisfying our concerns.

Another vehicle intended to enhance the performance of U.S. firms in world markets is the export trade certificate of review process. Congress passed the Export Trading Company Act of 1982 to address the perception that U.S. antitrust laws--

particularly treble damage exposure--inhibited efficient export conduct by U.S. firms. Under the Act, a U.S. firm or group of firms contemplating export conduct can obtain in advance a determination whether the government considers that the conduct would have an anticompetitive effect on a U.S. market.

In essence, if the Department of Justice and the Department of Commerce, the agency with which we share administrative responsibility under the Act, conclude that a firm's proposed export conduct would not have an anticompetitive effect within the United States, the firm is given a certificate that protects the holder from civil or criminal liability under the antitrust laws for conduct that is specified in and complies with the certificate. The one exception is that the Department of Justice may seek an injunction against "conduct threatening clear and irreparable harm to the national interest."

Although private plaintiffs do have a right of action under the Act, that right is significantly different from an antitrust cause of action. First, only actual damages and injunctive relief--not treble damages--are available. Second, there is a two-year statute of limitations instead of a four-year statute. Third, there is a presumption in favor of the certificate holder. Finally, a successful defendant can be awarded attorney's fees.

While this Administration is doing a number of things to help American industry improve its competitive position in world markets, we are staunchly opposed to efforts to shelter

American businesses from foreign competition. There can be little doubt that consumers benefit greatly from the low prices and product diversity that foreign competition brings. More often overlooked is the fact that it is frequently foreign competition that provides the competitive spur to invigorate American businesses. Moreover, a free and open trade policy here directly benefits American industry by enabling the Government to keep markets open abroad for American firms.

To minimize protectionist policies, the Division participates substantially in the interagency trade process within the Administration and is active in formulating and presenting Administration positions on trade issues before Congress. Our purpose in these efforts is to ensure that the United States does not succumb to protectionist pressures. The preservation of open domestic markets is not only beneficial to American consumers, it is also essential if we are to succeed in keeping foreign markets open--an issue that is critical to U.S. exporters.

Let me leave you with one general observation. Even if our overall antitrust approach is broadly acceptable to economists, antitrust experts, and the public generally, that does not mean that individual enforcement decisions will never be controversial. Some will be.

Antitrust enforcement always seems like a good idea--when applied to the other guy's business. Industries will still seek antitrust exemptions for themselves and try to make us forget that we will pay just as dearly for an anticompetitive merger as for an anticompetitive import quota bill. Cities and their politicians will still squawk when their companies are acquired by outsiders and try to make us forget that the whole economy will suffer from artificial constraints on the movement of corporate assets. Inefficient firms will still seek protection from rough-and-tumble competition and try to make us forget that we distort the market system when we seek to protect competitors rather than the competitive process. And those with magic governmental fixes to all our problems will always be with us--this year they happen to be called industrial policy advocates--and they will try to make us forget the long record of failure of unnecessary economic regulation.

The truth is that immunization from the rigors of the marketplace is no prescription for America's long-run economic health. Rather, economic growth can best be achieved through enlightened reliance on the old, grey antitrust laws.