Department of Justice

"60 MINUTES WITH THE HONORABLE JAMES F. RILL"

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It is my pleasure to be here today. It will come as no surprise, when I report to you that this past year has been a fantastically busy one, in which we accomplished much.

The Division currently has a record number of criminal investigations open, a number of substantial ongoing civil investigations, and, as always, a challenging merger docket. We have never been so busy with our competition advocacy work, or with the Administration's regulatory reform initiatives. On the international front, we have concluded a significant cooperation agreement with the EC, placed lawyers and economists in Poland and Czechoslovakia to provide long-term technical assistance to their competition authorities, provided short-term assistance and competition law and policy seminars for other developing free market economies, and we have continued our work on the Structural Impediments Initiative talks with Japan.

While I could spend all my time discussing each of those projects, there are two others upon which I will focus: the 1992 Horizontal Merger Guidelines, which were issued yesterday,

April 2,1/ and the Department's new policy on the application of the antitrust laws to foreign cartels that harm U.S. export trade, which was announced formally by the Attorney General earlier this morning.2/

Briefly, on the second item -- the application of U.S. antitrust laws overseas -- much already has been said and written. I want to emphasize today a point that seems often to be lost in the public discussion: This policy, which revises the now famous Footnote 159 in the Department's 1988 Guidelines for International Operations, is a policy of general application.3/ It is not aimed at any particular country or group of countries, or at any particular set of business organizations. Instead, it is aimed at conduct -- wherever it occurs -- that would violate the U.S. antitrust laws if engaged in here (such as price-fixing, bid-rigging, market allocation, and boycotts), and that directly, substantially and reasonably foreseeably affects U.S. export trade.

1/ Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines (April 2, 1992) (hereinafter "1992 Guidelines"). These revisions update the Merger Guidelines released by the Department in 1984 (hereinafter "1984 Guidelines").

2/ Department of Justice Press Release 92-117, April 3, 1992.

3/ Department of Justice, Antitrust Enforcement Guidelines for International Operations page 30 n. 159 (1988).

It is important to keep in mind that the policy does not alter existing jurisdictional rules and doctrines, so the courts must establish personal jurisdiction as before. And, the policy does not make conduct that would be legal in the U.S. illegal because it occurs elsewhere.

I would like to turn now, to another very recent development -- the new, 1992 Horizontal Merger Guidelines issued jointly by the Deparment of Justice and the Federal Trade Commission. These new Guidelines represent the next logical step in the continued refinement of the Deparment's analysis of mergers, a process set in motion with Bill Baxter's work on the 1982 Merger Guidelines.

These Guidelines are the first ever to be issued jointly by the Department and Commission. In and of itself, this is an important step. The two agencies that share primary responsibility for federal antitrust merger enforcment now are on record as applying the same analytical framework and standards. The benefits to the business community of increased certainty about the antitrust treatement of mergers at the federal agencies should be substantial.

Before turning to the features of the 1992 Guidelines, I first want to acknowledge the enormous effort and commitment of everyone who worked on the revisions, who thought about them carefully, and who challenged me and each other with ideas about the substantive content of the Guidelines. As a result, I believe we have produced a superior product that sets an important standard in merger analysis. Of course my staff deserves deep thanks -- the lawyers and the economists, both past and present. I want to thank the FTC Staff, the Commissioners and their staff, and particularly Chairman Steiger for her leadership -- I think we have accomplished something important. And there are a host of others, including the National Associaton of Attorneys General, who patiently read and debated drafts of the revision and improved the result. Thank you.

Our purpose in undertaking the Guidelines revision project was to incorporate into the 1984 Merger Guidelines the legal, economic, and practical learning that has taken place since their release almost eight years ago. I believed then, as I do now, that the 1984 Merger Guidelines present a sound framework for antitrust analysis, but one that has been improved with the benefit of experience. I would like to express my deep respect and appreciation for the work of Bill Baxter, the Assistant Attorney General responsible for the 1982 Guidelines, whichwere

largely retained in the 1984 revisions. Our work today directly flows from the concepts embodied in both the 1982 and the 1984 Guidelines. I want to take this opportunity now to highlight quickly some of the significant features of the new Guidelines.

