CURRENT ANTITRUST ISSUES IN U.S. FEDERAL ENFORCEMENT

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Remarks of Mary Lou Steptoe Before Brazilian Institute of Studies On Competition and Consumer Matters

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It is a very great pleasure to address this noted body of international antitrust experts. In my time on the podium I will address three topics -- three areas of antitrust law where the U.S. antitrust agencies, the Federal Trade Commission ("FTC") and the Antitrust Division of the Department of Justice ("DOJ"), are breaking new ground. My first topic will be the agencies' resurgence of enforcement activity in the area of vertical price fixing. Then I will turn to the agencies' concern with a new type of merger; and finally I will describe a new type of review protocol, the "Quick Look", which is helping the agencies manage their resources in a time of increased caseload and shrinking budget.

I Resale Price Maintenance (RPM)

Since 1911 it has been and remains absolutely (per se) illegal for firms at different levels in the chain of distribution to enter into a vertical price fixing (resale price maintenance) agreement. On the other hand, it is permissible for the supplier to suggest a resale price to any distributor, and no violation will result if the distributor independently decides to observe specified resale prices. Similarly, no violation results if a supplier has a unilateral policy of announc ing resale prices in advance and terminat ing any distributor which does not adhere to its suggested price.

RPM violates Section 1 of the Sherman Act and Section 5 of the FTC Act. Evidence of an agreement is essential to establishing the violation, and an illegal agreement need not be willing, but can be the result of coercion. However, what conduct will give rise to an inference of agreement, coerced or otherwise, is the subject of ongoing debate and much colorful and creative characterization. When RPM prosecution is in vogue, prosecutors are more willing to find an agreement in circumstantial evidence.

Both the FTC and DOJ, heeding the teaching of "Chicago School" theorists, subjected RPM to benign neglect in the 1980's and no companies were prosecuted for RPM during that period. In the case of the DOJ, the neglect was not merely benign: the agency took the official position that RPM should be evaluated under the rule of reason, and thus had a good chance of being declared legal. Pursuant to this stance, the agency attempted to persuade the Supreme Court to reverse its repeated decisions holding vertical price fixing per se illegal. Congress retaliated by prohibiting the Department from using any appropriated funds "for any activity to alter the per se prohibition on resale price maintenance."

The FTC was the first agency to resume RPM enforcement in 1991 with *Kreepy Krauly, U.S.A., Inc.* In *Kreepy*, it took a flagrant violation (signed agreements) to break the non-enforcement logjam. Ultimately, the agency issued a consent order obligating the respondent to rescind the written agreements, to cease and desist from entering into future agreements, and to affirmatively notify its dealers that they are free to set their own prices.

Since *Kreepy* the FTC has brought three more cases and expectations are that Clinton-appointed Chairman Robert Pitofsky will step up this pace. Each matter, *(Nintendo of America, Inc.*, *Keds Corp.*, and *Reebok Int'l Ltd.*) involved the sale of consumer products and injunctive relief was one of the remedies awarded in all three. As each case was prosecuted, however, a clear pattern developed - the additional relief got tougher and tougher. As a result of this pattern, relief in future RPM cases is likely to go beyond mere cease and desist orders and may include suspension of a corporation's *Colgate* rights to announce resale prices in advance and unilaterally refuse to deal with those dealers who will not comply. *Reebok*, the latest case, also prohibits so-called "structural termination" or "three strikes you're out" programs under which a manufacturer announces it will impose shipping holds or other penalties upon dealers who deviate from suggested prices, followed by automatic cessation of the penalty when the dealer once again follows the suggested price. There is legal debate over whether such programs are purely unilateral, or give rise to the sort of agreement that supports a Sherman Act violation. Clearly the FTC has joined the second camp.

