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STATEMENT

OF

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CHAIRMAN

FEDERAL TRADE COMMISSION

BEFORE THE

SUBCOMMITTEE ON TRANSPORTATION, TOURISM,

AND HAZARDOUS MATERIALS

COMMITTEE ON ENERGY AND COMMERCE

UNITED STATES HOUSE OF REPRESENTATIVES

OVERSIGHT HEARINGS ON MERGERS AND ACQUISITIONS

AUGUST 6, 1987

Mr. Chairman and members of the Subcommittee:

I very much appreciate this opportunity to testify on the subject of merger policy, and enforcement of the antitrust laws as they relate to mergers. Please note that this statement reflects my own views, and not necessarily those of the Commission or my fellow Commissioners.

In my testimony today, I shall first outline the antitrust laws enforced by the Commission that relate to mergers, and briefly describe the policies underlying those laws. Next, I will discuss the procedures utilized by the Commission in analyzing mergers under the applicable antitrust laws. I shall then summarize the substantive features of the analysis that the Commission applies in determining whether a particular merger should be challenged. Finally, I will address certain specific questions that the Chairman has asked me to consider. I have also provided a number of charts showing certain merger enforcement statistics requested by the Subcommittee.

Section 7 of the Clayton Act bars mergers and acquisitions that may substantially lessen competition or tend to create a monopoly. The Federal Trade Commission and the Department of Justice share responsibility for enforcing that statutory prohibition. The Commission also considers anticompetitive mergers and acquisitions to be unlawful under Section 5 of the

Federal Trade Commission Act, which prohibits "unfair methods of competition."

These laws exist for the protection of consumers and reflect the view that one of the best ways to protect consumers is to protect competition. Competition provides the optimal allocation of society's scarce resources and maximizes consumer welfare. Protection of competition may coincide with the protection of a local community, a labor union, the management of an individual company, or another special interest group, but this is not necessarily so. The antitrust laws must be enforced to preserve competition and to benefit consumers, not to serve some specific group at the expense of our national economic welfare.

How do mergers affect the competitive environment? Let me begin by placing recent merger activity in an economic and historical context. If we were to summarize the current state of the American economy in one word, that word would be "change." In a fundamental sense, the mergers and acquisitions we have seen in recent years are not a cause of change or instability in our economy. Rather, they are a response to changes in our competitive environment. Increased foreign competition, deregulation, and technological change are three major factors that have affected our economy and have stimulated mergers and takeovers in several industries. Steel, automobiles, and banking are just a few examples.

The biggest economic advantage we have over our foreign competitors is our ability to adapt in response to changes in the world economy. This is because free markets react most quickly and efficiently to altered competitive circumstances -- and respond best to consumers' needs. Our nation's economic record over the past few years, in terms of growth of output and employment, and prices paid by consumers, is one to be envied by all other countries. And this, in significant part, is because we allow our markets to adjust to new competitive realities, and part of that adjustment is a consequence of mergers and acquisitions.

Free markets for capital and corporate assets are vital to the efficient functioning of our economy. Mergers and acquisitions allow assets to be reorganized efficiently, and improve consumer welfare by reducing costs and prices. Mergers may injure consumers in only two situations. First, it is possible that an acquiring company will err and be unable to improve the productivity of the company it acquires. Government, however, certainly is in no position to second guess the judgment of those who have large sums of money at risk in these matters. Second, mergers are harmful where they may substantially lessen competition, with the effect of permitting or generating price increases. Our task at the Federal Trade Commission is to identify and prevent the very few transactions that are likely to increase prices and injure consumers by substantially lessening competition.

I will now turn to a discussion of the procedures and substantive analysis used by the Commission in carrying out that responsibility. Usually, the Commission becomes aware of proposed mergers and acquisitions when the parties to the transaction notify the Commission under Section 7A of the Clayton Act. Section 7A, otherwise known as the Hart-Scott-Rodino Antitrust Improvements Act of 1976, requires that certain proposed acquisitions of stock or assets be reported, before consummation, to both the Federal Trade Commission and the Department of Justice. The parties must then wait a specified period -- usually thirty days, but fifteen days in the case of a cash tender offer -- before they may complete the transaction. Whether a particular acquisition is subject to these requirements depends upon the value of the acquisition and the size of the parties, as measured by their sales and assets. Small acquisitions, acquisitions involving small parties, and other classes of acquisitions that are unlikely to raise antitrust concerns are excluded from the Act's coverage.[1]

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[1]Notwithstanding that many acquisitions are excluded from the advance reporting requirements of the Hart-Scott-Rodino Act, the Commission monitors such transactions, relying upon the general and business press, and complaints from customers, suppliers, and competitors of the merging firms. The Commission investigates such transactions and takes enforcement action whenever appropriate.