The Guidelines, I believe, now provide a more complete analytical road map, or framework, for assessing the antitrust implications of mergers. The principal motivation underlying this approach is to move away from wooden rules of universal application or simplistic opinion polling, and instead to provide a more reasoned analysis of the likely competitive effects of individual transactions based on the real-world market circumstances in which those transactions occur.

The Guidelines now provide context and reference points that will benefit many: The business community will benefit by improved guidance in understanding the analysis applied in merger review, and, therefore, in conforming merger behavior to the antitrust laws. The Agencies will benefit by improved guidance in developing merger investigations, and importantly, in litigating cases once they have determined that a merger violates the antitrust laws. Finally, one can expect that courts also will benefit by having the guidelines available to assist in the evaluation of parties' assertions. Rather than

having to engage in an ad hoc inquiry into the issues of big buyers and entry, for instance, the courts will have a framework for relating these issues to the statutory objective of preventing mergers, the effect of which may be substantially to lessen competition.

The Guidelines' framework consists of five steps. Each is necessary and together they are sufficient to determine whether a merger is likely to create or enhance market power or facilitate the exercise of market power. The five steps are: market definition, measurement and concentration; the potential adverse competitive effects of mergers; entry; efficiencies; and failure or existing assets.4/ I will touch upon each of the steps briefly.

Section 1 - Market Definition, Measurement, and Concentration

Market Definition

Defining the relevant market -- both its product and geographic scope -- based on demand-side responses to a small but signfiicant nontransitory price increase remains the first step of merger analysis. The treatment of market definition in

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4/ See 1992 Guidelines § 0.2.

the 1992 Horizontal Merger Guidelines is largely unchanged from the 1984 Guidelines.5/ The treatment of both market measurement and market concentration, however, are somewhat revised from the 1984 Guidelines.

Market Measurement

Market measurement entails identifying market participants and assigning market shares to them. Under the 1984 Guidelines, market participants included current producers and sellers of the relevant product; recyclers and reconditioners of durable goods, if those goods are included in the relevant market, and "production substituters."6/ Vertically integrated firms with captive production sometimes were included as market participants, but only if they would begin selling into the relevant market or would expand production of their downstream product in response to a small but significant and nontransitory price increase.7/

The new Guidelines, however, take a somewhat broader view of who is to be included among market participants, in order to

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5/ Compare 1992 Guidelines §§ 1.1 & 1.2 with 1984 Guidelines §§ 2.1 & 2.3.

6/ See 1984 Guidelines § 2.2.

7/ See 1984 Guidelines § 2.23.

capture more accurately the set of firms influencing premerger and post-merger competitive interaction.8/ Current producers or sellers of the relevant product, of course, are still included. But the Guidelines now also include all current producers or sellers of the relevant product, even if the firm is vertically integrated and produces only for its own internal consumption.9/ The reason for this is clear: if, in either the premerger or post-merger world, one eliminated all plants devoted to captive production, prices would rise. These firms are just as important to competitive interaction as firms that sell in the spot market of that contract to sell their entire output to a single customer.

Producers or sellers of recycled or reconditioned goods also are included market participants, if their products are included in the relevant market.10/ Note that it is producers or sellers of these goods, not recyclers or reconditioners, that are included as market participants. The impact on consumers of extending the life of durable goods currently in

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8/ See 1992 Guidelines § 1.3.

9/ See 1992 Guidelines § 1.31.

10/ See 1992 Guidelines § 1.31.

use is captured in the analysis of the timeliness of entry.11/

In the revised Guidelines, three forms of uncommitted entrants also are included as market participants. Uncommitted entrants are firms that likely would commence production of the relevant product within one year without the expenditure of significant sunk costs of entry and exit, in response to a "small but significant and nontransitory" price increase.12/ Because their ability to make quick uncommitted supply responses probably influenced the market pre-merger, and would be likely to influence it post-merger as well, all forms of uncommitted entrants are counted equally as market participants.

First, production substituters still are included as market participants, though now only if the switching of existing facilities is likely within one year, in response to a small but significant and nontransitory price increase, and without the expenditure of significant sunk costs.13/

11/ See 1992 Guidelines § 3.2.

12/ See 1992 Guidelines § 1.32.

13/ See 1992 Guidelines § 1.321.

