

UNITED STATES DISTRICT COURT
DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA,

Plaintiff,

v.

BAKER HUGHES INCORPORATED;
HUGHES TOOL COMPANY;
NORTON COMPANY; and
EASTMAN CHRISTENSEN COMPANY,

Defendants.

Civil Action No. 90-0825

Filed: 4/10/90

Entered:

Judge Royce C. Lamberth

COMPETITIVE IMPACT STATEMENT

Pursuant to Section 2(b) of the Antitrust Procedures and Penalties Act ("APPA"), 15 U.S.C. §§ 16(b)-(h), the United States of America files this Competitive Impact Statement relating to the proposed Final Judgment submitted for entry with the consent of Baker Hughes Incorporated, Hughes Tool Company, Norton Company and Eastman Christensen Company in this civil antitrust proceeding.

I

NATURE AND PURPOSE OF THE PROCEEDING

On APR 10 1990, United States filed a Complaint alleging that the proposed merger of Baker Hughes Incorporated (hereinafter

"BHI") and Eastman Christensen Company (hereinafter "EC") would violate Section 7 of the Clayton Act (15 U.S.C. § 18). The Complaint alleges that the effect of the merger may be substantially to lessen competition in the manufacture for sale in the United States of three types of diamond drill bits (hereinafter "diamond bits") -- polycrystalline diamond compact (hereinafter "PDC") bits, natural diamond bits and thermally stable polycrystalline (hereinafter "TSP") bits -- which both BHI, through its wholly owned subsidiary Hughes Tool Company (hereinafter "HTC"), and EC manufacture and sell. These three types of diamond bits are used by energy exploration companies to drill oil and gas wells. The Complaint seeks, among other relief, a permanent injunction preventing defendants from, in any manner, combining their PDC, natural diamond, and TSP bit businesses.

On _____, the United States and defendants filed a stipulation by which they consented to the entry of a proposed Final Judgment designed to eliminate the anticompetitive effects of the merger. Under the proposed Final Judgment, as explained more fully below, BHI would be required to sell, by August 6, 1990, its diamond bit business. If it should fail to do so, a trustee appointed by the Court would be empowered to sell this business.

The United States, BHI, HTC, EC and the Norton Company (hereinafter "Norton") have agreed that the proposed Final Judgment may be entered after compliance with the APPA. Entry of the proposed Final Judgment will terminate the action, except that the Court will retain jurisdiction to construe, modify, and enforce the Final Judgment, and to punish violations of the Final Judgment.

II

EVENTS GIVING RISE TO THE ALLEGED VIOLATION

On December 19, 1989, BHI, Norton, and Norton's wholly-owned subsidiaries ECC Texas Holdings I, Inc. and ECC Texas Holdings II, Inc. entered into a purchase agreement under which Norton would cause full ownership of the business of EC to pass to BHI. This acquisition would, if unchallenged, effectively merge all of the businesses of BHI and EC, including their PDC, natural diamond and TSP bit businesses. The purchase price to be paid by BHI to Norton for the business of EC is approximately \$550 million.

BHI and EC are both large, diversified oil field services companies that provide a wide variety of the tools and services necessary for the exploration and production of oil and gas reserves. BHI reported total 1989 sales of about \$2.3 billion, and EC reported total 1989 sales of about \$211 million. BHI, through its subsidiary HTC, produces PDC, natural diamond and TSP bits at manufacturing facilities located in Houston, Texas,

Aberdeen, Scotland and Escobar, Argentina. 1/ BHI's total 1989 worldwide sales of PDC bits, natural diamond bits and TSP bits were, respectively, about \$17 million, \$700,000 and \$300,000. EC produces its PDC, natural diamond and TSP bits at manufacturing facilities located in Salt Lake City, Utah and Celle, West Germany. EC's 1989 worldwide sales of PDC bits, natural diamond and TSP bits totaled, respectively, about \$19 million, \$2.7 million and \$11.6 million.