If either the Commission or the Department of Justice determines during the initial waiting period that further inquiry is appropriate, Section 7A(e) authorizes that agency to request additional information or documentary materials from either, or both, of the parties participating in the reported transaction. Such a request, commonly referred to as a "Second Request," extends the waiting period for twenty days -- ten days for cash tender offers. The extension period does not begin to run until substantially all of the requested information and documents are received from the parties.

If, as a result of this investigation, the Federal Trade Commission believes that a proposed transaction may violate the antitrust laws, it may authorize its staff to petition a federal district court for a preliminary injunction prior to the expiration of the waiting period. Such an injunction will prohibit consummation of the transaction while the Commission conducts an administrative proceeding to determine whether, on the merits, the transaction violates the antitrust laws. The Commission may also decide to permit consummation of the merger, but commence an administrative proceeding at a later time to obtain divestiture.

The internal procedures employed by the Commission in assessing mergers are as follows. The Premerger Notification Office within the Bureau of Competition receives the Hart-Scott-

Rodino filings, prepares short summaries of each, and circulates the summaries to designated personnel within the Bureau of Competition, the Bureau of Economics, and the Commissioners' offices. If investigation is appropriate, an attorney or attorneys in one of the litigation sections is assigned to the transaction and economic support is provided by economists from the Bureau of Economics. The Merger Screening Committee of the Bureau of Competition meets each Thursday to consider whether particular transactions should be investigated, and to review recommendations by staff attorneys to issue Second Requests. This Committee is chaired by the Director of the Bureau of Competition or, in his absence, by the Deputy Director in charge of mergers. Both the investigating attorneys and economists provide recommendations to the Committee concerning whether investigations should be opened, or whether requests for additional information should be issued. When the Bureau Director concludes that a Second Request should be issued, he forwards an appropriate recommendation to the designated Commissioner, usually the Chairman, who decides whether to issue the Second Request. I should note here that I am describing the usual but not necessarily the exclusive procedure for issuing Second Requests. The Commission may, of course, issue a Second Request even when the Bureau Director does not recommend doing so.

The staff usually commences intense investigative efforts as soon as the Second Request is issued, and investigational hearings to obtain testimony of the parties and others under oath are often conducted even before the parties comply with the Second Request. When the staff has concluded its investigation, it prepares memoranda advising the Commission of the facts, and recommends whether or not the Commission should issue a complaint and seek injunctive relief. The Directors of the Bureau of Competition and the Bureau of Economics also frequently submit their own recommendations. Thus, each merger is carefully analyzed and the Commission receives the benefit of a wide range of views.

With reference to the Subcommittee's question concerning the adequacy of the existing Hart-Scott-Rodino mechanisms, there is some disagreement on this issue among the members of the Commission. Personally, I am persuaded that the Act in its current form provides the Commission and its staff with sufficient time to analyze proposed mergers and acquisitions. I am not aware of any instance in which the Commission might have acted differently with respect to a merger if the waiting period had been longer.

Although the waiting period following the issuance of a Second Request may seem quite short, there are three factors that operate to provide the Commission with substantially more time in most cases. First, as I mentioned earlier, the Hart-Scott-Rodino waiting periods do not include the time that the merging parties take to comply with the Second Request. The merging firms often take several weeks, and in some cases months, before complying sufficiently to restart the Hart-Scott-Rodino clock. Further, the Commission pursues its merger investigations even while the merging firms are responding to the request.

Second, we often have prior experience with the market or firms affected by the proposed transaction. Thus, effort expended on earlier investigations often allows subsequent inquiries to be more focused and efficient.

Finally, in a large percentage of Hart-Scott-Rodino transactions, the merging parties voluntarily grant the Commission additional time to complete its investigation. In short, we have always had sufficient time under the current waiting periods to investigate and analyze even very complex transactions. Some of my fellow Commissioners, however, believe that the Second Request waiting period for cash tender offers should be extended to equal the period for non-cash tender offers. This would require doubling the time from 10 days to 20. I disagree with this position because I see no evidence that such an extension is necessary.