The DOJ has more recently, but equally vigorously, entered the fray with a series of cases, *Canstar Sports USA, Inc.*, *California Sun Care, Inc.*, and *Playmobile USA, Inc.*, in which the agency awarded relief similar to that in the FTC cases and in one of which concurrent state relief was ordered. The pattern of awarding tougher relief in these cases is evidence that the DOJ does not intend to be left behind by the FTC in this new era of RPM enforcement.

To add to corporate worries, many states conduct parallel investigations which often yield additional relief, monetary and otherwise.

Will the activity continue? Well, FTC Chairman Robert Pitofsky has written "[I]t has always struck me that nullification of enforcement against resale price maintenance, ... was the most indefensible prosecutorial decision in the last twelve years." Beyond this, it is important to recognize that RPM cases are a prosecutor's dream; easy to find, and easy to justify to the public. They are easy to find because distributors will always complain that they were cut off because they wished to discount (as opposed to being cut off for unclear premises or surly service). To their credit, the agencies know well that every discontented distributor does not present an antitrust violation. However, this is one area of the law where the cases come to the agency, instead of the agency having to spy out a hidden conspiracy.

My second point as to why the enforcement will continue is that these cases, unlike some more abstruse theories of antitrust law, are easily understood by the public. My eighty-five year old mother does not under stand why tying is illegal, but she does object to practices which limit her opportunities to get goods at a discount. That is why the antitrust agencies, if they have a choice, will always bring RPM cases that affect consumer goods, such as shoes and electronics, over cases that concern obscure intermediary products.

The consumer goods cases as target-of-choice leads me to one final observation. To date the federal antitrust agencies have been content to merely stop RPM when they find it. The state antitrust agencies have been more creative in their remedies. They actively look for ways to reimburse their consumers for the amount they were overcharged by the price-fixing. They have required the defendant to issue coupons that gave money off consumers' next purchase, and they have calculated the overcharge and disbursed it to the public in various ways.

II Vertical Merger Enforcement

Vertical mergers have been receiving renewed attention from antitrust enforcers in recent years. Vertical mergers involve firms that operate at different but complementary levels in the chain of production and/or distribution. As with RPM, no vertical mergers were challenged in the 1980's, in accord with the Chicago School assumption that virtually all vertical relationships are either benign or efficient. In the 1990's, however, both antitrust enforcers and academics are displaying much more sensitivity to the potential anticompetititve effects of vertical mergers.

The FTC and the DOJ have, between them, challenged more than a dozen vertical mergers in the last three years.[126] This is small compared to the number of horizontal mergers reviewed and challenged, but it is highly significant given the total lack of activity in the previous decade. It is also significant because these mergers involve some very large transactions and complex theory, and thus are major drains on the agencies' resources. (How they deal with that issue is my third topic).

The agencies have not yet formally articulated their vertical merger analysis, as they have done for horizontal mergers in the 1992 Horizontal Merger Guidelines.[127] However, it is clear from speeches, cases brought, and the surviving portions of the 1984 Merger Guidelines[128] that there are three major theories of possible competitive harm which have general credence today with the FTC and the DOJ. So far, two of the theories have produced cases; the third is waiting in the wings.

The first theory is market foreclosure. Market foreclosure theory posits at least two situations in which competition can be injured by backward or forward integration. A firm with some market power can vertically

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[126] For FTC cases, see, e.g.,*Atlantic Richfield*, File No. C-3314 (1990); *TCI/Paramount*, File No. 941-0008 (1993); *Alliant Techsystems/Hercules*, File No. 941-0123 (1994); *Martin Marietta Corp./General Dynamics*, File No. C-3500 (1994); *Eli Lilly/McKesson*, File No. C-3594 (1995); *Martin Marietta/Lockheed*, File No. 951-0005 (1995); *Silicon Graphics/Alias & Wavefront*, File no. 9510064 (1995); *Lockheed Martin/Loral*, (1996); *Litton/PRC*, File No. 961-0002 (1996); *Hughes/Itek*, File No. 961-0018 (1996).