The Complaint alleges that the manufacture for sale of PDC bits, natural diamond bits and TSP bits are each relevant product markets for antitrust purposes. The primary use of drill bits is to cut through rock and other formations during drilling operations. To accomplish such penetration, bits are attached at the end of a drill string, consisting of long sections of pipe, and are rotated at high speeds. The primary technological distinction between the three types of diamond bits is the nature of the cutting elements, or cutters, that are embedded in the

1/ BHI and EC both typically use the same facilities, equipment and personnel to manufacture and sell all three types of diamond bit products. BHI, through HTC, is also a significant producer and seller of tricone drill bits, a product which EC does not manufacture and sell. In contrast to diamond bits, which have no moving parts, tricone bits contain three steel cones that rotate while the bit is drilling.

bottom and sides of the bits. 2/ Due to the difference in cutting elements and other design variations, each type of diamond bit achieves maximum drilling efficiency in different geological applications. PDC bits are most effective in drilling soft to medium hard formations, natural diamond bits are most effective in deep, hard formations and TSP bits are most effective in drilling formations that require heightened abrasion resistance and higher levels of heat generated during the drilling process. Because customers tend to select particular types of bits to drill particular types of geological formations, they generally do not view the three categories of diamond bits identified in the Complaint as substitutable for one another, and would not be likely to switch from one to another in the event of a small nontransitory price increase. Similarly, a small nontransitory increase in the price of any of the three types of diamond bits is not likely to cause a significant number of customers to

2/ PDC bits contain cutters made of synthetic diamond material called polycrystalline diamond compact, natural diamond bits contain cutters made of natural diamond and TSP bits contain cutters made of synthetic polycrystalline diamond that is thermally stable.

switch to tricone bits. 3/ Firms that produce and sell each type of diamond bit in the United States tend to compete with each other for sales throughout the country. As alleged in the Complaint, the United States is a relevant geographic market, within the meaning of Section 7 of the Clayton Act, for all three diamond bit product markets.

The Complaint alleges that the manufacture for sale in the United States of PDC, natural diamond and TSP bits is highly concentrated. Based on 1989 sales data, EC was the third largest firm in the PDC bit market, accounting for about 19 percent of sales, while BHI, the fourth largest firm, also accounted for about 19 percent. The merger of BHI and EC would result in a competitor that is the dominant firm in the PDC bit market, with about 38 percent of sales, and would increase the Herfindahl-Hirschman Index by about 720 to 2,580. With respect to the natural diamond bit market, EC was, in 1989, the second largest firm with about 28 percent of sales, and BHI was the fifth largest firm, with about 7 percent. The merger of BHI and EC would result in a competitor that is the dominant firm

3/ Diamond bits typically cost between three and eight times as much as tricone bits, but last longer and usually drill faster. Where daily drilling costs are high and the geological conditions are suitable, customers prefer to use diamond bits over tricone bits in order to reduce drilling time and, thereby, lower overall costs.

in the natural diamond bit market, with about 35 percent of sales, and would increase the Herfindahl-Hirschman Index by about 400 to 2,750. Based on 1989 sales, EC was the largest firm in the TSP bit market, accounting for about 60 percent of sales, and BHI was the fourth largest firm, accounting for about 6 percent. The merger of BHI and EC would result in a competitor that is the dominant firm in the TSP bit market, with about 67 percent of sales, and would increase the Herfindahl-Hirschman Index by about 770 to 4,950.

Entry into the United States markets for all three types of diamond bits is difficult, expensive and time consuming. To enter any of the three diamond bit markets and gain a significant market share, among other things, a firm must establish a reputation for the efficiency, durability and reliability of its product under actual drilling conditions in a wide variety of different geographic and geological conditions. Because the performance of a bit is critical to assuring the lowest possible drilling costs, and the risk of financial loss due to bit failure is substantial, customers are generally very reluctant to purchase bits from a new supplier that lacks a proven performance record. A new supplier, therefore, would face difficulty obtaining the sales and runs of its bits that are necessary to establish such a recognized performance record. In addition, to obtain significant market share, a new firm must establish and

maintain a substantial research and development capability, an expert technical service capability, and a sales and service force deployed at locations convenient to drilling sites.

