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PART ONE: MERGER ENFORCEMENT DEVELOPMENTS IN 2002

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* The views expressed herein are those of the authors and do not necessarily reflect the views of the Federal Trade Commission or any particular Commissioner. In addition, these authors express no views in the section's discussion of Department of Justice cases.

I. OVERVIEW OF THE ANALYTICAL FRAMEWORK FOR MERGER ANALYSIS

Federal antitrust review of mergers is governed by section 1 of the Sherman Act[1] and section 7 of the Clayton Act.[2] Section 1 broadly prohibits all contracts, combinations, and conspiracies that unreasonably restrain trade.[3] Section 7 deals more specifically with mergers, prohibiting any acquisition that may have the effect of substantially lessening competition or that may tend to create a monopoly.[4] While these statutes, which the federal government enforces through both the Federal Trade Commission ("FTC") and the Antitrust Division of the Department of Justice ("DOJ"), provide a substantive basis for the government to attack anticompetitive mergers, the procedural scheme for merger review is provided by the Hart-Scott-Rodino Antitrust Improvements Act of 1976 ("HSR Act").[5] The HSR Act generally requires the parties to any transaction involving the sale of assets or voting securities valued in excess of $50 million to file pre-merger notification and report forms with the FTC and the DOJ.[6] The HSR Act imposes a mandatory waiting period of, in most instances, thirty days during which the parties to the transaction are prohibited from closing while the DOJ and FTC conduct a review and elect whether to investigate further.[7] If, during this initial thirty-day period, either agency concludes that the transaction may be anticompetitive and therefore warrants further investigation, the HSR Act permits the

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1 15 U.S.C. § 1 (2000).

2 *Id.* § 18.

3 *Id.* § 1.

4 *Id.* § 18. The FTC may also challenge a merger or acquisition as a violation of section 5 of the Federal Trade Commission Act. *Id.* at § 45.

5 *Id.* § 18a.

6 16 C.F.R. pt. 803, app. (2003).

7 15 U.S.C. § 18a(b)(1)(B) (2000). During the early part of the initial thirty-day waiting period the FTC and DOJ determine, through an internal "clearance" procedure, which of the two agencies will review the proposed transaction.

agencies to request additional information from the parties (commonly referred to as a "Second Request"), which has the effect of extending the mandatory no-closing period while the investigation proceeds. In the absence of an investigation and the issuance of a Second Request, the parties are permitted to close the transaction upon the expiration of the initial thirty-day waiting period or upon the granting of early termination of that waiting period by either agency.[8]

Decades of judicial interpretation of section 1 of the Sherman Act and section 7 of the Clayton Act have resulted in an ever-developing federal common law of antitrust.[9] In 1992, in an effort to clearly articulate the analytical framework that the federal government would apply in assessing whether a merger is likely to substantially lessen competition, the FTC and the DOJ jointly issued the *Horizontal Merger Guidelines.*[10] The *Merger Guidelines* have not only guided DOJ and FTC enforcement activity, but have also been routinely applied by federal courts reviewing those transactions that the agencies have sought to enjoin.[11]

The *Merger Guidelines* set forth a two-pronged analysis, the first step of which involves an assessment of the structure of the market in which the proposed merger is occurring, and secondly the competitive effects of the proposed transaction in that market. The market structure analysis requires that the agencies first define the relevant product or service market(s) and geographic market(s) in which the merging parties operate, determine whether the parties compete in any of the same markets and, if so,

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[8] *Id.*

[9] *See, e.g.*, Texas Indus., Inc. v. Radcliff Materials, Inc., 451 U.S. 630, 640 (1981).

[10] U.S. DEP'T OF JUSTICE AND FEDERAL TRADE COMM'N, 1992 HORIZONTAL MERGER GUIDELINES § 0.1 (1992) (with April 8, 1997, Revisions to § 4), *available at* http://www.ftc.gov/bc/docs/horizmer.htm [hereinafter MERGER GUIDELINES]. Prior to 1992, each agency had its own set of guidelines applicable to mergers.

[11] *See, e.g.*, FTC v. H.J. Heinz Co., 246 F.3d 708, 716 n.9 (D.C. Cir. 2001); U.S. v. Sungard Data Sys., Inc., 172 F. Supp. 2d 172, 182 (D.D.C. 2001).

evaluate the change in market concentration that would result from the proposed transaction.[12] If, post-merger, the levels of market concentration will not have materially increased, the analysis is ordinarily at an end with no further investigation required.[13] Even if the agency finds that the relevant market is or is likely to become concentrated, it is unlikely to challenge the transaction if it finds that entry into the market is so easy (and likely) that the remaining participants in the market could not profitably raise prices or reduce output without attracting new, lower-priced competitors.[14]

If the reviewing agency finds that the transaction would significantly increase market concentration, it will then move to the second element of the *Merger Guidelines*' analysis—an assessment of whether the transaction will give rise to any adverse competitive effects.[15] Such effects can be either *unilateral* (i.e., whether the transaction will enable the merged firm to profit by unilaterally raising prices above the pre-merger level)[16] or *coordinated* (i.e., whether the transaction will facilitate tacit or express collusion among the remaining competitors in the market).[17] The agencies will typically challenge only those transactions which result in both a highly concentrated market and a likelihood that the merger will give rise to either unilateral or coordinated anticompetitive effects.[18]

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[12] *See* MERGER GUIDELINES, *supra* note 10, at § 0.2.

[13] The level of concentration in a particular market is measured using the Herfindahl-Hirschman Index ("HHI"), an economic measure of competitor size and dispersion that is calculated by summing the squares of the individual market shares of all the participants in a market. The method of calculating and using the HHI is described in greater detail in § 1.5 of the Merger Guidelines.

[14] *See* MERGER GUIDELINES, *supra* note 10, at § 3.

[15] *Id.* § 0.2.

[16] *Id.* § 2.21.

[17] *Id.* § 2.1.

[18] *See, e.g.*, United States v. Sungard Data Sys., Inc., 172 F. Supp. 2d 172, 180 (D.D.C. 2001). Most merger enforcement actions, however, end in a negotiated remedy that results in the simultaneous filing of a complaint and a consent agreement.

In a 1997 amendment to the *Merger Guidelines*, the DOJ and FTC recognized that, even where a merger may increase market concentration to levels where a transaction might otherwise be challenged, the merger may lead to efficiencies sufficient to overcome any potential anticompetitive effect. The *Merger Guidelines* state that "[t]he Agency will not challenge a merger if cognizable efficiencies are of a character and magnitude such that the merger is not likely to be anticompetitive in any relevant market."[19] The *Merger Guidelines* warn, however, that efficiencies are likely to save an otherwise anticompetitive merger only when the likely anticompetitive effects of the transaction, absent the efficiencies, are relatively minor.[20] Historically, efficiency defenses have been difficult to prove, and courts have been suspicious of them.[21] As discussed below, however, the agencies continue to invite parties to present well-reasoned and economically sound efficiency justifications for their transactions.[22]

Each year, only a small fraction of the transactions reported to the FTC and the DOJ under the HSR Act[23] are investigated. In 2001, the most recent year for which data are available, of 2,376 reported transactions only seventy raised competitive issues sufficient to cause the agency to further investigate those transactions by issuing a Second Request for Information.[24] A Second Request for Information is the primary tool used by the FTC and the DOJ to

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[19] *See* MERGER GUIDELINES, *supra* note 10, at § 4.

[20] *Id.*

[21] *See, e.g.*, FTC v. H.J. Heinz Co., 246 F.3d 708, 716, n.9 (D.C. Cir. 2001); FTC v. Cardinal Health, Inc., 12 F. Supp. 2d 34, 61 (D.D.C. 1998).

[22] *See* Timothy J. Muris, Understanding Mergers: Strategy and Planning, Implementation, and Outcomes, Remarks at the Federal Trade Commission's Roundtable on Understanding Mergers: Strategy and Planning, Implementation, and Outcomes (December 9, 2002), *available at* http://www.ftc.gov/speeches/muris/mergers021209.htm.

[23] 15 U.S.C. § 18a (2000).

[24] Federal Trade Commission, Annual Report to Congress Regarding the Operation of the Hart-Scott-Rodino Premerger Notification Program, 5 (Sept. 2002), *available at* 2002 WL 31202676.

investigate transactions that raise significant antitrust issues. Of these seventy transactions, fifty-five were challenged: thirty-two by the DOJ[25] and twenty-three by the FTC.[26] Of these fifty-five, some resulted in consent decrees negotiated by the reviewing agency and the parties, others resulted in the parties abandoning their transaction, and still others led to court resolutions.[27] Despite the very small number of transactions that trigger a substantive investigation, the process is still often criticized.

One recent and particularly provocative criticism of the merger review process, from within the FTC itself, is that the agencies tend to place too much emphasis and reliance on empirical evidence to demonstrate likely anticompetitive effects of proposed mergers, to the exclusion of evidence such as economic modeling that is arguably more reliable.[28] A more common and frequent criticism, heard during this year's Milton Handler address, is that the statutory framework under the HSR Act results in the vast majority of challenged transactions being settled by consent agreement in a non-public process between the parties and the agencies.[29] The result is a dearth of judge-made law in this area. In the last several years, the agencies have responded to this criticism by bringing more cases, including successful challenges, to the merger of office supply superstores Staples and Office Depot,[30] which addressed important issues of market definition; the merger of baby-food makers Heinz and

[25] *Id.* at 14.