For DOJ cases, see, e.g., *United States v. AT&T*, Civ. Action No. 94-CV01555 (D.D.C. 1994); *United States v. MCI Communications Corp.*, Civ. Action No. 94-1317 (D.D.C. 1994); *United States v. British Telecommunications/MCI*, (1994); *United States v. Sprint/France Telecom/Deutsche Telecom,* (1995).

[127] U.S. Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines (1992), reprinted in 4 Trade Reg. Rep. (CCH) § 13,104.

[128] Although the 1992 Horizontal Merger Guidelines supersede the 1994 Merger Guidelines with respect to horizontal mergers, the provisions in the 1984 Merger Guidelines regarding non-horizontal mergers [§§ 4.1, 4.2] have not been modified.

For speeches by agency officials, see, e.g., Mary Lou Steptoe, "FTC Vertical Enforcement," American Bar Association (November 4, 1994); Stephen C. Sunshine, "Vertical Merger Enforcement Policy," American Bar Association Antitrust Division (April 5, 1995); William J. Baer, "Report from the Bureau of Competition," American Bar Association Antitrust Section, (March 28, 1996);

1996.

For an economic approach, see Michael Riordan and Steve Salop, Evaluating Vertical Mergers: A Post-Chicago Approach, 63 Antitrust L.J. 513 (1995).

integrate, backwards for instance, and increase barriers to entry in the upstream market. If a substantial portion of the downstream market is now foreclosed to all but the newly integrated upstream producer, upstream potential entrants face a smaller pool of potential customers. A smaller market make entry less likely.

In closely related argument, if vertical integration is prevalent in an industry, a new entrant could be forced to enter at both levels. It might be necessary for a would-be downstream entrant also to enter at the upstream level in order to assure a supply of a vital input. Conversely, a would-be upstream entrant may also be forced to enter downstream to assure a ready outlet for its products. Dual entry can be riskier, costlier, and more time-consuming, thus raising barriers to entry. This is a concern that prompted a 1990 consent agreement between the FTC and Arco. Arco had proposed to buy certain chemical business of a major customer, Union Carbide. The agency alleged that Arco's capture of such a large amount of demand market would make it unattractive for any company to enter upstream and compete with Arco. The consent decree in that matter freed up demand, and upstream entry is now occurring.

This theory also supported DOJ's challenge to AT&T's acquisition of McCaw Cellular, the United States' largest cellular telephone carrier. AT&T is both a long-distance telephone carrier and a major manufacturer of cellular telephone equipment. The consent decree provides both that long-distance rivals of AT&T would have access to McCaw systems equal to AT&T's access; and that cellular rivals of McCaw that use AT&T equipment would continue to have access to necessary products. As you can see, the consent (which has since been superseded by legislation) addressed foreclosure at two different levels of the telephony delivery system.

The second theory posits that some vertical mergers may decrease horizontal competition, either by making collusion easier, or by giving the vertically integrated firm an unfair advantage over its unintegrated rivals. This is the information exchange theory, which supports a number of actions brought by the antitrust agencies. The FTC's consent governing the merger of Lockheed and Martin Marietta is illustrative.

The merged aerospace firm makes both satellites and the rockets to launch them. Lockheed satellites might also, however, be launched on rockets made by the firm's competitors. In the course of arranging for such a launch, Lockheed's satellite division would necessarily learn a great deal about the technology and business practices of competing rocket manufacturers. If that information were then to find its way back to Lockheed's rocket division, it could harm competition, either by fostering collusion or giving Lockheed

Martin a competitive edge. It might make the Lockheed rocket division less aggressive in its bidding, and it might make the competing rocket makers less aggressive in devising free-rideable innovations.

To solve these kinds of problems, the Commission, as it has in several other vertical mergers, required the construction of a legal "firewall" to prevent the flow of information between the affected divisions of the merged firm. The Lockheed Martin consent prohibits the satellite division from disclosing to other divisions any non-public information received from competing suppliers of rockets. By the "firewall" solution, the agencies have attempted to permit the general efficiencies of vertical mergers while isolating and correcting any anticompetitive potential they may have.