I now turn to a discussion of the substantive analysis applied by the Commission in determining whether to challenge proposed mergers and acquisitions. The antitrust laws are intended to preserve competition -- to provide consumers with the greatest possible variety of goods and services of the highest possible quality at the lowest possible prices. Thus, when we review a merger, our concern is whether the transaction is likely to benefit consumers or to hurt them. More specifically, the fundamental question is whether the combined firm, alone or with other firms, will likely be able to increase prices and reduce output as a result of the merger.

The Commission analyzes this question in two steps. First, we must ascertain and define the arena in which the merging firms compete. In antitrust jargon, this means defining the relevant product and geographic markets. The issues we consider include: From whom can customers purchase the product in question? Can other products be substituted for it, and at what price? Are there other companies that could begin producing the product within a reasonable time? How far can the product be transported? Are imports increasing, or are they blocked by trade barriers?

Once we have defined the relevant market, we turn to the question of whether the merger is likely to affect competition adversely in that market. Again, the analysis covers many factors, including: How many other companies compete in the market? What is their relative competitive strength? What is the current state of competition in the market? Are there any barriers or impediments to entry by firms currently outside the market? Could competitors already in the market easily collude, or are there so many product varieties and prices that collusion would be infeasible? Can buyers effectively hold down prices? Will the acquisition help reduce costs and thus prices?

Our analysis also considers the impact of the merger on concentration levels in the market, but as even this brief summary discussion has suggested, merger review is not, nor can it be, reduced to a simple numbers game. It is never enough merely to identify some recognized industry segment and count up the number of players. I believe we have made great strides in recent years to improve the sophistication and accuracy of our merger analysis, and we hope to make even further progress in the future. In my view, the process we employ combines good law and good economics to yield good policy results. The antitrust enforcement agencies are effectively blocking mergers that threaten competition, and are allowing procompetitive mergers to proceed with a minimum of governmental interference.

You asked me to respond to several other questions that I have not explicitly addressed thus far in my discussion of the

Commission's enforcement procedures and policies. I shall now turn to those issues.

You inquired whether the nature of our analysis depends on whether a transaction is hostile or friendly. The short answer is no, although we try to avoid affecting the outcome of a hostile takeover contest except as an unavoidable consequence of our enforcement efforts.

Let me explain briefly. Hostile takeover efforts are a critically important mechanism for facilitating the efficient movement of assets to their highest valued use. Unfortunately, the vernacular associated with these efforts has helped to give them an unsavory image. Corporate "raiders" sell "junk bonds" to raise funds so that they can destroy the finest firms in the United States, unless their targets can find "white knights" to protect themselves or pay off the raiders with "greenmail." In fact, "hostile" takeovers are nothing more than a way of disciplining inefficient corporate managers. It is a misnomer to call such a takeover effort "hostile;" incumbent shareholders are usually happy to sell their shares at a premium to the acquiring firm. Frequently, only the incumbent managers are hostile, and that is often because they expect to lose their jobs if the takeover effort succeeds. That may happen in any successful takeover effort, and I am sure that you will hear from literally dozens of incumbent and former managers on the subject. But affording job security to incumbent managers is not a valid basis for making takeovers more difficult.

The important policy point is rather that free and unfettered competition for the control of corporations and the assets they own is highly desirable -- even essential -- to a vigorous and healthy economy. Takeover attempts are launched because the bidder believes that the value of the target's stock has been depressed by poor management. The bidder typically offers a premium to obtain controlling stock, expecting to oust existing management and deploy the firm's productive assets more effectively.

The transfer of corporate control in such circumstances benefits the bidder, the target company's shareholders and the economy as a whole. The successful bidder benefits by realizing gains from the enhanced profitability of the acquired target. Shareholders benefit because bidders for corporate control offer substantial premiums over the pre-offer market price of corporate shares, and because the threat of takeovers motivates incumbent management to improve. The entire economy benefits both from the transfer of corporate control to more efficient management and from the incentives that takeovers create for better managerial performance.

There is considerable evidence from stock market studies that takeovers produce benefits for the entire economy. Studies comparing the share prices of companies involved in takeovers to prices in the market as a whole show that the value of stock in both target firms and acquiring companies increases in response to takeovers. Share prices of target firms increase by 53.4 percent compared to the market,[2] while those of acquiring firms increase by 2.3 percent.[3] The difference between the aggregate value of the firms after a takeover and their aggregate value absent a takeover represents the creation of wealth attributable solely to the takeover. Takeovers thus enhance the welfare of society.

