DEPARTMENT OF JUSTICE

Merger Enforcement Decisions Under Uncertainty and Imperfect Information

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I. Introduction

Thank you, Jim, for the opportunity to join you today at The Deal's third annual Corporate Governance Conference. I have been a fan of your show for a long time now and commend you for the education you provide to the broader public on the decisions that go into investing.

I recently had the pleasure of reading the commencement address that Jim delivered at Bucknell University last month,[1] and was moved by his story of trying to break into journalism, of success, failure, resilience, and personal growth. I found it inspiring, and believe his message—"it's ok to fail, but not to quit"[2]—is important not just for college graduates, but also established professionals, always to bear in mind.

What good journalists, successful investors, and effective law enforcers understand is that an inquisitive approach and recognition of where our information gaps exist help inform sound judgments about markets and industrial behavior. As Bridgewater co-founder Ray Dalio put it, "My success in life has come much more from my knowing how to deal with my not-knowing than what I know."[3] What sounds like a simple aphorism is, in fact, a core pillar of economics: successful investors must appreciate the value of information and the nature of uncertainty.

Economists Jack Hirshleifer and John Riley explain: "All human endeavors are constrained by our limited and uncertain knowledge—about external events past, present, and future; about the laws of Nature, God, and man; about our own productive and exchange opportunities; about how other people and even we ourselves are likely to behave."[4] Weighty as this all sounds, these

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[1] Commencement Address by Jim Cramper P'18, Bucknell University (May 20, 2018), https://www.bucknell.edu/news-and-media/events-and-calendars/commencement/photos-speeches-and-videos/commencement-speeches/commencement-2018-jim-cramer-p18-address.
[2] *Id.*
[3] Richard Feloni, *The Head of the World's Largest Hedge Fund Says Going Broke in 1982 Was the 'Best Thing that Ever Happened' to Him*, BUSINESS INISDER, Apr. 13, 2017, http://www.businessinsider.com/bridgewater-ray-dalio-lesson-from-going-broke-2017-4.
[4] JACK HIRSHLEIFER & JOHN G. RILEY, THE ANALYTICS OF UNCERTAINTY AND INFORMATION 1 (Cambridge Univ. Press 1992).

insights form the basis of the economic theory of uncertainty and information. As the same two economists note, information and uncertainty theory "now flourishes not only in departments of economics but in professional schools and programs oriented toward business, government and administration, and public policy."[5]

As antitrust enforcers, we adhere to the same principles in carrying out our mission of protecting competition, free markets, and economic liberty. Each day, we confront multi-billion dollar transactions, all of which come backed by public assurances that harm to competition is nonexistent, that efficiencies will be enormous, and that an enforcement action will fail. Like any good journalist or investor, the job of the antitrust enforcer is to probe behind the promises and determine based on the evidence and sound economic theory whether a transaction threatens competitive harm, while recognizing that we ultimately must make a predictive judgment in a world of uncertainty, limited information, and risk.

II. Merger Enforcement and Predictive Judgments

We carry out our job of protecting competition and consumers in evaluating M&A transactions with that in mind. Our goal in approaching the merger review process is to have an open mind as well as a certain level of healthy skepticism to make sure we make the right calls on behalf of the American consumer. Enforcement actions must rely on sound economic theory and evidence that a transaction or practice threatens harm to competition and consumers.[6] Where such evidence exists, it is our duty as enforcers vigorously to enforce the antitrust laws and protect free enterprise, and we, appropriately, bear the burden of proof in a court.

[5] *Id.*
[6] Makan Delrahim, "Don't Stop Believin': Antitrust Enforcement in the Digital Era," at 2 (Apr. 19, 2018), https://www.justice.gov/opa/speech/file/1054766/download.

In addition to assessing competitive impact, the evidence-based approach that we apply allows us to review claims of what actually fuels a merger and whether a merger will generate substantial efficiencies. The empirical record supports a careful and probing approach. Where scholars and agencies have conducted merger retrospectives, they have found that publicly promised benefits to competition and consumers don't always pan out.[7]

One of the first questions we ask parties seeking to merge is to explain the rationale for their deal. Often, the answers are revealing. In one recent instance, a corporate executive came to the Department of Justice and candidly explained that his company sought to acquire a competitor because it was easier to buy its customers than to compete for them. That could be a very valid business reason for an acquisition, and it doesn't necessarily prove anticompetitive harm, but it is not always the best competitive justification for a transaction. More often, though, executives and their attorneys come prepared to extol the virtues of a transaction, the competition that it will generate, and why consumers will be better off once it closes.