[26] *Id.* at 19.

[27] *Id.*

[28] *See generally* Timothy J. Muris, Improving the Economic Foundations of Competition Policy, Remarks at George Mason University Law Review's Winter Antitrust Symposium (Jan. 15, 2003), *available at* http://www.ftc.gov/speeches/muris/improveconfoundatio.htm.

[29] *See, e.g.*, Stephen M. Axinn, Antitrust Merger Review: In Search of Congruence Between Legislative Purpose and Administrative Policy, Remarks at the Association of the Bar of the City of New York's Milton Handler Annual Antitrust Review (Dec. 10, 2002), *in* 2003 COLUM. BUS. L. REV. 487.

[30] FTC v. Staples, Inc., 970 F. Supp. 1066 (D.D.C. 1997).

Beech-Nut,[31] which addressed the role of efficiencies in the analysis of mergers in concentrated markets, and, the sale of the loose leaf tobacco business of Swedish Match to its competitor National Tobacco Company,[32] which addressed issues of market definition, concentration, and efficiencies.

Some in the business community have long been critical of the Second Request process under the HSR Act, because it can result in enormous costs and lengthy delays for the parties. Some believe it forces many companies to abandon transactions despite the strength of their legal positions. It is not unusual for the expense of complying with a Second Request alone to run into the millions of dollars on top of the very significant cost of litigation in the event the agencies seek to enjoin the transaction. If these costs alone are not prohibitive, in a number of instances the delay caused by the filing of a court action can be decisive in killing a deal, particularly where the parties to the merger are publicly traded companies.[33] As the following review of significant developments in 2002 demonstrates, the agencies are recognizing and responding to some of these procedural concerns.[34] In addition, the past year of merger enforcement, though not marked by any groundbreaking or dramatic legal developments, also reveals important nuances in the substantive legal analysis applied by the federal agencies and the courts in reviewing mergers.

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[31] FTC v. H.J. Heinz Co., 246 F.3d 708 (D.C. Cir. 2001).

[32] FTC v. Swedish Match, 131 F. Supp. 2d 151 (D.D.C. 2000).

[33] *See, e.g.*, Jaret Seiberg, *Hicks Muse: Hold the Pickle*, THE DAILY DEAL, (Oct. 29, 2002), *at* www.thedeal.com (discussing abandonment of merger by parties following filing by FTC of motion for a preliminary injunction blocking the acquisition).

[34] The FTC, for example, recently promulgated a set of "Best Practices" applicable to both the issuance of, and compliance with, Second Requests. *See* Federal Trade Commission, Statement of the Federal Trade Commission's Bureau of Competition On Guidelines for Merger Investigations (Dec. 11, 2002), *at* http://www.ftc.gov/os/2002/12/bcguidelines021211.htm.

II. SIGNIFICANT DEVELOPMENTS AT THE FEDERAL TRADE COMMISSION

A. The Cruise Ship Mergers

In late fall 2001, the FTC began its investigation of the Cruise case,[35] which involved the simultaneous investigation of two rival deals: the proposed "friendly" creation of a "dual listed company" combining Royal Caribbean Cruises Ltd. ("Royal Caribbean") and P&O Princess Cruises plc ("Princess"), and the competing hostile tender offer by Carnival Corporation ("Carnival") for Princess. Almost one year later, on October 4, 2002, the Commission voted in a rare 3-to-2 decision to close its investigation without taking any enforcement action. In an unusual but universally welcomed development, the FTC also published detailed statements setting forth the reasoning and analysis of both the majority and the dissenting Commissioners.

In the North American cruise market, either transaction would involve a 4-to-3 merger resulting in very high market shares and a post-merger firm controlling almost fifty percent of this market.[36] The smallest major competitor remaining would have been Star Cruises, which operates under the Norwegian Cruise Lines ("NCL") brand in North America. Post-merger, the top two firms would control over eighty percent of the market, and the top three over ninety-five percent.[37] The HHI for each transaction showed large

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[35] The investigation, which was carried out by the FTC's Northeast Regional Office in New York City and the FTC's Bureau of Economics in Washington, D.C., took place over a 10-month period, during which time the cruise industry began to recover from its post-September 11 economic slump.

[36] Joseph J. Simons, Director, Bureau of Competition, Fed. Trade Comm'n, Merger Enforcement at the FTC, Keynote Address to the Tenth Annual Golden State Antitrust Law and Unfair Competition Law Section of the State Bar of California (Oct. 24, 2002), *available at* http://www.ftc.gov/speeches/other/021024 mergeenforcement.htm.

[37] Dissenting Statement of Commissioners Sheila F. Anthony and Mozelle W. Thompson, *In re* Royal Caribbean Cruises Ltd., FTC File No.

increases in an already concentrated market. In the case of Royal Caribbean and Princess, the HHI rose from a highly concentrated 2,800-plus to over 3,700, in the case of Carnival and Princess, the HHI approached close to 3800.[38] Under the *Merger Guidelines,* concentration levels of this magnitude trigger a presumption that the transaction is likely to result in anticompetitive effects.[39] As the *Merger Guidelines* make clear, however, "market share and concentration data provide only the starting point for analyzing the competitive impact of a merger."[40]

While the investigation encompassed all the so-called "traditional" aspects of merger investigations, including vast amounts of documents, interviews, hearings, and considerable information and commentary from third party sources, the case also involved an unusually large amount of data concerning transaction prices, bookings, ship deployments, and the financial characteristics of the industry and of the parties. These data were the subject of an extensive amount of empirical analysis by the FTC's Bureau of Economics.[41]

021-0041 (Oct. 4, 2002) *available at* http://www.ftc.gov/os/2002/10/cruisedissent.htm [hereinafter *Dissenting Statement*]. There are numerous smaller cruise lines in North America, including Disney Cruise Lines, and also a number of European cruise lines, such as Royal Olympic and Festival, that operate some ships in North America. Thus, although the market is highly concentrated, there would be at least two major firms and a good number of much smaller firms competing post-merger.

[38] Under the *Merger Guidelines*, a market is considered highly concentrated when the HHI exceeds 1800.

[39] *See* MERGER GUIDELINES, *supra* note 10, § 1.51.

[40] *Id.* § 2.0.

[41] Statement of the Fed. Trade Comm'n, *In re* Royal Caribbean Cruises Ltd., FTC File No. 021-0041 (Oct. 4, 2002), *available at* http//www.ftc.gov/os/2002/10/cruisestatement.htm [hereinafter *Commission Statement*]; Simons, *supra* note 36, at 3. According to FTC Bureau of Economics Director David Scheffman, the parties produced over 100 gigabytes of data which FTC staff reduced to a workable 20 gigabytes. *See* ABA Section of Antitrust Law, *FTC Cruise Line Merger Investigation, in* THE ANTITRUST SOURCE (Jan. 2003) *at* http://www.abanet.org/antitrust/source/jan03/lerner.pdf.

1. Market Definition

The traditional test under the *Merger Guidelines* for market definition is whether a hypothetical monopolist in the relevant industry can impose a small but significant and non-transitory increase in price ("SSNIP").[42] This is usually defined as a five percent increase for at least a two-year period. If the hypothetical monopolist can impose such a price increase, the boundaries of the product and geographic markets are delineated.

In the Cruise case, the threshold issue was whether there was a separate market for "ocean-cruising", or whether cruising was part of a much larger "all-vacation" market. If cruising were part of a larger vacation market, it would comprise about four percent of that market and neither merger would raise competitive concerns. If, on the other hand, cruising were a separate market, market shares created by either merger raised significant competitive concerns.

An analysis of the empirical data on pricing and sales showed that industry elasticities were very high relative to the so-called "Critical Loss."[43] This meant that an across-the-board price increase would clearly not be profitable because the hypothetical monopolist would lose more than it would gain by such an increase.[44] While this fact, in addition to other evidence in the case, suggested that a cruising market might not be appropriate under the *Merger Guidelines*,[45] there was evidence that a hypothetical monopolist could raise *average prices* by using the yield management systems[46] to selectively impose targeted

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[42] *See* MERGER GUIDELINES, *supra* note 10, § 1.0.

[43] Critical Loss is the number of customers that would have to be lost to make a price increase unprofitable. In the cruise industry, where all costs are virtually fixed, the data showed that the Critical Loss is extremely low. Simons, *supra* note 36, at 4.

[44] *Id.*

[45] *Id.*

[46] See *Commission Statement*, *supra* note 41, at 8 n.9, stating

increases without surpassing Critical Loss. The yield management system would allow the hypothetical monopolist to fine-tune price increases by imposing larger increases on more inelastic consumers, thereby mitigating the effects of a small Critical Loss component.

