REMARKS OF THE ATTORNEY GENERAL
ABA ANTITRUST SECTION SPRING MEETING
THE SHOREHAM HOTEL
WASHINGTON, D. C.
APRIL 1, 1982

There is a story about certain widget sellers who were suspected of conspiring to fix prices in violation of the antitrust laws. An investigator approached one of the sellers and confronted him with the accusation. The seller smiled complacently and said:

"Oh, no. There used to be something of a problem along those lines, but not anymore."

"Really?" asked the investigator, "Why not?"

"We used to hold meetings all the time to fix prices," responded the seller, "but our lawyers told us that was illegal. So now we do it all by telephone."

There will always be some confusion as to what the law requires. Antitrust law, however, has exhibited more than its share. Over the years, some notions with little or no basis in economic reality have nevertheless become a part of our antitrust laws. In fact, the laws of antitrust have strayed so far from economic reality that a businessman -- even in league with his lawyer or lawyers -- cannot be sure of the legality of reasonable business decisions that make good economic sense for both producer and consumer. My subject today, the antitrust principles applicable to mergers, amply demonstrates the uncertainty and unreality of too much law today.

Partly because of its importance and partly because of several highly-publicized mergers, merger policy has been very topical during the last year. As is often the case with complex and controversial subjects, much of the public comment has been confused and confusing.

The intensity of merger activity is related to a wide variety of factors, such as tax and accounting laws, regulatory requirements, and general financial and economic conditions. For reasons that are not fully understood at this time, merger activity appears to be cyclical. Certainly the current level of activity is not unprecedented. According to some statistics, the merger movement of the late 1960s was at least comparable to

what we are seeing today. In any event, it must be remembered that antitrust enforcement policy is at most just one of many factors affecting the level of merger activity.

Although one might have supposed it a truism, my statement last June that "bigness is not necessarily badness" seems to be repeated with great solemnity in almost every story about the Administration's antitrust policy. This Administration does not view absolute size with intrinsic hostility. Indeed, even if we did, we would have no legislative mandate to apply such a view in our merger enforcement activities.

As you know, section seven of the Clayton Act is the antitrust statute most commonly used to challenge mergers and acquisitions. It prohibits only those mergers that may "substantially...lessen competition, or...tend to create a monopoly." The statute speaks of an effect on competition in a market, and absolute size bears no necessary relationship to that issue. For example, the creation of even an enormous firm would be unlikely to affect competition if there were dozens of similarly-sized firms in its market. Similarly, section one of the Sherman Act, as it is and should be interpreted in light of the passage of section seven, does not import any different standard for merger analysis.

While we stand behind the proposition that "bigness is not necessarily badness," we also believe that its implications have sometimes been mischaracterized. Some -- perhaps those who believe that bigness is necessarily badness -- have suggested that these words convey a hidden message that "anything goes" with respect to mergers. That is certainly a distorted interpretation of what I said and, more significantly, totally inconsistent with the performance of the Department. If you examine the decisions of the past year, you will find that the Department has moved very aggressively against a number of mergers -- large and small -- that presented a threat to competition in economically identifiable markets.

During 1981, 1084 merger notification reports were filed -- compared to 824 in 1980 -- and challenging anticompetitive mergers remained an important part of our enforcement program. For example, we challenged certain aspects of DuPont's acquisition of Conoco, and allowed that transaction to proceed only after the competitive problems were resolved. We also challenged an

acquisition in the cigar industry and recently agreed to a consent decree that will prevent unacceptable increases in industry concentration. Just two months ago, we filed a section seven case and an accompanying consent decree requiring Baldwin-United Corporation to divest competitively overlapping assets in conjunction with its acquisition of MGIC.

Sometimes it was unnecessary for us to file a merger case. Our announced intentions to file suit against proposed mergers in the beer and plastic pipe fitting industries prevented anticompetitive transactions from being consummated.

Our policy of challenging anticompetitive mergers will continue. The new Merger Guidelines that will be issued shortly will memorialize and formalize the standards that are already being used. As I consider the need for new Merger Guidelines I am reminded of an old story about Oliver Wendell Holmes late in his distinguished career on the Supreme Court. Holmes, so the story goes, found himself on a train. Confronted by the conductor, Holmes couldn't find his ticket. Recognizing the distinguished jurist, however, the conductor told him not to worry, that he could just send in his ticket when he found it. Holmes looked at the conductor with some irritation and replied:

> "The problem is not where my ticket is.
> The problem is, where am I going?"

The new Merger Guidelines will give everyone a better idea of where we are going in terms of enforcement policy.

To understand what we are about to do with our new Merger Guidelines, it is useful to understand what has been done before.