On some occasions, we hear a tale of woe and calamity that would ensue if the parties *cannot* merge. For example, parties may assert that the prospect of new competition in their market will make it difficult to survive in a changing, dynamic economy. Digital media platforms, with which you are all familiar, frequently arise as the boogeyman that threatens to swallow incumbent competitors whole, even when those digital media companies have little to no presence in the relevant market in which we evaluate that transaction. The law, however, does not recognize these concerns as a justification for an otherwise illegal merger. The antitrust laws, as the Supreme

[7] *See, e.g.*, JOHN KWOKA, MERGERS, MERGER CONTROL, AND REMEDIES (MIT Press 2015); Bruce A. Blonigen & Justin R. Pierce, "Evidence for the Effects of Mergers on Market Power and Efficiency," Finance and Economics Discussion Series 2016-082 (Washington, Board of Governors of the Federal Reserve System 2016), https://www.federalreserve.gov/econresdata/feds/2016/files/2016082pap.pdf; Orley Ashenfelter & Daniel Hosken, *The Effect of Mergers on Consumer Prices: Evidence from Five Mergers on the Enforcement Margin*, 53 J.L. & ECON. 417 (2010); Graeme Hunter, Gregory K. Leonard & G. Steven Olley, *Merger Retrospective Studies: A Review*, 23 ANTITRUST 34 (2008).

Court has reminded us, "were passed for 'the protection of *competition*, not *competitors*.'"[8] To date, only one substantive exception to an anticompetitive merger has been accepted by courts: a "failing firm" defense.[9] The defense that "we are getting crushed by a new, more efficient, innovative competitor" has yet to be recognized by the courts.

This legal backdrop informs our exercise of prosecutorial discretion. Some have observed that an illegal merger rarely, if ever, has been cleared in court based on the efficiencies defense[10]—that is, the defense that transaction-specific, verifiable efficiencies outweigh harm to competition—and then draw the conclusions that efficiencies should never carry the day in merger evaluations, and therefore that efficiencies warrant minimal scrutiny by enforcers. Those conclusions are misplaced. I believe the rarity of successful efficiency defenses in courts stands as a testament to the success of the Antitrust Division's exercises of prosecutorial discretion not to challenge mergers that offer substantial pro-competitive benefits and minimal harm.

III. The Continuity of Vertical Merger Enforcement Policy

In regard to our exercise of discretion, I understand that some journalists and observers have expressed concern that the Division no longer believes vertical integration and mergers can be efficient and beneficial to competition and consumers. Some point to our recent decision to challenge some aspects of the AT&T/Time Warner merger as a supposed bellwether for a new vertical approach. Rest assured: these concerns are misplaced. Allow me to explain why.

[8] Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 224 (1993) (quoting Brown Shoe Co. v. United States, 370 U.S. 294, 320 (1962)).
[9] *See, e.g.*, Citizen Publ'g Co. v. United States, 394 U.S. 131, 138 (1969) (confining the failing firm defense to "its present narrow scope").
[10] FTC v. CCC Holdings, Inc., 605 F. Supp. 2d 26, 72 (D.D.C. 2009).

First, we have long recognized that vertical integration can and does generate valuable efficiencies that benefit consumers. Indeed, most vertical mergers are pro-competitive or competitively neutral. The same is, of course, true of horizontal transactions.