The Guidelines further recognize that in addition to production substituters, all supply responses that likely would occur within one year in response to a small but significant and nontransitory price increase should be included as market participants. These supply responses may occur as new firms commence production in the relevant market14/ or as existing firms extend rather than switch existing facilities to commence production of the relevant product.15/

In addition to the speed with which these supply responses would occur, the sunk costs associated with them are critical to the identification of uncommitted entrants. Sunk costs are defined as the acquisition costs of tangible and intangible assets that cannot be recovered through the redeployment of those assets outside the relevant market.16/ Significant sunk costs are those that would not be recouped within one year of the commencement of the supply response, assuming a small but significant and nontransitory price increase. Given competitive performance in the pre-merger market, and a five

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14/ See 1992 Guidelines § 1.322.

15/ See 1992 Guidelines § 1.321.

16/ See 1992 Guidelines § 1.32.

percent price increase, you can see that sunk costs in excess of five percent of total annual costs will be regarded as significant.

Market Concentration

Moving on to market concentration -- still within the first step of the overall analytical framework -- the revised Guidelines also restate the role of market concentration in the analysis of mergers. The 1984 Merger Guidelines established certain concentration thresholds above which challenge was likely.17/ Other market factors were relevant, but with the exception of ease of entry, the importance of these other factors was expressly minimized.18/ At the highest range -- where merger increased the HHI by more than 100 points and resulted in a post-merger HHI substantially in excess of 1800 -- an analysis of other market factors would establish that a

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17/ See 1984 Guidelines § 3.1.

18/ Other market factors relating to the ease and profitably of collusion were regarded as "most like to be important where the Department's decision whether to challenge a merger is otherwise close." 1984 Guidelines § 3.4. Efficiencies had to be proven by "clear and convincing evidence." Id. § 3.5. The failing firm doctrine was characterized as a long-established, but ambiguous doctrine" the elements of which were to be construed "strictly." Id. § 5.1.

merger was unlikely to have adverse effects "only in extraordinary cases."19/

Significantly, the new Guidelines abandon the "likely to sue" formulation because it is descriptive neither of our practice nor of sound analysis. We should not be basing decisions to challenge solely on market concentration. Instead, we should and will take market concentration into account, along with the other factors set out in in the Guidelines, and base our decisions on the full range of circumstances.

Under the new Guidelines, a merger that increases the Herfindahl-Hirschman Index ("HHI") of market concentration by more than 100 points in a moderately concentrated market (post-merger HHI between 1000 and 1800) or by more than 50 points in a highly concentrated market (post-merger HHI above 1800), "potentially raise significant competitive concerns depending on the other factors set forth in Sections 2-5 of the Guidelines."20/

19/ See 1984 Guidelines § 3.11(c).

20/ See 1992 Guidelines § 1.51.

A merger that increases the HHI by more than 100 points in a highly concentrated market is presumed likely to create or enhance market power or facilitate its exercise.21/ This presumption of adverse competitive effects arising from market concentration, once established, may be overcome by a reasoned analysis of the likely competitive effect of the particular transaction; that analysis includes not only market concentration, but also the the new competitive effects section and other remaining sections of the Guidelines.

The competitive effects section and the other factors are of equal weight in the analysis, regardless of the level of post-merger concentration or the magnitude of the change in concentration resulting from the merger. Conversely, the weight accorded to concentration data does not increase with the level of post-merger concentration or the change in concentration. The evidentiary role of the presumption arising from concentration remains the same.22/

21/ See 1992 Guidelines § 1.51(c).

22/ See Federal Rule of Evidence 301 and the accompanying notes.

Section 2 - The Potential Adverse Competitive Effects of Mergers

The second analytical step in the merger analysis under the 1992 guidelines is the assessment of a merger's potential adverse competitive effects.23/ Merger analysis has moved away from the structuralist approach of the 1960's that assumed that adverse effects flow ineluctably from increases in concentration. There currently is growing recognition, in the new Guidelines and elsewhere, that it is conduct, not structure, that causes anticompetitive effects, although structure can influence the likely effect of conduct. Accordingly, the new Guidelines treat concentration not as an end in itself, but as an indicator that needs to be interpreted and considered along with other market factors.

The 1984 Guidelines placed predominant emphasis on mergers that facilitated the post-merger exercise of market power through collusion, either express or tacit.24/ But the "leading firm proviso" and other passages in the 1984 guidelines made it clear that there also was a concern with mergers that facilitate the unilateral exercise of market power.25/

23/ See 1992 Guidelines § 2.