Given these benefits, the Commission attempts to avoid situations in which its own investigative activities resolve a takeover contest for reasons unrelated to substantive antitrust concerns. For example, we are especially careful to minimize the delay caused by issuance of a Second Request where such delay could effectively decide the winner in a hostile contest. Commission investigations of hostile mergers are therefore managed very closely to ensure that they proceed rapidly, yet are as thorough as those conducted for friendly transactions.

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[2]Securities and Exchange Commission, Office of the Chief Economist, The Economics of Any-or-All, Partial, and Two-Tier Tender Offers, Table 4A (1985).

[3]Economic Report of the President 197 (1985).

You also asked whether the Commission's merger analysis includes consideration of such groups as employees and local communities. As I noted earlier, our concern focuses on how a merger will affect consumers generally. Thus, the welfare of any given local community is addressed only in the sense that its members are consumers of the products affected by the acquisition. Unless a merger is anticompetitive, however, we will not attempt to halt it simply as a function of its effects on special interest groups. Nor would it be good policy to do so.

There is no doubt that the competitive process frequently involves business failures, plant closings, and layoffs. The costs associated with these effects are painful both to some individuals and to some groups in society. We know, nonetheless, that interference with competition leads to results that are even less perfect and ultimately much more painful. The benefits of competition to society as a whole far outweigh the costs to the affected individuals of business failures, plant closings, and layoffs. Unfortunately, these costs are visited on a readily identifiable and small group of locally-situated people. It is relatively easy for such groups to unite and voice their objections.

The beneficiaries of competition, by contrast, are often widely scattered throughout the country, so that no one individual or group of individuals enjoys a significant portion of the benefit. For example, if a given merger would increase prices five cents per unit for each of the hundreds of millions of units sold in the market, the effect on any individual buyer could be quite minor, while the total loss in consumer welfare could be enormous. The beneficiaries of sound merger enforcement are therefore not likely to make their views known. Thus, it is the Commission's role to defend their interests against the special interests -- whether those special interests are corporate managers who seek monopoly profits, or unions, towns, or other entities who seek protection from competition through legislation or other means.

In short, the mission of the Federal Trade Commission is to protect the consuming public at large. Our commitment, manifested in the antitrust laws, is to protect competition, not to eliminate it or its effects. There may well be appropriate ways to assist the particular individuals who are adversely affected by mergers, but the use of the antitrust laws to block efficient acquisitions is clearly not a proper means to that end.

Another question you posed is whether the Commission considers the effects of debt incurred to finance acquisitions, particularly where part or parts of the acquired company may be divested in order to generate cash. Generally, the answer is no, because the market provides very strong incentives to insure that debt factors do not reduce consumer welfare.

Addressing first the concern regarding divestiture of an acquired firm's assets, I note that such assets are not destroyed when they are sold by the acquiring firm. Rather, they pass into the hands of persons who are willing to buy them because they believe they can use them more productively. Indeed, the prospect that acquired assets can be employed more efficiently explains why the acquiring firm is willing to buy the target at a premium price. Except where the bidder hopes to produce an anticompetitive effect, there is no rational reason to pay a high price for the privilege of destroying productive assets. The end result of divestiture is more efficiency, which benefits consumers through lower costs and prices.[4]

With respect to the possibility that an acquisition will leave the acquired firm overly burdened with debt, the same line of reasoning applies: the market generally provides the best incentive for people to act efficiently. In virtually all cases, the acquiring firm must invest some of its own money, and perhaps more significantly, lenders are putting their money at risk as well. If the acquired company fails, then both the acquiring firm and the lenders bear huge losses. Thus, there are powerful

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[4]Of course, in order to identify any adverse effects on competition, we do separately review the divestitures or spin-offs that arise from an initial acquisition.

incentives against overburdening an acquired company with so much debt that it cannot compete effectively. Where no anticompetitive effects are likely, the actors making investment decisions with their own money are in a much better position than the government to assess prospectively the merits of the transactions they undertake.

There are certain situations in which we do consider the impact of debt on the viability of a company. If a merger may cause an anticompetitive effect, but partial divestiture of the acquired company will cure the problem, we carefully scrutinize the assets or companies proposed for divestiture to insure that they are competitively viable. We are especially vigilant in this regard, because if the divested company does not survive, the competitive problems we sought to avoid will reappear to injure consumers.