Second, to the extent that any recent action points to a closer review of vertical mergers, it is not new. Congress amended the merger laws in 1950 specifically to include vertical mergers.[11] That has not changed. Since then, the Antitrust Division and the Federal Trade Commission have identified problems arising from certain vertical acquisitions that could result in exclusion or raising of rivals' costs in a manner that hurts competition.[12] The fact that courts have entered consent decrees to remedy the anticompetitive aspects of some vertical mergers underscores the fact that these types of harm do arise. In some instances, the concerns regarding harm arising from vertical aspects of a merger have caused parties to abandon a transaction entirely or to agree to certain kinds of remedies.[13]

Some commentators point to recent public speeches about our preferred approach to antitrust remedies—namely, the preference for structural remedies to an anticompetitive aspect of a merger and greater trust in markets rather than ineffective behavioral remedies. This skepticism of behavioral remedies for vertical mergers not a new development. For many years, enforcers and commentators have expressed serious skepticism of the efficacy of behavioral remedies,[14] and in my experience at the Division, those concerns have been well-founded. We have made a number

[11] *Brown Shoe*, 370 U.S. at 312, 315-17.
[12] *See* Steven C. Salop & Daniel P. Culley, *Vertical Merger Enforcement Actions: 1994-2016* (Georgetown Univ. Law Ctr., June 30, 2017), https://scholarship.law.georgetown.edu/facpub/1529/.
[13] *E.g.*, U.S. Dep't of Justice, Press Release, "Lam Research Corp. and KLA-Tencor Corp. Abandon Merger Plans" (Oct. 5, 2016), *available at* https://www.justice.gov/opa/pr/lam-research-corp-and-kla-tencor-corp-abandon-merger-plans; William McConnell, "LAM, KLA-Tencor Cancel $10.6 Billion Merger Deal," THESTREET.COM, Oct. 5, 2016, *available at* https://www.thestreet.com/story/13843323/1/lam-kla-tencor-cancel-10-6b-deal.html.
[14] Antitrust Division Policy Guide to Merger Remedies, (Oct. 2004), *available at* https://www.justice.gov/atr/archived-antitrust-division-policy-guide-merger-remedies-october-2004#3e; John E. Kwoka & Diana L. Moss, *Behavioral Merger Remedies: Evaluation and Implications for Antitrust Enforcement*, 57 ANTITRUST BULL. 979 (2012).

of revisions to our consent decrees for the purpose of enforcing them more effectively, recognizing that neither we nor courts have the resources to police business interactions in an industry over the course of several decades. We instead seek to place our trust in markets.

As I have previously expressed, where a reasonable probability of anticompetitive effects exists, the role of the enforcer is to eliminate the risk and let the markets dictate prices—not to design elaborate remedies that purport to reduce that risk while usurping regulatory powers.[15] Structural remedies to an illegal merger, such as divestitures, substantially eliminate the risk of harm and preserve natural incentives for businesses to compete.

Our most recent example of favoring structural relief is the decision we announced last week in the Bayer/Monsanto merger.[16] The Division obtained a substantial but tailored divestiture package of assets that resolved, to the best of our abilities, the competitive harms that were identified in that transaction. Specifically, we required Bayer to divest its seed treatments that, when combined with Monsanto's seeds, would create a threat of foreclosure to rival seed manufacturers.[17] This serves as a valuable reminder that parties can still enjoy the benefits and efficiencies of a merger while completely curing the source of vertical harm, rather than relying on a band-aid of behavioral remedies. I think businesses should welcome this approach because it benefits them and provides for greater predictability.

To reiterate, our approach to vertical mergers has not changed, and our recent enforcement efforts are consistent with the Division's longstanding bipartisan approach to analyzing such mergers. We will continue to recognize that vertical mergers in general can yield significant

[15] Makan Delrahim, "Competition and Deregulation Roundtable #2 Remarks of Assistant Attorney General Makan Delrahim," at 4 (Apr. 26, 2018), https://www.justice.gov/opa/speech/file/1057841/download.
[16] Press Release, Department of Justice, "Justice Department Secures Largest Negotiated Merger Divestiture Ever to Preserve Competition Threatened by Bayer's Acquisition of Monsanto" (May 29, 2018), https://www.justice.gov/opa/pr/justice-department-secures-largest-merger-divestiture-ever-preserve-competition-threatened.
[17] *Id.*

economic efficiencies and benefits to competition. Lumping all "verticals" together under the same umbrella, by comparison, obscures the reality that we conduct a vigorous investigation, aided by over 50 Ph.D. economists, in each instance.

IV. Conclusion

To conclude, I would like to thank you again, Jim, for the invitation to join such an impressive array of speakers, including some of the finest investors and executives in the world. I commend you all for your diligent efforts to create economic value for your shareholders by tirelessly searching for the truth and taking great risks, knowing that you might fail, but never quit.