24/ See 1984 Guidelines § 3.4.

25/ See 1984 Guidelines § 3.12.

The new Guidelines, in contrast, discuss the exercise of market power in terms of both "coordinated" and "unilateral" effects. Coordinated exercises of market power are "actions by a group of firms that are profitable for each of them only as a result of the accommodating reactions of the others."26/ Unilateral exercises of market power, on the other hand, are actions of single firm that are profitable without the accommodation of rival firms.

Coordinated Interaction

The new Guidelines first discuss coordinated interaction, which is, of course, the successor to discussions of collusion in the 1984 Merger Guidelines. The term "coordination," however, is intentionally broader than the term "collusion." It is meant to convey that we are concerned with more than the prospect of express post-merger collusion. "Coordination" also reaches various forms of tacit collusion and other conduct that requires the accommodation of rivals in order to be profitable.27/ Coordination does not, however, include all

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26/ See 1992 Guidelines § 2.1.

27/ See 1992 Guidelines § 2.1.

forms of oligopolistic interdependence because not all forms of coordination involve accommodation.

Successful coordinated interaction entails three elements: first, there must be terms of coordination; second, there must be a way to detect deviations from those terms; and third, there must be a way to punish deviations from these terms. Terms of coordination. Detection. Punishment. Without any one of the these elements, coordinated interaction is unlikely because, if attempted, would break down. The analysis of the new Guidelines therefore, now expressly focuses on whether market conditions are conducive to each of these elements.

Under the new Guidelines market conditions need not be conducive to reaching and enforcing terms of coordination that perfectly replicate the performance of a monopolist. Instead -- and this is important to note -- the terms of coordination may be imperfect or incomplete. The Guidelines are concerned about any terms of coordination that result in price elevation and restriction of output.28/

28/ See generally Denis, Market Power in Antitrust Merger Analysis: Refining the Collusion Hypothesis, 60 Antitrust L.J. _____ 1992 (forthcoming).

Time does not allow a discussion of particular market factors spelled out in the new Guidelines that make the market "conducive" to coordinated interaction, but I should note that in identifying the market factors relevant to each element of coordinated interaction, it is critical to relate them to a single fundamental point: that the stability of any coordination rests on each participant's balance of the net gains to be reaped from undetected deviations from the terms of coordination; the probability and speed of detection of those deviations; and, the net losses from any ensuing punishment.

The incentive of a particular firm to deviate from terms of coordination depends on the profits it gains from the coordinated interaction, the additional sales it could gain by deviating from the terms of coordination, the firm's capacity for and cost of supplying these additional sales, the decrease in price it must offer in order to achieve these sales, and the profits it would earn if the deviation were detected and punished. It is not helpful to assert that detection and punishment are impossible because of some particular market factor if the arguments do not inform this analysis.

There is no big buyer defense in the new Guidelines, and there was none in the 1984 Merger Guidelines.29/ The existence of big buyers, by itself, says little about the likelihood of post-merger coordinated interaction, though the procurement process and the structure of the buyer market, in context, are relevant to the analysis. The ability to capture large chunks of business in a single contract -- most likely a multi-year contract with a large buyer -- may raise the gains due to a deviation from an agreement to the point that deviating becomes more profitable than continued coordinated interaction.30/ But this outcome is not dependent on any sophistication or aggressiveness on the part of buyers. If sellers appreciate these conditions, they are unlikely to attempt coordinated interaction because any such effort will be doomed to fail.31/

29/ Section 3.42 of the 1984 Guidelines, Information About Specific Transactions and Buyer Market Characteristics, has been misread as establishing a big buyer defense. See FTC v. R.R. Donnelly & Sons, 1990-2 Trade Cas. (CCH) ¶ 69,239 (D.D.C. 1990).

30/ See 1992 Guidelines § 2.12.

31/ See generally Denis, Collusion Hypothesis.

Unilateral Effects.

Obviously, I am cutting short some very important points in order to touch on others, the next of which is the treatment of unilateral actions that affect the exercise of market power in the post-merger market. The discussion of unilateral effects in the 1992 Guidelines builds on the leading firm proviso of the 1984 Merger Guidelines.32/ It goes further, however, to take into account that the nature of the unilateral effect, and the other market factors relevant to a particular effect, depend on the primary characteristics that distinguish firms and shape the nature of their competition.