III

EXPLANATION OF THE PROPOSED FINAL JUDGMENT

The United States brought this action because the effect of the proposed merger of BHI and EC may be substantially to lessen competition, in violation of Section 7 of the Clayton Act, in the United States markets for the manufacture for sale of PDC, natural diamond and TSP bits. The risk to competition posed by this transaction, however, substantially would be eliminated were BHI's diamond bit business to be sold to a purchaser that would operate the business as an active, independent and financially viable United States competitor in each of the three relevant diamond bit markets. To this end, the provisions of the proposed Final Judgment are designed to accomplish sale of BHI's bit business to such a purchaser and prevent the anticompetitive effects of the proposed acquisition.

Section IV of the proposed Final Judgment requires defendants, by August 6, 1990, to divest BHI's diamond bit business to a purchaser that has the intent and capability to compete promptly and effectively in the manufacture for sale of PDC, natural diamond and TSP bits in the United States. BHI's diamond bit business, as defined in the proposed Final Judgment,

consists of all assets of BHI, in particular those of HTC, necessary or predominately used to research, develop, test, manufacture, service, finance or market, domestically and internationally, BHI's diamond bit products. The assets to be divested include all of BHI's existing diamond bit patents, technology, inventories, supplies and equipment, as well as its manufacturing plants in Houston, Texas and Aberdeen, Scotland, and all manufacturing equipment from its plant in Escobar, Argentina, which is primarily a tricone bit production facility. The business divested will also include a research and development center containing the equipment needed to design, test and introduce new diamond bits into the marketplace, and a copy of all data recording diamond bit performance in the possession of either BHI or EC at the date of divestiture. Excluded from the assets to be divested is the right to use the tradename of "Hughes Tool Company", which HTC will continue to use to market its tricone bits.

The proposed Final Judgment also contains provisions designed to ensure that the purchaser of the divested assets will have the opportunity to hire a work force sufficient to maintain BHI's diamond bit business as an effective competitor in the United States. Under Section X of the proposed Final Judgment, defendants are required to encourage and facilitate employment by the purchaser of all BHI employees whose current duties primarily

relate to its diamond bit business, and will be prohibited from employing these individuals for one year after the divestiture. In addition, defendants shall assist the purchaser in hiring such other HTC sales, marketing and research and development employees that it needs by providing information and consultation regarding the employees' relative job duties and performance.

Under the proposed Final Judgment, defendants must take all reasonable steps necessary to accomplish quickly the divestiture of BHI's diamond bit business, and shall cooperate with bona fide prospective purchasers by supplying all information relevant to the proposed sale. Should BHI fail to complete its divestiture by August 6, 1990, the Court will appoint, pursuant to Section V, a trustee to accomplish the divestiture. The United States will have the discretion to delay the appointment of the trustee for up to an additional three months should it appear that the defendants are engaged in negotiations likely to result in the required divestiture.

Following the trustee's appointment, only the trustee will have the right to sell BHI's diamond bit business, and defendants will be required to pay for all of the trustee's sale-related expenses. When the trustee's appointment becomes effective, BHI's diamond bit business will include a five year exclusive license to use the tradename of "Hughes Diamond Bit Products." The trustee shall also have the authority to select, in addition

to HTC's diamond bit employees, thirty-nine sales and marketing and three research and development employees of HTC, who the defendants must encourage to accept employment with the purchaser of the divested assets and will be prohibited from employing for one year after the divestiture.

Section VI of the proposed Final Judgment would assure the United States an opportunity to review any proposed sale, whether by the defendants or by the trustee, before it occurs. Under this provision, the United States is entitled to receive complete information regarding any proposed sale or any prospective purchasers prior to consummation. Upon objection by the United States to a sale of BHI's diamond bit business by the defendants, a proposed divestiture may not be completed. Should the United States object to a sale of the divested assets by the trustee, such sale shall not be consummated unless approved by the Court.

Under Section IX of the proposed Final Judgment, defendants must take certain steps to ensure that, until the required divestiture has been completed, both HTC and BHI's diamond bit business will be held separate and apart from EC. Until such divestiture, the defendants must also preserve and maintain BHI's diamond bit business as a saleable and economically viable ongoing business.