Since the early 1960s, the evolution of case law has been less than clear. Twenty years ago, in its well-known Brown Shoe decision, the Supreme Court emphasized the need to analyze a wide variety of considerations in evaluating a merger. Unfortunately, it rendered no practical guidance as to how the many specific considerations should be evaluated and weighed in reaching an ultimate conclusion. The very vagueness of that decision may have caused judges in subsequent merger cases to place primary emphasis on simplified assumptions and shorthand "tests" about the competitive effects of transactions they were called upon to review.

Certainly, after the Supreme Court's 1963 opinion in Philadelphia National Bank, judicial analysis was confined almost exclusively to levels of market concentration and the market shares of the combining firms. Such analysis largely reflects both a desire for judicial economy and reliance upon outworn and inaccurate economic literature of the 1930s and 1940s.

The economic literature has become far richer and more sophisticated since those early years. It has become increasingly clear to economists and legal scholars that some of the simplified assumptions relied upon by the courts have been applied with unjustified enthusiasm. During the last six or seven years, the courts themselves have begun gradually to turn away from too rigid an adherence to economic formulae confined to market concentration and market share -- such as the four-firm concentration ratio. The broadened analysis has permitted consideration of additional elements relevant to the realistic assessment of the likely competitive effects of any proposed transaction. For example, eight years ago in the General Dynamics case, the Supreme Court held that while historic market shares alone may establish a prima facie case, the inference of illegality may be rebutted by evidence that past market shares do not accurately reflect present and future competitive conditions in the relevant market. The Court has also emphasized the need for establishing realistic market definitions. It has required evidence that expansion through acquisition into a market in which a firm has not previously competed actually poses a threat to competition in that market.

The merger enforcement policy of the Department of Justice has generally followed the evolution of the law in this area. As a result, the Antitrust Division has concentrated its efforts in recent years on mergers that could adversely affect horizontal competition. Accordingly vertical and conglomerate merger cases have ceased to be a major enforcement focus of the Division. Nevertheless, the Antitrust Division also challenges mergers that do not involve direct competitors. Certain mergers may adversely affect horizontal competition by eliminating potential competition even if there is no direct horizontal overlap between the parties to the transaction. In addition, despite the emphasis on market share and concentration data, the Division has not ignored other considerations relevant to the analysis of horizontal competitive effects in determining whether to challenge particular transactions.

In 1968 the Department of Justice issued merger guidelines developed during the Johnson administration. The stated purpose of those Guidelines was to provide guidance to the business community. Section Seven is hardly a model of specificity, and large sums of money may be at risk in mergers and acquisitions. Thus, the desire to provide some guidance was fully justifiable.

As I have noted, the merger decisions by the Supreme Court after the 1950 amendment to the Clayton Act were hostile in the extreme to merger activity of virtually any size, shape, or description. These decisions led Justice Stewart to observe in a 1966 dissent that the "sole consistency" in the Court's merger jurisprudence was that "under §7, the Government always wins." The 1968 Guidelines were an attempt to communicate where the Department would draw the lines. Although it is difficult to measure the effects of the 1968 Guidelines with precision, I believe that they were largely successful in achieving that end.

New Merger Guidelines are necessary because developments in the courts, in economics, and in the Department have rendered the old Guidelines obsolete. They no longer provide accurate guidance about the Department's enforcement intentions.

Since 1968, the character of the Supreme Court's antitrust jurisprudence has moved -- correctly in our view -- in the direction of a more economic orientation. Mergers, however, are but one of many areas of the law vying for the Court's attention, and this salutary development has been more marked in other areas of antitrust law. The Court's decision in GTE Sylvania, for example, has dramatically improved the antitrust analysis of distribution restrictions. Although the principles of cases such as GTE Sylvania extend throughout antitrust, it is inevitable that those principles will collide with older decided cases reflecting different principles. This is the real problem in merger law. Although there have been some significant decisions since 1968, there have been no real landmarks. Nevertheless, it is clear to those who follow the area closely that the present Court would not decide some of the earlier cases in the same way. Those earlier decisions do, however, remain on the books as technically valid precedents. This situation is certain to produce wildly disparate results as the lower federal courts interpret the antitrust tea leaves in significantly different ways. Given the state of the case law,

rendering antitrust advice about the legality of a merger is a job only for the brave.

The economic underpinnings of merger policy also have shifted since 1968. The 1968 Guidelines reflect the then widespread belief that there was a very close relationship between the concentration of a market and its likely economic performance. As the industrial organization literature has become more sophisticated, the validity of earlier assumptions has been questioned both by courts and by commentators.