In addition, there was sufficient evidence for the FTC to conclude that the two cruise lines view each other as the most significant competitor in the relevant market and thus attempt to closely monitor each others' prices, deployments, and other behavior, and at times react to one another's prices and capacity announcements.[47] Although there was some evidence that cruise lines consider land-based resources as competitive threats and vice versa, the FTC defined ocean cruising as a relevant market,[48] and North America—as opposed to the whole world—as the relevant geographic market.[49]

2. Unilateral Competitive Effects

The FTC investigated both potential unilateral and coordinated effects that might result from either of the

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> As in other segments of the general hospitality industry, the cruise companies use various forms of 'yield management' (sometimes called 'revenue management'). Yield management involves the use of estimates of predicted load factors relative to actual load factors as one indicator of whether price should be changed. One factor that goes into this pricing decision is information about the prices of competitive offerings. For example, if load factors are low relative to prediction and competitors have significantly lower prices, there could be added impetus to decrease prices in order to increase load factors. The Merger Guidelines' hypothetical monopolist would (by definition) not be faced with competitive offerings and so would likely sometimes make decisions on price different from the decisions it would make if faced with competition.

[47] *Commission Statement*, *supra* note 41, at 3; *Dissenting Statement*, *supra* note 37, at 1.

[48] *Commission Statement*, *supra* note 41, at 3.

[49] *Id.*

proposed mergers. Although both the majority and dissenting Commissioners agreed that concentration levels created by either merger raised the presumption of anticompetitive effects, the two sets of commissioners arrived at dramatically different conclusions concerning the likelihood that such effects would actually occur.

The FTC found that, if the merged firm raised prices unilaterally, it would still risk losing even its inelastic customers to other competitors. While these customers may be inelastic with respect to cruising, at least some significant fraction would be much more "elastic" among cruise line competitors because of the low levels of loyalty among customers for specific cruise lines.[50] In addition, the econometric evidence did not support a differentiated-product unilateral-effects theory largely because the data indicated that the cruise lines were unable to identify a set of customers to whom they could target an increase.[51]

The FTC also looked extensively at the likely effect of unilateral reductions in capacity or redeployment out of North America on cruise prices. A financial analysis of vessel profitability along with further econometric analysis of capacity and pricing data showed that either capacity reduction or redeployment would require a very substantial reduction in the merged entity's total fleet. That analysis also demonstrated that any resultant increase in price was not likely to recoup the revenue lost on otherwise highly profitable ships.[52]

The dissenting Commissioners argued that a unilateral exercise of market power could be targeted toward various niche markets where the merger consolidates the two best alternatives in various cruise products. The dissenting

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[50] Simons, *supra* note 36, at 6. Throughout this analysis, it must be kept in mind that the *Merger Guidelines* test for market definition is not the same as the test for either unilateral or coordinated effects. The market definition test assumes a market without any competitors to a hypothetical monopolist, while the tests for anticompetitive effects examine the current market conditions.

[51] *Id.* at 6.

[52] *Id.* at 7.

Commissioners offered Alaska as an example, where Carnival and Princess have long dominated the market and would have a very high combined market share.[53]

3. Coordinated Interaction

The FTC investigation focused primarily on determining whether the parties could implement a coordinated price-discrimination scheme, raising prices to inelastic customers while keeping prices for elastic customers lower, and whether the parties could effectively coordinate capacity reductions or redeploy capacity to exert upward pressure on price. Based in significant part on its empirical and financial analyses, the FTC concluded that no identifiable category of cruise passenger price transactions could provide a basis for challenging either merger whether under a theory of coordinated interaction on price or coordinated reduction in capacity.[54]

The FTC found that prices among the parties varied substantially and unsystematically, that discounting was ubiquitous, and that prices were not transparent.[55] The FTC could not, for example, discern patterns or relationships between transaction prices and particular categories of customer, type of ship, or trip characteristics. On this basis, the FTC concluded that it was virtually impossible for the cruise lines to identify inelastic customers to which price increases could be targeted and that no mechanism existed for a coordinated price increase predicated on self-selection

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[53] *Dissenting Statement*, *supra* note 37, at 3-4.

[54] *Commission Statement*, *supra* note 41, at 5-6.

[55] The FTC found prices in the cruise industry to be very complex and voluminous. For example, prices vary by type of cabin, type of ship, itineraries sailed, time of year, time of booking, and travel agent location. The different cruise companies pursue heterogeneous pricing strategies, follow disparate itineraries, and offer a multitude of different cruise "experiences" in terms of type of ships, on-board atmosphere and facilities. There is an enormous amount of discounting and frequent price changes—up and down—throughout the cycle of a cruise ship's booking curve. *Commission Statement*, *supra* note 41, at 4.

by inelastic passengers.[56] The variability or randomness of cruise pricing would effectively impede any effort by the cruise lines to detect cheating, thus rendering any effort to coordinate pricing unenforceable.

While the dissent acknowledged that pricing in the industry is complex, it concluded that if moved to do so, the parties could exploit the reduction in competition to the detriment of consumers.[57]

The FTC also examined whether, in a post-merger, highly concentrated market, the remaining firms would be able to coordinate a reduction in the number of ships built, a slow-down in expanding capacity, or a redeployment of ships to non-North American markets. Again, the FTC analyzed a large amount of data, including financial information on ship profitability and the relationship between increases and decreases in capacity and transaction prices. The FTC concluded that the remaining firms would have to coordinate a reduction or redeployment of a substantial portion of their existing fleets to achieve a meaningful price increase, such that engaging in such a strategy would be unprofitable.[58] The FTC found it was equally unlikely that the remaining firms would be able to coordinate a reduction in the number of ships built for the purpose of driving up prices and profits. Each competitor has strong unilateral financial incentives to add new capacity, which is also the most important form of product differentiation in the industry.[59]

The dissent argued that the proposed transaction would create the incentive to collectively reduce the rate of industry growth. As support, the dissent pointed to the transparency of ship orders in the industry. Orders are placed well in advance and ships take eighteen to twenty-four months to build. Although the dissent acknowledged that the industry growth trend is likely to continue for the short term, its statement pointed to documentary evidence in the

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[56] *Id.*

[57] *Dissenting Statement, supra* note 37, at 2.

[58] *Commission Statement, supra* note 41, at 6.

[59] *Id.*

investigation reflecting an industry-wide desire to limit the rate of industry growth and ease downward pressure on prices.[60] Thus, the dissent concluded that, with ship orders and deployments well known in the industry, the dominant firm could easily set a new, slower pace that its nearest competitors could be expected to follow.[61]

Under the *Merger Guidelines,* in order for new or expanded entry into a market to mitigate the potential for anticompetitive effects, entry should be timely, likely, and sufficient.[62] On this point, the FTC found that, even if substantial capacity constraints were achievable by the remaining firms, such anticompetitive redeployment or capacity reduction would be vulnerable to "highly likely" entry or expansion in North America. That entry or expansion would be provided by the European cruise lines or the North American cruise line fringe and would erode any potential profitability of such capacity reduction.[63] The dissent contended, however, that the investigation's findings made it "far from certain" that post-merger entry or expansion would occur on a sufficient scale to offset the presumption of anticompetitive effects raised by the industry's high post-merger concentration levels.[64] The dissent pointed to high barriers to de novo entry due to required economies of scale, the cost and time to build a ship, the difficulty and time required to reposition ships, marketing and distribution requirements, and the problems of permits and port entry in certain locations.[65]

The FTC's publication of written majority and dissenting opinions has been a uniformly welcomed development in explaining the analytical framework used by the agencies in merger enforcement.[66] However, critics of the decision itself

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[60] *Dissenting Statement*, *supra* note 37, at 2.

[61] *Id.*

[62] *See* MERGER GUIDELINES, *supra* note 10, § 3.

[63] *Commission Statement*, *supra* note 41, at 6-7.

[64] *Dissenting Statement*, *supra* note 37, at 2.

[65] *Id.* at 2-3.

[66] Subsequent to the FTC decision, Carnival won the bidding war over rival Royal Caribbean, and Carnival and Princess are in the process of

may point to the opinion as a shift in enforcement policy without judicial guidance. It could be argued that a prima facie case could have been made merely on the basis of high market shares and certain testimony and documents. However, even the *Merger Guidelines* emphasize that market shares are only an analytical starting point. Nonetheless, with its strong emphasis on the crucible of econometric analysis, the Commission Statement appears to drive up a notch the burden of proof for those who seek to persuade the agency to challenge transactions. On the other hand, as the Commission statement advises, "[t]he fact that we have cleared merger proposals at relatively high concentration levels in this particular situation does not mean that we will . . . do so in the future."[67] Thus, the Commission continues to focus on a case-by-case approach to merger transactions.

B. *Wal-Mart*

The FTC's 2002 investigation of the acquisition by Wal-Mart Stores, Inc. ("Wal-Mart")[68] of one of Puerto Rico's largest supermarket chains, Supermercados Amigo, Inc. ("Amigo"), represents another significant development in merger enforcement.[69] For the first time, the FTC determined—based on substantial documentary and testimonial evidence—that the traditional "supermarket" product market definition did not apply, and included club

merging. Suzanne Kapner, *World Business Briefing Europe: Britain: Cruise Merger Advances*, N.Y. TIMES, Jan. 9, 2003, at W1.

[67] *Commission Statement*, *supra* note 41, at 1.

[68] Wal-Mart is the world's biggest company in terms of sales. *Wal-Mart Dethrones Exxon as World Champion in Sales*, WALL ST. J., Feb. 8, 2002, at B9 ("Wal-Mart Stores, Inc. has overtaken Exxon Mobil Corp. as the biggest company, based on sales; for the fiscal year to January 31, 2002, Wal-Mart posted sales of $218 billion, about $5 billion more than Exxon Mobil.").