Your final question dealt with mechanisms for evaluating the effectiveness of Commission merger decisions. If the Commission decides not to challenge a merger, and this decision proves to be mistaken in the sense that the merger leads to anticompetitive behavior, we expect to detect our error by one of three possible means. First, if there is a subsequent merger in the same market, our investigation should reveal whether the market has changed adversely since our previous inquiry. Second, other actors in the market, including especially customers of the merged firms, are likely to complain if prices increase. Third, our litigation attorneys monitor various industries through the newspapers and trade press, and thus become aware of potential problems in that manner. As I noted earlier, the fact that the Commission did not challenge a merger during the Hart-Scott-Rodino review period does not in any way prevent us from attacking the transaction later through an administrative proceeding.

I am not aware of any industry in which anticompetitive conduct has resulted from a Commission decision against challenging a merger. I believe that our processes are working quite efficiently, blocking those mergers that harm consumers and interfering as little as possible with those that benefit the public. Those who criticize the Commission's performance should bear the burden of documenting instances in which prices have increased due to a merger that we declined to challenge. I am confident that such a demonstration cannot be made.

Mr. Chairman, this concludes my prepared statement, and I would now be happy to address any questions that you or other members of the Subcommittee may have.

ECONOMIC INDICATORS

Calendar Years	Total Employment (million)	Inflation (Percent Change in CPI)	GNP (1982 Dollars) (millions)	Dow Jones Average (30 Industrials)
1979	100.4	11.3	3.19	844
1980	100.9	13.5	3.19	891
1981	102.0	10.4	3.25	933
1982	101.2	6.1	3.17	884
1983	102.5	3.2	3.28	1190
1984	106.7	4.3	3.50	1178
1985	108.8	3.6	3.59	1328
1986	111.3	1.9	3.68	1793
1987				2547*