As I have already mentioned, the enforcement policy of the Department itself has shifted since 1968. These changes, of course, reflect in large part judicial and economic developments. It is abundantly clear that some of the positions in the 1968 Guidelines, particularly concerning conglomerate mergers, have, quite appropriately, not been well received by the courts.

In this context, it may be useful to emphasize a distinction that may be easily missed. In a number of respects, the new Guidelines will represent a significant change from the old ones. If one compares the policy of the new Guidelines to that actually followed by the Department over the last five or six years, however, the contrast is less marked. The old Guidelines have not reflected the actual policy of the Department for some time. Although it was expressly contemplated that the Guidelines would be revised to take into account future developments, the long-needed revisions have occurred only in the past year under the direction of Assistant Attorney General Baxter.

It is impossible to describe the new Guidelines in detail in a speech, but I would like to preview for you some of the more significant changes that we expect to make.

One important difference between the old and the new Guidelines will be the emphasis given to the question of market definition. The purpose of market definition in merger analysis is to establish the relevant economic contexts in which a proposed transaction should be evaluated. In many ways, market definition is the single most important part of merger analysis. It determines the characterization of a merger as horizontal, vertical, or conglomerate. It obviously influences the determinations of market concentration and impact upon competition.

Although market definition is important, it is rarely easy. In the real world, one thing tends to blur into another without the sharp lines often assumed in economics texts. Perhaps for this reason, the 1968 Guidelines include only a few paragraphs which amount to little more than an admonition to "define a market." We have already devoted a great deal of time and effort to this issue, and a substantial part of the final document will be devoted to it. Our goal is to specify generally the characteristics of a properly defined market and then to give as many specific rules of thumb as possible. For example, one important question frequently is the speed with which other sellers could provide competitive products in a market if the price in that market increased. We hope to indicate with some specificity the extent of price increase and the period of time in which such a response must occur in order to influence our analysis.

Having defined the markets involved in a proposed merger, the Department will assess the effect of the merger on competition among the firms in each of those markets. Harm to competition is most common and most obvious when the merging firms already operate in the same market. Under certain conditions, however, it can also occur when the firms operate in vertically related markets or in markets that are close to one another in terms of either geographic location or product similarity.

The new Guidelines will set out a two-step procedure for evaluating horizontal mergers once the relevant market is defined. The first step will emphasize the concentration of the market. The second step will emphasize other considerations relevant to the likelihood of successful collusion among the firms in that market.

Concerning the first step, in a change that sounds more difficult than it really is, we propose to use a measure of concentration -- the Herfindahl Index -- that has certain advantages over the more traditional four-firm concentration ratio. Unlike concentration ratios, this index increases whenever the number of firms in the market declines or the inequality in market share among any given number of firms increases. Thus, the size of a permissible acquisition continuously declines as the size of the larger of the merging firms increases.

Among the considerations relevant to the second-step analysis of possible collusion are product

variation, previous conduct by firms in the market, characteristics of buyers in the market, and the performance of the market. When those considerations strongly indicate that collusion is particularly likely or unlikely, appropriate adjustments will be made to the deductions from the concentration analysis.

Another change from the old Guidelines will be our attempt to define relatively "safe harbors" as well as conditions of special danger. For example, we are unlikely to challenge a horizontal merger if the post-merger concentration of the market would be less than 1000 on the Herfindahl Index. This effort is likely to be particularly important in the "non-horizontal" merger category. We believe that in some circumstances such mergers can present competitive problems of real significance, but the majority of such mergers are unlikely to do so. By describing in relatively objective terms the conditions necessary for competitive problems to exist, we hope to communicate to the bar and the public those situations in which enforcement activity is unlikely.

I would like to emphasize what we will not and, indeed, could not accomplish in the new Merger Guidelines. The new Guidelines will not provide a litmus test for mergers. In cases that suggest possible competitive problems, the Department devotes substantial time and resources to our analysis. The Guidelines will indicate only the questions asked and the approaches utilized in that analysis. We hope and believe that in doing so they will make a useful contribution to this important and difficult area of antitrust law.

There is an old antitrust story concerning one of the "malefactors of great wealth," to use Teddy Roosevelt's words. This businessman was considering a new merger to expand his industrial empire. He cabled the details of his plans to his attorney to discover whether they would meet any difficulties under the federal antitrust laws. The attorney telegraphed a four-word answer: "Merger possible; conviction certain."

Although the ideal of certainty will not be reached by the new Merger Guidelines, we do believe that they will increase the ability of the bar and the business community to know the course the Department will pursue concerning mergers. At the same time, they will ensure that the Antitrust Division's efforts better reflect competitive reality. Both of these goals should serve the economic interests of the public.