[69] This merger was investigated by staff in the FTC's Northeast Regional Office, as well as the Bureau of Economics in Washington, D.C.

stores[70] in the relevant markets in Puerto Rico. While the FTC maintains that this decision reflects a continuation of a fact-based, case-by-case approach in merger investigations and limited its finding to Puerto Rico, numerous supermarkets are hopeful that the expanded product market definition in this case will pave the way for future clearance of a greater number of supermarket mergers.[71] Another reason this case is of interest is that after the FTC and the Puerto Rico DOJ jointly investigated the merger, and after the FTC announced its consent agreement permitting the transaction to proceed subject to certain divestitures, the Commonwealth of Puerto Rico sued to halt both the merger and the divestiture transactions.

1. Broadened Market Definition

In prior supermarket mergers, the FTC has defined the product market as traditional, full-service supermarkets.[72] In reviewing Wal-Mart's proposed acquisition of Amigo and assessing the relevant product market, the FTC conducted an extensive factual analysis. In the filings accompanying its proposed complaint and the settlement agreement, the FTC cites information obtained from testimony and documents (including price-checking documents, consumer surveys, and analyses of actual competitive effects and responses) as

[70] Club stores are stores that offer a wide selection and deep inventory of food and grocery products and general merchandise—often in large-sized packages or in packages of two or more conventional-sized items—to businesses and individuals that have purchased club memberships. Wal-Mart Stores, Inc. and Supermercados Amigo, Inc.; Analysis to Aid Public Comment, 67 Fed. Reg. 70952 (Nov. 27, 2002) [hereinafter *Wal-Mart Compl.*].

[71] David Ghitelman, *FTC May Finally Say Clubs, Big Boxes Vie with Supermarkets*, SUPERMARKET NEWS, Apr. 8, 2002, at 4.

[72] *See, e.g.*, Koninklijke Ahold NV and Bruno's Supermarket, Inc. Analysis to Aid Public Comment, 66 Fed. Reg. 65711 (Dec. 20, 2001); Schwegmann Giant Super Markets, Inc. Proposed Consent Agreement with Analysis to Aid Public Comment, 60 Fed. Reg. 13993 (Mar. 15, 1995). Because of their nature as a combined full-service supermarket and mass merchandise store, the Commission has also included supercenters in the "full-service supermarket" or "traditional supermarket" category.

examples of what persuaded it to determine that many supermarket operators on the island viewed club stores as substantial competitors.[73] The FTC further concluded that a substantial portion of retail purchasers in Puerto Rico regarded full-service supermarkets and club stores as reasonably interchangeable;[74] i.e., that club stores met the *Merger Guidelines*' test for inclusion in the relevant product market. The test, as applied here, asks whether, when faced with a hypothetical small but significant and non-transitory price increase by traditional supermarkets, a sufficiently large number of customers would switch to club stores to render such an increase in price unprofitable. The Commission's investigation demonstrated that the answer to this question was yes. Accordingly, the FTC concluded that in this case the product market should be expanded to include retail sales of supermarket-type items by club stores.[75]

2. Action by the Commonwealth of Puerto Rico

In many instances in which federal and state antitrust authorities jointly investigate mergers, their ultimate determination of whether to challenge the transaction or agree to a settlement is consistent.[76] The Wal-Mart/Amigo merger is an exception.[77] On November 21, 2002, the FTC

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[73] *Wal-Mart* Compl., *supra* note 70.

[74] *Id.* at 70,952-54.

[75] *Id.*

[76] *See, e.g.*, Establissements Delhaize Freres et Cie "Le Lion" S.A., 65 Fed. Reg. 46932 (Aug. 1, 2000) (investigated and settled jointly by FTC, North Carolina, and Virginia); United States v. Sony Corp., 1998 WL 1542829 (S.D.N.Y. May 6, 1998) (investigated and settled jointly by DOJ, New York, and Illinois); and United States v. USA Waste Serv., 1998 WL 1285897 (N.D. Ohio Sept. 24, 1998) (investigated and settled jointly by DOJ and numerous states).

[77] Another instance of a differing result involves the merger of American Stores Co. ("American") and Lucky Stores, Inc. ("Lucky"). On August 31, 1988, the FTC gave its final approval of American's merger with Lucky, which was conditioned on American divesting several designated supermarkets. The next day, the State of California filed action against

announced that pursuant to the terms of a proposed settlement, Wal-Mart could proceed with its purchase of Amigo provided it divested four Amigo stores in three separate geographic markets in Puerto Rico, so as to ensure competition in those markets among supermarkets, supercenters, and club stores.[78] On December 5, 2002, just hours after the parties consummated the merger and divestitures, the Puerto Rico Secretary of Justice announced that she was planning to file suit against Wal-Mart, which had refused to agree to maintain purchases of local products at pre-merger levels, and refused to promise not to lay off any of Amigo's existing employees.[79] The following morning, Wal-Mart and Amigo filed a complaint in the United States District Court in Puerto Rico, alleging that the Secretary of Justice's anticipated suit would violate their constitutional rights under the commerce, equal protection, and due process clauses. That afternoon, Wal-Mart and Amigo were granted a temporary restraining order against the Secretary of Justice.[80] Around the same time, the Secretary of Justice filed suit in local court on behalf of the Commonwealth of

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the stores, alleging that the merger violated section 1 of the Sherman Act, and section 7 of the Clayton Act. The state sought an injunction requiring American to divest of all of Lucky's assets and businesses in the State of California. *See* California v. American Stores Co., 495 U.S. 271, 275-76 (1990) (holding that states can seek divestitures post-FTC approval and post-consummation of a merger).

[78] Press Release, Fed. Trade Comm'n, Preserving Competition, FTC Requires Divestitures Before Allowing Wal-Mart's Acquisition of Supermercados Amigo in Puerto Rico (Nov. 21, 2002), *available at* http://www.ftc.gov/opa/2002/11/wmamigo.htm.

[79] Wal-Mart Stores, Inc. v. Rodriguez, 236 F. Supp. 2d 200 (D.P.R. 2002) (citing the Secretary of Justice's press release). Prior to the Secretary of Justice's suit, the legislature of the Commonwealth of Puerto Rico held hearings regarding the merger. Press Releases, House of Representatives of the Commonwealth of Puerto Rico (Oct. 29-31, 2002), *at* http://www.camaradepuertorico.org/octubre2002.html.

[80] The federal district court's temporary restraining order, issued on December 6, 2002, at 2:30 p.m., precluded the Secretary of Justice from filing an action in the courts of the Commonwealth of Puerto Rico impeding or interfering with the acquisition of Amigo by Wal-Mart. Wal-Mart Stores, Inc. v. Rodriguez, 236 F. Supp. 2d 200, 203 (D.P.R. 2002).

Puerto Rico under Puerto Rico's anti-monopoly laws, and was issued an *ex-parte* order enjoining the integration of Wal-Mart and Amigo.[81]

After conducting evidentiary hearings, the federal court on December 26, 2002 issued an opinion and order in which it held that the Secretary of Justice had "abused her power" by trying to block the transaction and that her actions amounted to "protectionism of local suppliers that is forbidden" by federal law.[82] The court's order prohibited the Secretary of Justice from "thwart[ing], imped[ing], or interfer[ing] with the acquisition of Supermercados Amigo, Inc. by Wal-Mart Puerto Rico, Inc."[83] Wal-Mart and Amigo argued in subsequent court filings that the language of the order obliges the Secretary of Justice to "voluntarily dismiss[] without prejudice, the case filed by her in the Commonwealth court."[84] This event was of interest to many state attorneys generals, who along with other entities during the last week of February filed amici briefs on behalf of the Secretary of Justice in the First Circuit Court of Appeals.[85] On February 28, 2003 the day after the FTC

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[81] Estado Libre Asociado de Puerto Rico v. Wal-Mart Puerto Rico, Inc., No. KPE 02-2847 (907) (Ct. First Instance P.R. Dec. 6, 2002) (order granting preliminary injunction).

[82] Wal-Mart Stores, Inc. v. Rodriguez, 238 F. Supp. 2d 395, 416 (D.P.R. 2002), *remanded to* 322 F.3d 747 (1st Cir. 2003).

[83] *Id.* at 422.

[84] *See, e.g.*, Wal-Mart's Motion for Remedies at 2-3, Wal-Mart Stores, Inc. v. Rodriguez, 238 F. Supp. 2d 395 (D.P.R. 2002).