The agencies are also on the watch for, but have not yet found, a case where vertical integration is used to evade regulation. Public utilities, for instance, can increase prices only with the approval of a regulatory commission. In theory, a utility is allowed to recover its costs, or rate base, plus a reasonable profit. In order to evade regulation and increase this allowable profit, however, a regulated utility might integrate backwards by acquiring a supplier in a competitive and unregulated market. The integrated entity could then increase its price of supplying inputs, such as coal or gas, to the regulated entity. In this matter, the regulated entity would pad its rate base and earn a regulated return on these higher costs. In addition, the upstream entity, the coal or gas company, would earn supranormal profits, paid for the customers of the regulated business.

Of course, many vertical mergers are not at all problematic from an antitrust viewpoint, and are procompetitive, undertaken for efficiency reasons. A vertical merger can reduce search and transactions costs by enabling the integrated company to buy some inputs from itself. Vertical integration may be technologically efficient if the production of upstream and downstream products together is less expensive than separate production. Vertical integration may also be important in securing a stable supply of vital input, making downstream production more predictable and less costly. The challenges for a reviewing antitrust agency are: first to distinguish the benign mergers from the anticompetitive ones; and, second, where a merger has mixed aspects, to craft a remedy which corrects the anticompetitive problem but allows the overall merger to proceed.

III The Quick Look Policy For Reviewing Premerger Filings

As if it were not enough that the agencies are adding new issues to their lexicon of antitrust violations, they are facing tidal wave of mergers and acquisitions which must be reviewed before consummation, under the Hart-Scott-Rodino ("HSR") Premerger Notification procedures. Filings have increased by 77% since 1992, and stood at 2,816 transactions reported in fiscal year 1995. The pace for FY 1996 is increasing. Moreover, the transactions being reported are different from the financially driven deals of the 1980's. Deals today are very often strategic - competition looking to expand product lines, enhance R&D capabilities, and achieve integrative efficiencies. As a result, they are deals the antitrust enforcers are more likely to need to review.

At the same time, the antitrust authorities, like many other government agencies, are facing a budget- cutting Congress. If they are not actually shrinking, they are certainly not receiving appropriations that allow the agencies to grow at anywhere near the same rate as their merger review responsibilities.

Accordingly, the agencies are under enormous pressure to manage their resources efficiently. One way they have done so is to inaugurate a "Quick Look" approach to certain mergers. The FTC started using the Quick Look in 1990, at my instigation. It is now commonly used in one-third to one-half of the FTC's cases. This year, the DOJ also formally adopted the procedure. Here is how it works:

Parties to a proposed merger are given the option of furnishing information on one or more potentially dispositive antitrust issues and avoiding a response to a full "second request" (HSR inquiry) if the information resolves those issues in favor of allowing the transaction to proceed.

Appropriate use of the quick look allows the merging parties to reduce their compliance burdens and to consummate acquisitions more quickly. It also benefits the agency by allowing it to carry out its statutory merger review obligations more efficiently.

Typically, a quick look is most likely to be helpful if there are no more than one or two issues on which the outcome of the investigation is expected to turn. Staff will then propose a quick look to the parties at the time the second request is issued, and discuss its possible scope. If the parties agree to a quick look, the full second request remains outstanding, but the parties' response to the remainder of the second request is held in abeyance. Staff will continue to employ the usual investigative methods, including seeking information from third parties; but staff's investigation, and the parties' initial submission of information, will focus on the targeted issue.

Quick looks have focused on a wide range of issues, but some issues better lend themselves to the approach that others. Quick looks frequently address product and geographic market definition issues. Product market definition can be the decisive issue in a merger investigation. Sometimes definitive evidence is elusive: for example, there may be little in the way of evidence of buyer reactions to relative price changes among potentially competing products. But even without econometric data, documents such as the parties' marketing plans can indicate the contours of the relevant product market.