In a market for differentiated products, producers might attempt to balance the gains of imposing a slightly higher price against the inevitable losses of such action. Each firm attempts to maximize its profits, given the prices of the other firms. A merger in such a market can disrupt this delicate balance. A slightly higher price for one or both of the products of the resulting merged firm will induce some of the customers that are unwilling to pay the higher price for one product to switch to the other product, now also controlled by the merged firm. What formerly was an unprofitable strategy,

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32/ See 1992 Guidelines § 2.2 and 1984 Guidelines § 3.12.

now is a profitable strategy because the merged firm has internalized or captured what used to be a diversion of sales.

Several market factors relate to whether this unilateral price elevation will have any substantial effect.33/ Most apparent is how closely substitutable the products of the merging firms are for one another. The closer the products are as substitutes -- that is, the more consumers that regard the products of the merging firms as their first and second choices -- the more substantial will be the effect.34/ The size of the merging firms also is important hence the requirement that the combined market share of the merged firm exceed thirty-five percent.35/ Finally, the new Guidelines call for an evaluation of the ability of non-party competitors to reposition their own product lines to prevent the merging firms from internalizing what would otherwise would be a diversion.36/

33/ See 1992 Guidelines § 2.21.

34/ See 1992 Guidelines § 2.211.

35/ See 1992 Guidelines § 2.211.

36/ See 1992 Guidelines § 2.212.

In a market for homogeneous goods -- or goods that are essentially undifferentiated, if you prefer -- firms attempt to maximize their profits by setting their outputs in light of the outputs of other firms. A output reduction resulting in a price increase that would not be profitable before a merger, may become profitable after the merger if the merged firm has a larger combined base of sales on which to enjoy the subsequent price elevation.37/

Again, the other relevant market factors are suggested by understanding the nature of the potential adverse competitive effect. As in the case of differentiated product markets, the resulting size of the merged firm is important. Small firms would not have a large enough base of sales on which to enjoy the subsequent price rise. For that reason, the Guidelines again impose the requirement that the merged firm have a combined market share of at least thirty-five percent.38/ Finally, in order for the merged firm successfully to suppress output and raise price, non-parties must be incapable of economically responding to the output reduction with output expansions of their own. The extent of non-party excess

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37/ See 1992 Guidelines § 2.22.

38/ Id.

capacity and the cost of utilizing that excess capacity are, therefore, critical to the analysis.39/

Section 3 - Entry Analysis.

The new treatment of entry is another of the most significant advances of the 1992 Guidelines.40/ You probably have noticed that the discussion of entry in the new Guidelines comes after the discussion of competitive effects, whereas entry in the 1984 Guidelines was treated before the discussion of "other factors" in Section 3.4. This change was made because the whole point of entry analysis is whether the propsect of committed entry will deter or counteract the competitive effects of concern. To answer this question, of course, it is necessary first to identify the competitive effects of concern.

The 1984 entry standard was clearly stated as a first principle: "if entry into the market is so easy that existing competitors could not succeed in raising price for any significant period of time, the Department is unlikely to

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39/ See 1992 Guidelines § 2.22.

40/ See 1992 Guidelines § 3.

challenge mergers in that market."41/ But the application of this point was unclear. Most of the information was provided in footnotes that listed relevant factors, including the expected life of the assets required to enter, whether sunk investments are required to enter (a potentially strong deterrent to entry if significant), whether there is growth or decline in the market or a scarcity of the assets required to enter, and economies of scale.42/

In recent years, the Department elaborated on the entry analysis of the 1984 Guidelines in speeches requiring that that entry be timely, likely and sufficient to deter or prevent the potential adverse competitive effects of a merger.43/ Each these three steps of the analysis is necessary. The 1992 Guidelines include and substantially elaborate on this framework.

41/ See 1984 Guidelines § 3.3.

42/ See 1984 Guidelines § 3.3 n. 21 and 22.

43/ See Rill, Merger Enforcement at the Department of Justice, 58 Antitrust L.J. 45, 47-48 (1990)(endorsing the entry analysis in Whalley, After the Herfindahls are Counted: Assessment of Entry and Efficiencies in Merger Enforcement by the Department of Justice, remarks before the 29th Annual PLI Antitrust Seminar (Dec. 1, 1989)).