[85] There were three such briefs filed. One was on behalf of twenty states, another was submitted by the American Antitrust Institute, and the third was by the Organization for Competitive Markets and the Puerto Rico Farm Bureau. Numerous supermarket competitors also earlier filed suit in local court, requesting preliminary and permanent injunctions against the merger and monetary relief for alleged anticompetitive vertical conduct by Wal-Mart. Cooperativa del Consumidores del Noroeste, Inc. v. Wal-Mart Stores, Inc., Civil No. KPE 02-2503 (907) (Oct. 25, 2002), *available at* http://www.ca1.uscourts.gov/cgorbin/getopn.pl?opinion=02-2710.01A. The Puerto Rico Court of Appeals dismissed the private suit to the extent that it sought to enjoin the merger because private parties do not have standing to stop mergers under Puerto Rico's Monopolies and

approved and announced its Final Decision and Order,[86] Wal-Mart, Amigo, and the Secretary of Justice settled their suits and agreed to jointly move to vacate the district court opinion and order.[87] Their settlement included the divestiture of two additional Amigo stores.[88]

C. The FTC's Vertical Merger Decisions

Vertical mergers involve two companies that have a customer-supplier relationship. For example, a vertical merger occurs when a distributor of one product acquires a manufacturer of the same product or when the manufacturer of an end product acquires the manufacturer of an input for that end product. Vertical mergers typically attracted much less enforcement attention than horizontal mergers because of the frequent presence of significant efficiencies and a less direct impact on competition. Nonetheless, in the last year, typically, the FTC considered two significant mergers that were, at least arguably, vertical.

In June, the FTC voted to block Cytyc Corp.'s acquisition of Digene Corp., an acquisition that would have combined Cytyc's ninety-three percent share of the market for liquid-based Pap tests, used to screen women for cervical cancer, with Digene's monopoly position in DNA-based tests for the human papilloma virus ("HPV").[89] The parties' testing devices resided in adjacent markets. While they did not test for the same illnesses, the tests were closely connected for both medical and technical reasons. First, HPV is viewed as a cause or precursor of nearly all cervical cancers. As a result, according to the FTC, HPV tests "are used as a follow-

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Trade Restrictions Act, Act No. 77 of June 25, 1964, as amended, P.R. Laws Ann. T.10, § 257. The conduct claims remain in litigation.

[86] *In re* Wal-Mart Stores, Inc., No. C-4066 (Feb. 27, 2003) (F.T.C. Feb. 27, 2003) (consent order), *available at* http://www.ftc.gov/os/2003/02/walmartdo.htm.

[87] Wal-Mart Stores, Inc. v. Rodriguez, 322 F.3d 747 (1st Cir. 2003).

[88] *Id.*

[89] Press Release, Fed. Trade Comm'n, Federal Trade Commission Seeks to Block Cytyc Corp.'s Acquisition of Digene Corp. (June 24, 2002), *available at* http://www.ftc.gov/opa/2002/06/cytyc_digene.htm.

up test when Pap test results are unclear."[90] Second, the FTC determined that the Digene HPV test is "most commonly and efficiently conducted using a residual sample obtained from a liquid Pap test, but doing the test this way requires FDA approval."[91] The connection between the two tests and Digene's monopoly in HPV tests, make it essential that liquid-based Pap tests are compatible, and approved by the FDA for use, with the Digene HPV test.

In voting to block the acquisition, the FTC articulated two theories of competitive harm. First, the FTC noted that, for the reasons outlined above, sellers and users of Pap tests had to be able to use the Pap test in conjunction with Digene's HPV test. The FTC was concerned that,

> [b]y purchasing Digene, Cytyc would be in a position to eliminate its only existing competitor (TriPath) by limiting access to Digene's HPV test, and, in a similar manner, could also thwart the entry of other firms that have planned to begin selling liquid Pap tests in the United States in the near future.[92]

The FTC concluded that by refusing to cooperate with TriPath and other firms obtaining FDA clearance to run the Digene HPV test from their Pap samples, and by refusing to provide Digene tests to their competitors on economically viable terms, Cytyc would be able to eliminate or substantially eliminate the only competition it faced in liquid Pap tests.[93]

The FTC's second theory of competitive concern was strictly horizontal. The FTC found that Digene's HPV test was "rapidly expanding into the much larger arena of primary screening" in which it would compete head-to-head with Cytyc's Pap test.[94] Indeed, the FTC concluded that "HPV testing is the most likely technology to compete against

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[90] *Id.*

[91] *Id.*

[92] *Id.*

[93] *Id.*

[94] Press Release, Fed. Trade Comm'n, Federal Trade Commission Seeks to Block Cytyc Corp.'s Acquisition of Digene Corp., *supra* note 89.

liquid Pap testing as a primary cervical cancer screening tool in the future."[95] This loss of future horizontal competition provided the FTC with an additional basis to challenge the acquisition. After the FTC voted to block the transaction, the parties abandoned their merger plans.

The second vertical transaction that the FTC considered involved Synopsys, Inc.'s ("Synopsys") acquisition of Avant!.[96] In a 5-0 vote, the FTC decided not to challenge the combination of two manufacturers of tools used in the "electronic design industry" ("EDA Tools") to design integrated circuits used in computers, cellular telephones, and other electronic devices.[97] Synopsis had a dominant market share in so-called "front-end" logic synthesis tools.[98] Avant! had approximately half the market for "back-end" place and route tools.[99] While the products were not substitutes for each other, each performed essential functions in the design of integrated circuits.[100]

The parties and others advised the FTC that the acquisition would lead to a better integration between the Synopsis front-end product and the Avant! back-end product.[101] What was unclear, however, was whether Synopsis would make its products inter-operable with Avant!'s competing providers of back-end products after the acquisition. At least as a theoretical matter, once Synopsis owned Avant!, its incentive to provide such inter-operability

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[95] *Id.*

[96] Press Release, Fed. Trade Comm'n, Federal Trade Commission Votes to Close Investigation of Acquisition of Avant! Corporation by Synopsys, Inc. (July 26, 2002), *available at* http://www.ftc.gov/opa/2002/07/avant.htm

[97] *Id.*

[98] *Hearings on Fed. Trade Comm'n Re-authorization Before Senate Comm. on Commerce, Science and Transportation,* 107th Cong. (2002) (statement of Sheila F. Anthony, Commissioner), *available at* http://www.ftc.gov/os/2002/07/sfareauthtest.htm.

[99] *Id.*

[100] *Id.*

[101] *Id.*

would be greatly reduced.[102] Despite this concern, which was expressed by Commissioners Anthony,[103] Leary,[104] and Thompson[105] in three separate statements, the FTC did not challenge the merger because it determined that there was insufficient evidence to test it. In light of the speculative nature of the case and the lack of substantial supporting evidence, the FTC chose to take no action.[106] However, all three Commissioners who addressed the issue expressed concern that post-closing developments might reveal that the theoretical concerns were real.[107] Accordingly, they made it clear that this was a transaction the FTC might revisit at a later date, if the circumstances so warranted.[108]

III. SIGNIFICANT DEVELOPMENTS AT THE DEPARTMENT OF JUSTICE

A. *SunGard*

The vast majority of merger enforcement proceedings commenced by the FTC and the DOJ are resolved by consent decree or by the parties abandoning the transaction. Consequently, reported decisions are relatively rare. A notable recent exception was the late 2001 decision by the United States District Court for the District of Columbia in

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[102] *See id.*

[103] Statement of Commissioner Sheila F. Anthony, *In re* Synopsys, Inc./Avant! Corp., FTC File No. 021-0049 (July 26, 2002), *at* http://www.ftc.gov/os/2002/07/avantanthonystmnt.htm.

[104] Statement of Commissioner Thomas B. Leary, *In re* Synopsys, Inc./Avant! Corp., FTC File No. 021-0049 (July 26, 2002), *at* http://www.ftc.gov /os/2002/07/avantlearystmnt.htm.

[105] Statement of Commissioner Mozelle W. Thompson, *In re* Synopsys, Inc./Avant! Corp., FTC File No. 021-0049 (July 26, 2002), *at* http://www.ftc.gov/os/2002/07/avantthompsonstmnt.htm.

[106] *See, e.g.*, Hearings on Fed. Trade Comm'n Re-authorization, *supra* note 98.

[107] *See* Statement of Commissioner Anthony, *supra* note 103; Statement of Commissioner Leary, *supra* note 104; Statement of Commissioner Thompson, *supra* note 105.

[108] Statement of Commissioner Thompson, *supra* note 105.

responded with over ninety customer statements attesting to their willingness to switch in response to such a price increase. In the face of such conflicting customer evidence, the court was unable to determine whether the declarations submitted by the DOJ were truly representative of the shared hotsite client base, and thus concluded that "the statements submitted by both parties prove very little, if anything at all."[113] More persuasive than conflicting customer declarations were internal SunGard documents referring to internal hotsites as its "primary competitor", and statistical evidence establishing that more customers were lost to internal hotsites each year than to all other external vendors combined.[114]

Ultimately, the DOJ's argument failed because its posited product market was too static for a high-technology industry characterized by an "extremely heterogeneous group of customers, particularly in terms of their needs and computer equipment," rapidly changing computer capabilities, and falling costs of hardware and communications.[115] The court concluded that the price for shared hotsite services was set not by any inelastic customers, but by the marginal customers who do have the ability to switch, or credibly threaten to switch, to internal hotsites or quickship alternatives. Absent the ability of the merged firm to price discriminate against the inelastic customers, which the DOJ did not prove, the court's economic analysis seemed in accordance with the prescriptions of the *Merger Guidelines*.

SunGard, thus, not only demonstrates the importance of customer evidence in defining a relevant product market, but is vindication of the core economic principle that prices in any market are set at the margin. The presence of a sizeable group of marginal customers should, absent price discrimination, be sufficient to expand the market even in the presence of a group of customers for whom demand is inelastic.