Pursuant to Section V, should the trustee not accomplish the divestiture within six months of appointment, the trustee and the

parties will make recommendations to the Court, which shall enter such orders as it deems appropriate to carry out the purpose of the trust, which may include extending the trust or the term of the trustee's appointment. Section XIII provides that the proposed Final Judgment will expire on the fifth anniversary of its entry by the Court.

IV

REMEDIES AVAILABLE TO POTENTIAL PRIVATE LITIGANTS

Section 4 of the Clayton Act (15 U.S.C. § 15) provides that any person who has been injured as a result of conduct prohibited by the antitrust laws may bring suit in federal court to recover three times the damages the person has suffered, as well as costs and reasonable attorneys' fees. Entry of the proposed Final Judgment will neither impair nor assist the bringing of any private antitrust damage action. Under the provisions of Section 5(a) of the Clayton Act (15 U.S.C. §16(a)), the proposed Final Judgment has no prima facie effect in any subsequent private lawsuit that may be brought against defendants.

V

PROCEDURE AVAILABLE FOR MODIFICATION OF THE PROPOSED FINAL JUDGMENT

The United States and defendants have stipulated that the proposed Final Judgment may be entered by the Court after compliance with the provisions of the APPA, provided that the

United States has not withdrawn its consent. The APPA conditions entry upon the Court's determination that the proposed Final Judgment is in the public interest.

The APPA provides a period of at least 60 days preceding the effective date of the proposed Final Judgment within which any person may submit to the United States written comments regarding the proposed Final Judgment. Any person who wishes to comment should do so within 60 days of the date of publication of this Competitive Impact Statement in the Federal Register. The United States will evaluate the comments, determine whether it should withdraw its consent, and respond to comments. The comments and the response of the United States will be filed with the Court and published in the Federal Register.

Written comments should be submitted to:

Mark C. Schechter, Chief
Transportation, Energy &
Agriculture Section
Antitrust Division
Judiciary Center Building
555 4th Street, N.W.
Room 9403
Washington, D.C. 20001

VI

ALTERNATIVES TO THE PROPOSED FINAL JUDGMENT

The proposed Final Judgment requires that BHI's diamond bit business be sold to a purchaser that would use the business

promptly to become a viable competitor in each of the diamond bit markets alleged in the Complaint. Thus, compliance with the proposed Final Judgment and the completion of the sale required by the Judgment would resolve the competitive concerns raised by the proposed transaction, and assure that BHI's diamond bit business would remain an independent and active competitor to EC's diamond bit business in the United States.

One alternative to the proposed Final Judgment considered by the United States related to the assets that the trustee is authorized to sell in the event that defendants have not accomplished divestiture by August 6, 1990. The United States considered giving the trustee the authority to sell either BHI's diamond bit business or EC's diamond bit business in lieu of the current provisions, which allow the trustee to sell an additional asset -- exclusive use of Hughes' diamond bit tradename for five years -- and include the additional right to employ 42 sales, marketing and research and development personnel of HTC. The United States concluded that, rather than giving the trustee authority to sell an alternate business in an attempt to assure the creation of a viable independent competitor, the current provisions would provide sufficient assurance should BHI fail to effect the required divestiture, and should a trustee thus be empowered to make the sale.

Litigation is, of course, always an alternative to a consent decree in a Section 7 case. The United States rejected this alternative because the sale required under the proposed Final Judgment should prevent the merger of BHI and EC from having a significant anticompetitive effect in any of the three relevant diamond bit markets alleged, and will provide substantially all the relief requested in the Complaint. The United States believes that in the hands of an appropriate purchaser, BHI's diamond bit business will likely maintain its present market share in the United States.

The United States is satisfied that the proposed Final Judgment fully resolves the anticompetitive effects of the proposed merger alleged in the Complaint. Although the proposed Final Judgment may not be entered until the criteria established by the APPA (15 U.S.C. §§ 15(b)-(h)) have been satisfied, the public will benefit immediately from the safeguards in the proposed Final Judgment because the defendants have stipulated to comply with the terms of the Judgment pending its entry by the Court.

VII

DETERMINATIVE MATERIALS AND DOCUMENTS

There are no materials or documents that the United States considered to be determinative in formulating this proposed

Final Judgment. Accordingly, none are being filed with this
Competitive Impact Statement.

Dated:

Respectfully submitted,

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