Thus, if you see that manufacturers of liquid soap viewed bar soap as competition and would not raise prices for fear of losing sales to bar soaps - then you could authorize a merger of the only two liquid soap manufacturers. The market is "all soap" and in that market, competition continues. Note that this would be true even if some customers would never switch from liquid to bar soap. As long as other ones would, the liquid soap makers will fear to raise prices.

In some industries, geographic market definition data is easily obtained. For example, in the United States the health care industry is blessed (or cursed) with an enormous data base which shows, inter alia, where hospital patients and their admitting physicians reside. Therefore the agencies can usually quickly determine if two merging hospitals are the only competitors for these "customers", or whether they operate in geographic market where other hospitals provide meaningful competition.

The most common issue examined by quick look is ease of entry. This is for two reasons. First, as a matter of theory entry is a discrete issue that can end the competitive analysis: under the 1992 Horizontal Merger Guidelines, if entry into a market is easy, an acquisition in that market is unlikely to be anticompetitive. The second reason why entry lends itself to the quick look is practical: information on entry often is readily accessible.

Entry evidence can be as simple as giving government investigators the names (and telephone numbers) of firms which have come into the market in recent years. What is obvious to businessmen who sell "widgets" everyday may not be common knowledge to investigators who never heard of the product until they read the HSR filing.

Because the Merger Guidelines call upon the government to consider if entry would be timely, likely and sufficient, it is also possible to save a merger by a quick look at potential entry. Here the required information is a little more extensive, but still far from burdensome, either to produce or assess. The reviewing agency will want to know what companies are well-positioned to enter the market in question. Well-positioned goes beyond having financial resources (although that is important) and includes such factors as: do the parties identified as potential entrants have basic production skills, complimentary products, access to customers. Also, does entry (assuming the merged firm raised prices) make business sense - in other words, will the sales opportunities repay the investment in entry. For example, entry is usually more likely in a growing market, but it is not entirely out of the question in a declining market. I have seen the quick look work several times in the defense industry, where one would not normally expect easy entry. The difficulties and disincentives to entry can be enormous, given the technological complexity of much weaponry, and the shrinking market. However, both can be overcome if the Department of Defense (usually the sole buyer) is willing to say it would (a) switch to an alternate product or (b) induce entry by sponsoring a new firm with its internally developed technology and (c) has no plans to discontinue purchases of the specific product in question. In such cases the prospect of winning a big defense contract - especially if it has a long-term prospects of roll-over into future requirements - can justify the cost of entry.

That is a high tech, one customer example. For something quite different, let me give you my experience last year with a proposed merger between two manufacturers of a generic (unbranded) personal care product. The ingredients were simple, so there was no issue of it being too costly or complex to make easily. We also thought consumers would try a new product because it would cost them only a few dollars to do so. Here the question was whether a new entrant could gain nationwide distribution, to get to those consumers. At the FTC we talked with several regional and national chain retailers (drugstores, grocery stores and discount stores). They all told us that, if the merged firm raised prices,they would gladly take on a new supplier. If fact, a couple of the retailers, who were backward integrated into manufacturing certain related consumer products, said they could and would make the item themselves.

The role of foreign producers and imports has been the focus of several quick looks, variously taking the form of entry, supply substitution, and geographic market definition issues.

In the majority of cases in which it has been used, the quick look has resulted in termination of the investigation without requiring the parties to comply with the full second request. Quick look investigations also tend to be significantly shorter than full investigations; roughly half of quick look cases are resolved within six weeks from issuance of the second request. One of the investigations discussed above was closed less than one month after the parties furnished the quick look material. The other investigations were closed shortly after the second requests were issued. Not all quick look investigations will be this swift, but these are not atypical examples.