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[113] *Id.* at 192 n.23.

[114] *Id.* at 189.

[115] *Id.* at 182.

In his comments at the Milton Handler Antitrust Review, Acting Assistant Attorney General Pate expressed some trepidation about trying future merger cases on such an abbreviated schedule as that in *SunGard*.[116] That concern is understandable, especially given the *SunGard* court's acknowledgment that "[t]he difficulty in attempting to decipher any conclusions about defendants' approximately 7,500 customers was obviously exacerbated by the abbreviated discovery schedule in this case."[117] The DOJ should be commended, however, for agreeing to the expedited trial on the merits. In light of the exigencies of the bankruptcy process, absent the agreement of the DOJ to an expedited schedule, Hewlett Packard would likely have emerged as the successful bidder for the Comdisco assets despite its bid of $125 million less than SunGard's. Some observers believe that outcome would have harmed not only the bankrupt company and its creditors, but ultimately consumers as well.

In the bankruptcy context, in which competitors often emerge as the most suitable buyer given their knowledge and experience in the industry, *SunGard* sets an important procedural precedent in that litigation may now be viewed as a viable option to resolve competitive concerns raised by the DOJ. Previously, even the specter of an antitrust issue raised by a competitor's bid might have been enough to defeat a nascent deal. Weighed against this development, however, is the possibility that in the future the DOJ may be wary of agreeing to consolidate a preliminary injunction hearing with a full trial on the merits, at least in a case where customer evidence will be critical.[118]

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[116] R. Hewitt Pate, Antitrust Enforcement at the United States Department of Justice: Issues in Merger Investigations and Litigation, Remarks at the Association of the Bar of the City of New York's Milton Handler Annual Antitrust Review, *in* 2003 COLUM. BUS. L. REV. 507.

[117] *SunGard*, 172 F. Supp. 2d at 183.

[118] The DOJ alleged a product market that included customers using mainframes with those using midrange processors. The court noted that "[i]nstead of fine-tuning its presentation to account for significant differences among defendants' customers, the government lumped *all*

SunGard is also an important substantive precedent in merger law in the area of "captive capacity." The DOJ argued that internal hotsites should be excluded from the relevant market because, absent the availability of those facilities to the market in general, they would not serve to constrain prices charged by the merging firms. The court rejected this argument as inconsistent with the *Merger Guidelines*, stating: "What is significant is not whether the companies that currently use internal solutions have the capacity to enter the market as vendors for others, but whether the customers that currently use shared hotsites would switch to an internal hotsite in response to a SSNIP."[119]

Companies in many markets may face "make or buy" decisions, and the *Merger Guidelines* contemplate that the cost differential between the internal and the external option is the beginning, and not the end, of the analysis of assessing the "competitive significance" of captive capacity.[120] Captive capacity is relevant to the product market definition analysis to the extent that, in response to a five-to-ten percent non-transitory increase in price, those companies with captive capacity would use it themselves or would make that capacity available to the merchant market. To the extent such companies would do so and, as a result, defeat the price increase, that capacity represents a competitive alternative to consumers in the merchant market and, according to the *Merger Guidelines* and *SunGard*, should be included in the relevant market.

SunGard also raises the different question of how to assess the competitive significance of companies currently in the merchant market as consumers of shared hotsite services who could, in response to a five-to-ten percent increase in price, credibly threaten to "make" instead of "buy" through establishing their own internal hotsite. The court found on

customers together." *Id.* at 192. If the tight schedule rather than trial strategy was responsible for this decision, it is yet another indicator that the DOJ might not agree to such a compressed trial on the merits, at least where customer evidence is so important.

[119] *SunGard*, 172 F. Supp. 2d at 187.

[120] MERGER GUIDELINES, *supra* note 10, § 1.31.

the evidence that, not only had a significant group of customers already decided to leave the merchant market in favor of internal hotsites, but that other customers could credibly threaten to do so.[121] Captive capacity is thus important not only in assessing the overall size of the market (and thus the market shares of the merging firms), but also the competitive effects of the proposed merger on existing customers in the market. The *SunGard* court found the presence of captive capacity to be an alternative for at least some customers, and therefore a constraint on the pricing of SunGard and Comdisco.

B. *EchoStar*

On October 28, 2001, EchoStar Communications Corporation ("EchoStar") reached an agreement with Hughes Electronics Corporation ("Hughes") and its parent, General Motors Corporation, to buy Hughes in a deal then valued at approximately $26 billion. EchoStar, through its DISH Network, and Hughes, through DirecTV, are the only two providers of direct broadcast satellite ("DBS") services in the United States. Both the Federal Communications Commission ("FCC") and the DOJ had independent jurisdiction to review this merger, but according to different standards. The FCC's statutory mandate is to determine whether the transfer of FCC licenses necessary for the merged firm to conduct business will serve the "public interest, convenience and necessity,"[122] while under section 15 of the Clayton Act the DOJ seeks to enjoin mergers that are likely to "substantially lessen" competition in violation of section 7.[123] On October 10, 2002, the FCC released a detailed ruling in which it concluded that Echostar and Hughes failed to meet their burden of demonstrating that the merger is in the public interest.[124] On October 31, 2002, the DOJ together with twenty-three

[121] *SunGard*, 172 F. Supp. 2d at 187-88.
[122] 47 U.S.C. §§ 214, 310(d) (2000).
[123] 15 U.S.C. § 25 (2000).
[124] *In re* EchoStar Comm'n Corp., 17 F.C.C.R. 20559 (2002).

State Attorneys General filed suit in federal district court in Washington, D.C. to block the merger.[125] By December 10, 2002, Hughes and EchoStar had formally abandoned the transaction.[126]

The DOJ complaint suggests that this transaction had little prospect of ever being consummated. The DOJ alleged that a product market consisting of multichannel video programming distribution ("MVPD") existed. Hughes and EchoStar control 100% of the available spectrum that can be used to broadcast video programming to any household in the continental United States with an unimpeded view of the satellite. For the vast majority of American households, the local cable television provider is the only other MVPD source other than Hughes and EchoStar. For millions of others residing in rural areas without cable television, Hughes and EchoStar represent the only source of such programming. Consequently, the DOJ alleged that,

> [f]or millions of American households, the proposed merger is a merger-to-monopoly, reducing the number of MVPD competitors from two to one. For tens of millions of households—most of the United States—this is a merger-to-duopoly, reducing the number of MVPD competitors from three to two.[127]

Mergers to monopoly or duopoly face a strong presumption of illegality under existing antitrust doctrine. The *Merger Guidelines* state that efficiencies "almost never justify a merger to monopoly or near-monopoly."[128] Recent case law is in accord.[129] Nonetheless, the transaction raised

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125 Complaint, U.S. v. Echostar Comm'n Corp., (D.D.C. 2002). (1:02CV02138), *at* http://www.usdoj.gov:80/atr/cases/f200400/200409.pdf.

126 Press Release, Dep't of Justice, Statement by R. Hewitt Pate on the Abandonment of the Hughes/Echostar Transaction, (Dec. 10, 2002), *available at* http://www.usdoj.gov/atr/public/press_releases/2002/200539.htm.

127 Complaint, EchoStar Comm'n Corp. (D.D.C. 2002) (1:02CV02138).

128 MERGER GUIDELINES, *supra* note 10, § 4.

129 See, for example, *FTC v. H.J. Heinz Co.,* 246 F.3d 708, 720-21 (D.C. Cir. 2001), where the court stated that in highly concentrated markets the

an interesting question of public policy: should the regulators allow the only two DBS providers to merge in order to create a more effective competitor to the dominant cable television providers? Such a public policy trade-off is within the purview of the FCC's authority.

A short look back to prior DOJ activity in this area suggests that the parties had some reason to believe that such a public policy determination would be a reasonable possibility. In 1998, the DOJ filed suit seeking to prevent MCI from transferring the last remaining DBS spectrum to Primestar, a satellite television provider owned in part and controlled by five of the largest cable companies in the United States.[130] In that complaint, the DOJ characterized local cable television providers as "by far the dominant providers of MVPD services."[131]

Several months later, after the Primestar transaction was abandoned, the DOJ filed comments with the FCC in support of an application by MCI to transfer that same spectrum to EchoStar, thereby putting all of the available DBS spectrum in the hands of just two providers.[132] As the DOJ explained to the FCC, its action against Primestar "was predicated on the competitive concerns that would arise if scarce high-power DBS capacity were acquired and controlled by Primestar's cable company owners—firms that dominate the MVPD market."[133] In challenging PrimeStar's bid for DBS spectrum, the DOJ believed that this spectrum would be better used by one or both of the existing DBS providers, suggesting that DBS could be an effective constraint on ever-increasing cable

merging parties must prove "extraordinary" efficiencies representing "more than mere speculation and promises about post-merger behavior."

[130] Complaint, U.S. v. Primestar (D.D.C. 1998) (No. 1:98CV01193), *at* http://www.usdoj.gov:80/atr/cases/f1700/1757.htm (last visited Mar. 21, 2003).

[131] *Id.* ¶ 2.