First, in the new Guidelines, the period for measuring timeliness remains two years, to be measured as the time from a firm's intitial planning in response to the competitive effect of concern, to the time entry achieves significant market impact.44/

Second, entry must be economically likely.45/ Because this committed entry is, by definition, in for the long term, and because it must deter price elevations above pre-merger levels (or ensure that prices, if elevated as a result of the merger, are returned to pre-merger levels as a result of entry), the profitability -- and, therefore, the likelihood -- of committed entry is evaluated at pre-merger prices. This revision brings the Guidelines into line with current economic thinking, recognizing that committed entry is a function of prices that would prevail after entry, not the elevated pre-entry prices.

The Guidelines introduce an objective basis for judging the likelihood of entry based on the minimum viable scale ("MVS") of entry and the likely sales opportunities available to

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44/ See 1992 Guidelines § 3.2.

45/ See 1992 Guidelines § 3.3.

entrants. MVS is the smallest level of average annual sales that an entrant must persistently achieve in order to be profitable at pre-merger prices.46/ Note that MVS differs from MES (minimum efficient scale) which is the cost minimizing level of sales.47/ The likely sales opportunities available to entrants are a function of pre-existing market factors (that are discussed in the Guidelines) and the output reduction that would be caused if the merger was anticompetitive.48/

Entry is likely if MVS-sized entry would be achieved without depressing prices below pre-merger levels. This requires that MVS-sized entry fit within the likely sales opportunities available to entrants.49/

Sufficiency, the third and final leg of the entry analysis, requires that there be enough entry to respond fully to the merger-induced output reduction. If assets essential to entry

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46/ See 1992 Guidelines § 3.3.

47/ See 1992 Guidelines § 3.3. n.29.

48/ See 1992 Guidelines § 3.3.

49/ See 1992 Guidelines § 3.3.

are not adequately available due to incumbent control, entry, though it may be likely, might not be sufficient.50/

Sufficiency also requires that entry be of a character and scope that is responsive to the competitive effect of concern. For example, if the concern is unilateral price elevation in a market of differentiated products, the product of the entrant must have attributes that will enable it to disrupt the internalization of what would otherwise have been a loss of sales absent the merger.51/

Sections 4 and 5 - Efficiencies and Failure

I will be very brief about the final two sections of the new Guidelines -- efficiencies and failure -- in part because of the time constraints, and in part because of the rather minimal changes made in these two sections.

50/ See 1992 Guidelines § 3.4.

51/ See 1992 Guidelines § 3.4.

The treatment of efficiencies is substantively unchanged from the 1984 Guidelines.52/ The only change is to eliminate the requirement that efficiencies be proven by "clear and convincing" evidence.53/ This heightened evidentiary standard was interpreted by some as suggesting a certain hostility to efficiency-enhancing mergers. Under the new Guidelines, all elements of the analysis are treated the same, and the Department's policy continues to recognize economies of scale and other fixed costs savings as congnizable efficiencies, even though they might not in every case inure to the benefit of consumers in the short term.

The new Guidelines' treatment of the failing firm and failing division defenses also eliminates language that has been interpreted as suggesting a hostility to such arguments.54/ In addition, the new Guidelines add the notion that in order to prove the defense, failure must result in the exiting of the tangible or intangible assets of the failing firm from the relevant market.55/ Finally, the new

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52/ Compare 1992 Guidelines § 4 with 1984 Guidelines § 3.5.

53/ See 1984 Guidelines § 3.5.

54/ Compare 1992 Guidelines § 5 with 1984 Guidelines § 5.

55/ See 1992 Guidelines § 5.1.

Gudidelines clarify that liquidation value is the minimum price defining a reasonable alternative offer.56/

Conclusion

That was the whirlwhind tour of the 1992 Guidelines. There is much more to be said about them, and I am interested to hear your thoughts, as you have a chance to review them. I believe you will find, as you become more familiar with the 1992 Guidelines, that they are comprehensive, clear, and rational -- and imminently useful. As always, I wish there were more time to discuss the many interesting things going on at the Division these days. Thank you.

56/ See 1992 Guidelines § 5.1.