[132] *In re* MCI Telecommunications Corporation, No. SAT-ASG-19981202-00093 (F.C.C. Jan. 14, 1999) (comments of the United States Department of Justice), *available at* http://www.usdoj.gov:80/atr/public/comments/2173.htm.

[133] *Id.* ¶ 4.

rates. In this context, the DOJ supported the creation of a DBS duopoly as the most feasible way to provide for more effective competition against dominant local cable providers. In summarizing its position before the FCC, the DOJ explained that the transfer of MCI's spectrum to EchoStar,

> does not pose any significant risk to competition in the distribution of multichannel video programming. Rather, the transaction will greatly increase EchoStar's capacity to transmit video programming and, in so doing, will enhance its ability to compete aggressively and effectively against other distributors of multichannel video programming, including the cable companies that dominate these distribution markets.[134]

EchoStar and Hughes urged that reasoning upon the FCC in support of their proposed merger—that the merger would eliminate duplicative use of limited DBS spectrum (given the many channels carried by both Hughes and EchoStar), thereby permitting the merged firm to use that spectrum more efficiently to offer new and improved services to consumers. Those services included more local programming to more metropolitan areas, more HDTV channels and specialty programs, and broadband alternative to cable modems. EchoStar and Hughes also argued that the merged entity could more effectively compete with cable systems. According to the FCC opinion,

> [t]he Applicants argue that as separate companies, neither EchoStar nor DirecTV has been able to discipline cable companies' prices and that only through the merger will DBS be able to provide effective, price-reducing competition. The Applicants note that cable companies have been continuing to raise their prices in excess of the consumer price index.[135]

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[134] *Id.* ¶ 1.

[135] *In re* EchoStar Comm'n Corp., 17 F.C.C.R. 20559, 20638 (2002).

The outcome of this case ultimately appeared to turn on the question of claimed efficiencies, particularly the extent to which the parties could prove them to be merger-specific, "extraordinary" in their impact, and based on more than mere "speculation and promises" in light of the extremely high concentration levels.[136] The FCC rejected these efficiency claims because it was not persuaded that the capacity needed to improve the competitiveness of DBS against cable could be obtained only by the merger. The FCC pointed to improvements in digital compression and other technologies as affording DBS providers adequate means to obtain the capacity they would need to meet their programming objectives. In other words, a full merger of the only two DBS providers was not viewed by the FCC as indispensable to creating the additional capacity that the parties claimed they needed to compete with cable operators.[137] The FCC's analysis in this regard was consistent with the *Merger Guidelines* and the recent *Heinz* decision.

Other than the complaint filed by the DOJ and an accompanying press release, there are no public documents setting forth its analysis of the merger. In light of the DOJ's past analysis in *Primestar* and its related comments before the FCC, however, the DOJ appeared to give serious consideration to claims that the merged entity would be a more formidable competitor against the dominant cable providers. Indeed, the *Primestar* analysis by the DOJ laid a credible foundation for EchoStar and Hughes to pursue an efficiencies defense in a horizontal merger that would otherwise be presumptively unlawful. In light of the extraordinarily high market shares even in the relevant product market proposed by the merging parties,[138] however, the interesting public policy question of whether many

136 FTC v. H.J. Heinz Co., 246 F.3d 708, 721 (D.C. Cir. 2001).

137 *In re Echostar Comm'n Corp.*, 17 F.C.C.R. at 20638.

138 The FCC was unable to reach a conclusion on the precise confines of the relevant product market and referred that question to a hearing, but for the purposes of its analysis, it adopted the relevant product market proposed by the parties, which included at least all MVPD providers. *Id.* at 20609.

consumers should pay less for cable television at the cost of some consumers paying more for DBS is not an issue readily cognizable under the antitrust laws as typically interpreted by the courts or the enforcement agencies.

IV. OTHER DEVELOPMENTS IN 2002

A. International Merger Coordination: *GE/Honeywell* and its Aftermath

The most significant recent development on the international merger front is the much-analyzed (and much-criticized) decision by the European Commission ("EC") in the summer of 2001 to block the proposed merger between General Electric and Honeywell; the first merger transaction cleared by the DOJ but blocked by the European Union in its entirety.[139] The DOJ quite openly criticized the Commission's decision, characterizing it as a fundamental doctrinal disagreement over the economic purposes and scope of antitrust enforcement.[140] William Kolasky, former Deputy Assistant Attorney General in charge of international antitrust at the DOJ, described the case as "monumental in significance" because it demonstrated "how easily the goals of antitrust can become confused and frustrated and how large the consequences are when that happens."[141]

[139] COMP/M.2220, General Electric/Honeywell v. Commission (2001) , *available at* http://europa.eu.int/comm/competition/mergers/cases/decisions/m220_en.pdf (June 29, 1992) (declaring concentration to be incompatible with the common market and the EEA Agreement).

[140] *See, e.g.*, Charles A. James, Assistant Attorney General, Reconciling Divergent Enforcement Policies: Where Do We Go from Here?, Address at the Fordham Corporate Law Institute, 28th Annual Conference on Int'l Law and Policy (Oct. 25, 2001), *available at* http://www.usdoj.gov/atr/public/speeches/9395.pdf; Deborah Platt Majoras, Deputy Assistant Attorney General, GE-Honeywell: The U.S. Decision, Remarks at the Antitrust Law Section, State Bar of Georgia (Nov. 29, 2001), *available at* http://www.usdoj.gov/atr/public/speeches/9893.htm.

[141] William J. Kolasky, Deputy Assistant Attorney General, Global Competition Convergence and Cooperation: Looking Back and Looking

A look back at international merger developments in 2002 reveals that something positive also came from the GE/Honeywell experience. That case served as an impetus for U.S. and European antitrust enforcers to give new urgency to the work of their Joint Merger Working Group to promote convergence between U.S. and E.U. merger policy, as well as the International Competition Network ("ICN"), a platform for promoting convergence and cooperation among antitrust authorities worldwide.

The Joint Merger Working Group focused its efforts in 2002 on three principal issues: (1) merger process and timing; (2) conglomerate mergers; and (3) the role of efficiencies in merger analysis. While the ongoing work on efficiencies and conglomerate mergers is perhaps best described as facilitating a greater understanding of U.S./E.U. differences,[142] an important first step towards convergence, appreciable progress toward procedural harmonization was achieved in 2002 with the adoption of "best practices" for coordinating future merger reviews.[143] The objectives of the best practices are to "enhance cooperation between the U.S. antitrust agencies and the European Commission in merger review, minimize the risk of divergent outcomes and reduce burdens on parties participating in merger investigations."[144]

Similar objectives were pursued by the U.S. antitrust agencies on the world stage through the ICN, created in October 2001 by the United States, the European Commission, and representatives from fourteen other jurisdictions. Former Assistant Attorney General Charles

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Ahead, Address at the American Bar Association Fall Forum (Nov. 7, 2002), *available at* http://www.usdoj. gov/atr/public/speeches/200442.pdf.

[142] Charles A. James, Antitrust In the Early 21st Century: Core Values and Convergence, Address at the Program on Antitrust Policy in the 21st Century in Brussels, Belgium (May 15, 2002), *available at* http://www.usdoj. gov/atr/public/speeches/11148.pdf.

[143] Press Release, Dep't of Justice, United States and European Union Antitrust Agencies Issue "Best Practices" For Coordinating Merger Reviews (Oct. 30, 2002), *available at* http://www.usdoj.gov/atr/public/press_releases/2001/200407.htm.

[144] *Id.*

James described the ICN as "a new framework within which antitrust agencies from developed and developing countries will formulate and develop consensus positions on specific proposals for procedural and substantive convergence in antitrust enforcement."[145] Today the ICN includes antitrust regulators from over sixty jurisdictions. In 2002, the ICN Merger Working Group focused its efforts on: (1) merger notification and review procedures; (2) the analytical framework for merger review; and (3) investigative techniques for merger review.[146]

The ICN adopted "guiding principles" for merger review, and developed "recommended practices" for merger notification and review that were endorsed by ICN members at their first annual meeting held in September 2002 in Naples, Italy. The recommended practices focused on two issues of critical concern to the business community: the necessary jurisdictional nexus for a regulator to assert authority over a merger, and the need for objective filing thresholds for merger notifications based on dollar sales rather than market shares. The DOJ's former chief representative to the ICN described its first year as follows:

> ICN is already serving as an important force for international cooperation and convergence. It has so far brought together leaders of antitrust authorities from around the world to discuss practical issues of law enforcement. True to its name, it has provided antitrust officials with an opportunity to network, and consistent with its purpose, it has remained 'all antitrust all the time.' The 'virtual network' structure of ICN, and its organization around diverse working groups that consult regularly and informally throughout the year, have enabled ICN to produce concrete results far more quickly than we had imagined possible. If ICN accomplishes a fraction of

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[145] James, *supra* note 142, at 26.

[146] *See* International Competition Network, *Working Group: Mergers*, *at* http://www.internationalcompetitionnetwork.org/wg1.html.

> what it did during its first year in existence, it will no doubt be a remarkable success.[147]

The doctrinal rift created by GE/Honeywell served as the impetus for DOJ's reinvigorated push in 2002 for procedural and substantive convergence of international merger regulation at both the European and the international levels. While much work remains to be done on the procedural side, and substantive convergence remains elusive, the ICN offers real promise of achieving its ambitious goals while minimizing the likelihood that its future progress will be dependent upon another GE/Honeywell-type event that demonstrates how necessary its work has become.

In the aftermath of the GE/Honeywell merger and the renewed focus of the Joint Merger Working Group, there were several cases in 2002 involving successful cooperation between the U.S. and European antitrust agencies. The FTC's recent reviews of proposed mergers involving the cruise line industry, the market for fluoropolymer resins, and the markets for certain insecticides, herbicides, and defoliants exemplify this trend toward more harmonious relations. In approving the proposed cruise mergers, the FTC, while hewing to long-standing domestic antitrust policy, arrived at the same conclusion as the United Kingdom's Office of Fair Trading and Competition Commission and the EC. Significantly, the parties waived confidentiality, such that the agencies were able to share information and analysis.[148] Ultimately, the FTC and its foreign counterparts achieved compatible outcomes, approving the proposed transactions after intense scrutiny of the specific facts before them.[149]

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[147] William J. Kolasky, Deputy Assistant Attorney General, Global Competition Convergence and Cooperation: Looking Back and Looking Ahead, Remarks at the American Bar Association Fall Forum, Washington, D.C. (Nov. 7, 2002), *available at* http://www.usdoj.gov/atr/public/speeches/200442.pdf.

[148] Simons, *supra* note 36.

[149] In early January 2003, the EC announced that it would re-open its investigation after Carnival, which had prevailed against Royal Caribbean in its bid to acquire Princess, changed the terms of the deal. Nonetheless, the EC is expected to approve the acquisition again after a brief inquiry.

The FTC and the European Commission also successfully cooperated with each other in reviewing the proposed acquisition by Belgium-based Solvay S.A. of Ausimont S.p.A. of Italy. Solvay and Ausimont were two of only three producers of polyvinylidene fluoride ("PVDF") in the United States and were two of the three major PVDF producers in the world. PVDF is a fluoropolymer used in a wide variety of applications.[150] The FTC conditioned its approval of the acquisition on Solvay's divestiture of its American PVDF operations. The agency alleged that the markets for PVDF and melt-processible PVDF were already highly concentrated and that barriers to entry made the timely appearance of significant new competitors unlikely.[151] Because coordinated interaction on pricing would be made more likely, competition would be decreased.[152] The FTC's concerns were shared by the European Commission; both agencies accepted the parties' divestiture proposal.[153]

The FTC and the European Commission again achieved compatible outcomes in their review of the proposed acquisition by Bayer AG, a Germany-based corporation, of Aventis CropScience Holdings S.A., which is headquartered in France.[154] The transaction threatened to lessen competition in the markets for certain insecticides, herbicides, and defoliants.[155] Bayer was therefore required by the FTC to divest a number of its businesses and assets.[156]

Francesco Guerrera & Matthew Garrahan, *Brussels Reopens Probe Into P&O Deal*, FIN. TIMES, Jan. 6, 2003, at 19.

[150] Press Release, Fed. Trade Comm'n, FTC Settlement Would Preserve Competition in U.S. Market for Fluoropolymer Resins, *available at* http:// www.ftc.gov/opa/2002/05/solvayausimont.htm (May 2, 2002).

[151] *Id.*

[152] *Id.*

[153] Simons, *supra* note 36.

[154] News Release, Fed. Trade Comm'n, FTC Addressing Competitive Concerns in Core Markets, FTC Approves Bayer AG's Acquisition of Aventis CropScience Holdings S.A. (May 30, 2002), *available at* http:// www.ftc.gov/opa/2002/05/bayeraventis.htm.

[155] *Id.*

[156] *Id.*

"Although the geographic market for such products was limited to national boundaries, the limited number of market participants led to similar competitive effects across national boundary lines. Accordingly, a common remedy made sense from the point of view of both the parties and the enforcers, and, through a high degree of cooperation, a common remedy was achieved."[157]

V. LOOKING AHEAD TO 2003: THE ROLE OF EFFICIENCIES IN MERGER ANALYSIS

In a recent development evincing a trend toward a greater emphasis upon efficiency claims, the antitrust bar was explicitly challenged by the FTC to better develop efficiency defenses. In a speech given at an FTC antitrust roundtable, Chairman Timothy J. Muris urged the antitrust bar to bring greater detail and clarity to efficiency claims in proposed mergers.[158] Contrary to what he asserted is the bar's belief, efficiencies can and should play an important role in merger analysis. Chairman Muris stated that, while efficiencies are unlikely to outweigh the likely anticompetitive effects of a three-to-two or two-to-one merger in a market with high entry barriers, under other circumstances efficiencies can help tip the balance in favor of agency approval. He cited as an example the Commission's approval of the proposed merger of the third- and fourth-largest drug wholesalers: AmeriSource Health Corporation and Bergen Brunswig Corporation. He explained that not only was there not a viable theory of competitive harm in that case, but the transaction seemed likely to yield substantial, merger-specific efficiencies—including the enhancement of the merged entity's ability to compete with the other two largest drug wholesalers.

The Chairman criticized those who would insist that structural considerations—*e.g.*, a high HHI and a significant HHI increase—alone dictate the analysis. He posited that

[157] Simons, *supra* note 36.

[158] Muris, *supra* note 22.

neither the *Merger Guidelines* nor agency enforcement policy comports with that approach. Chairman Muris acknowledged that certain courts appear to have taken such a position, citing Cardinal Health[159]; Chairman Muris distinguished the "Baby Food" case,[160] explaining that,

> [t]he parties lost in the [court of appeals], in part, because the district court judge ignored both antitrust economics and relevant precedent, and did not even allow the substantial customer testimony supporting the merger, let alone give that testimony proper weight. Lacking such evidence, the D.C. Circuit found that the record did not sufficiently rebut the 3-to-2 or 2-to-1 structural presumptions on appeal.[161]

Chairman Muris concluded by observing that, to give prospective efficiencies their due weight, the Commission must be provided with evidence in support of them. Thus, the bar should make possible the fullest consideration of efficiency claims by supporting them with convincing and substantial data. Without that supporting evidence, the Commission will be hindered in its ability to weigh efficiencies in the balance and accurately assess a merger's competitive impact.

Notwithstanding Chairman Muris' invitation to parties to offer efficiency defenses in merger investigations, the antitrust enforcement agencies historically have, on the whole, set the bar relatively high for those who accept the Chairman's offer. Though not part of the *Merger Guidelines*, some have argued that both agencies generally take the overall view that "efficiencies count only to the extent they are likely to be passed on to consumers."[162] One FTC

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[159] *Id.*

[160] FTC v. H.J. Heinz, Co., 116 F. Supp. 2d 190 (D.D.C. 2000), *rev'd*, 246 F.3d 708 (D.C. Cir. 2001).

[161] Muris, *supra* note 22.

[162] Thomas B. Leary, Commissioner, Federal Trade Commission, Efficiencies and Antitrust: A Story of Ongoing Evolution, Remarks at ABA Section of Antitrust Law 2002 Fall Forum (Nov. 8, 2002), *available at* http://www.ftc.gov/speeches/leary/efficienciesandantitrust.htm.

Commissioner, however, has recently taken issue with this requirement, arguing that pass-on of efficiency savings need not be shown.[163] In his speech on efficiencies at the ABA Section of Antitrust Law 2002 Fall Forum, Commissioner Leary raised the prospect that efficiencies could be evaluated under a slightly different standard. His theory appears to be that if companies realize efficiencies, even if they are not initially, or immediately passed on, they ultimately will be passed on in some form.[164]

Commissioner Leary expresses skepticism about the underlying assumption that efficiencies can be segregated into variable cost savings that presumably will be passed on to consumers and fixed cost savings that presumably will not, saying that he is not confident that companies make these distinctions when pricing.[165] Further, Commissioner Leary maintains that eventually in a competitive environment, efficiency savings are likely to yield consumer benefits of some kind, "if not reductions in price, perhaps increased innovation and quality improvements."[166] In summary, he maintains the agencies should not be "overly fixated" with immediate pass-on to the consumer, and that efficiency effects are "much more subtle and longer lasting."[167]

In light of Chairman Muris' challenge to the bar, and Commissioner Leary's comments on the state of current

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[163] *Id.* at 10 (citing his own rationale for supporting the complaint in FTC v. H.J. Heinz Co., 246 F.3d 708, 716 n.9 (D.C. Cir. 2001)); Thomas B. Leary, *An Inside Look at the Heinz Case*, ANTITRUST, Spring 2002, at 32.

[164] Leary, *supra* note 162, at 10.

[165] *Id.* He also states that these fixed cost/variable cost allocations are imprecise, to say the least. *Id.* He cites another article that argues that a pass-on requirement should be rejected because the more competitive the relevant market, the less likely it is that merger-specific efficiencies will be reflected in the post-merger market price. *Id.* at n.84 (citing Paul L. Yde & Michael G. Vita, *Merger Efficiencies: Reconsidering the "Passing-On Requirement*, 64 ANTITRUST L.J. 735, 740 (1996)).

[166] Leary, *supra* note 162, at 10.

[167] *Id.*

efficiencies jurisprudence, the stage is set for this area of merger jurisprudence and agency practice to evolve.