1 Economic Report of the President 1987, p 280.

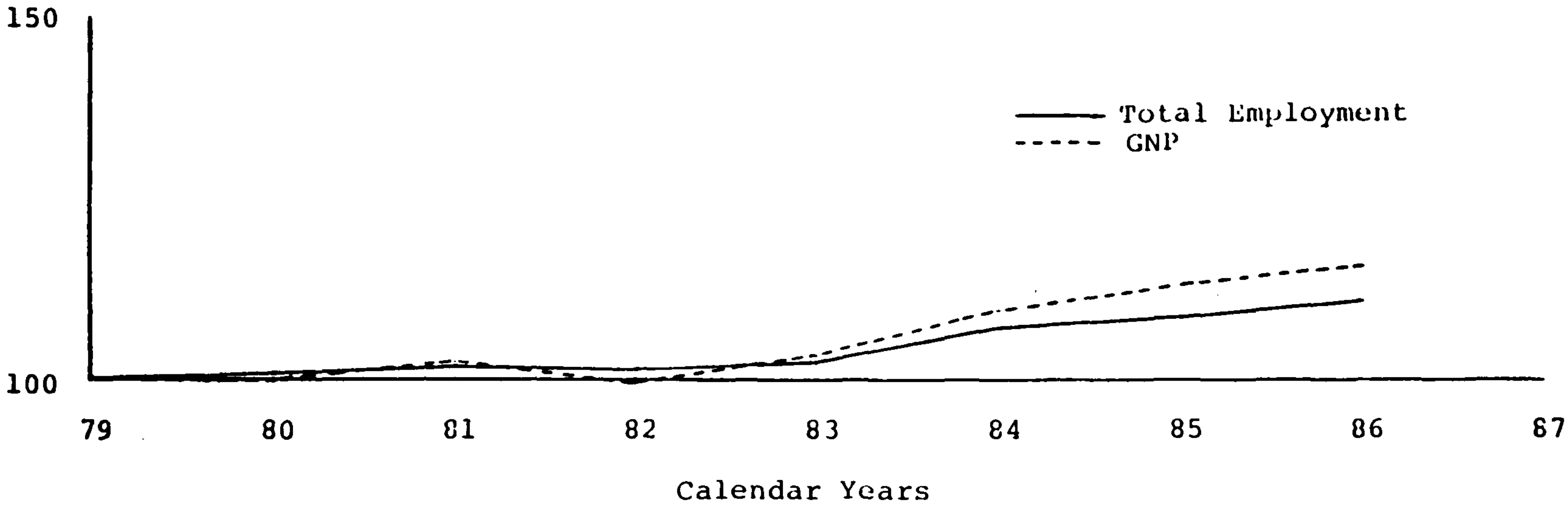
2 Ibid., p 311

3 Ibid., p 246

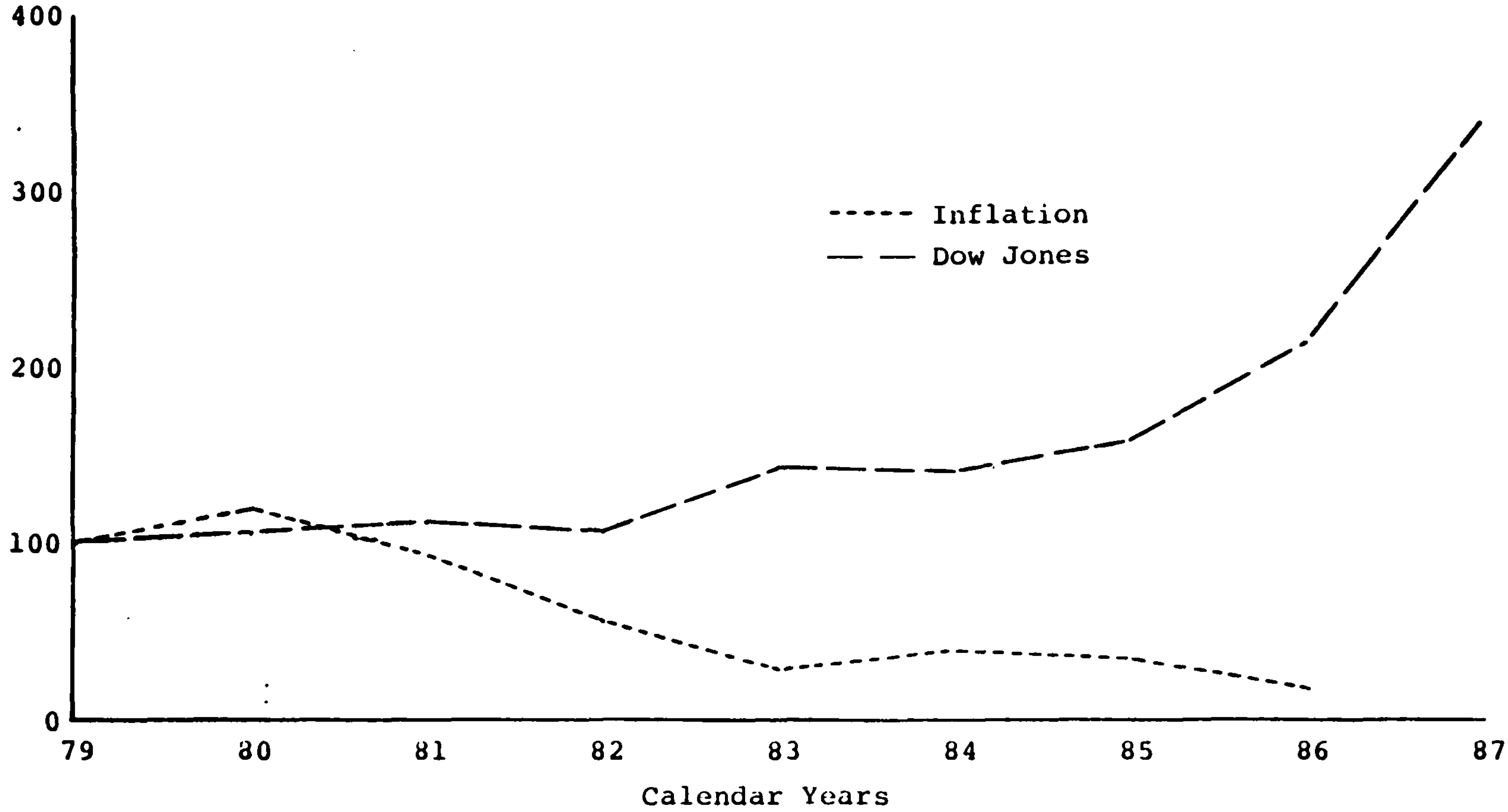
4 Dow Jones Average of 30 Industrials, Ibid. p 350

*Aug. 4, 1987, - Wall Street Journal, Aug. 5, 1987.

ECONOMIC INDICATORS
(1979 = 100)



ECONOMIC INDICATORS
(1979 = 100)

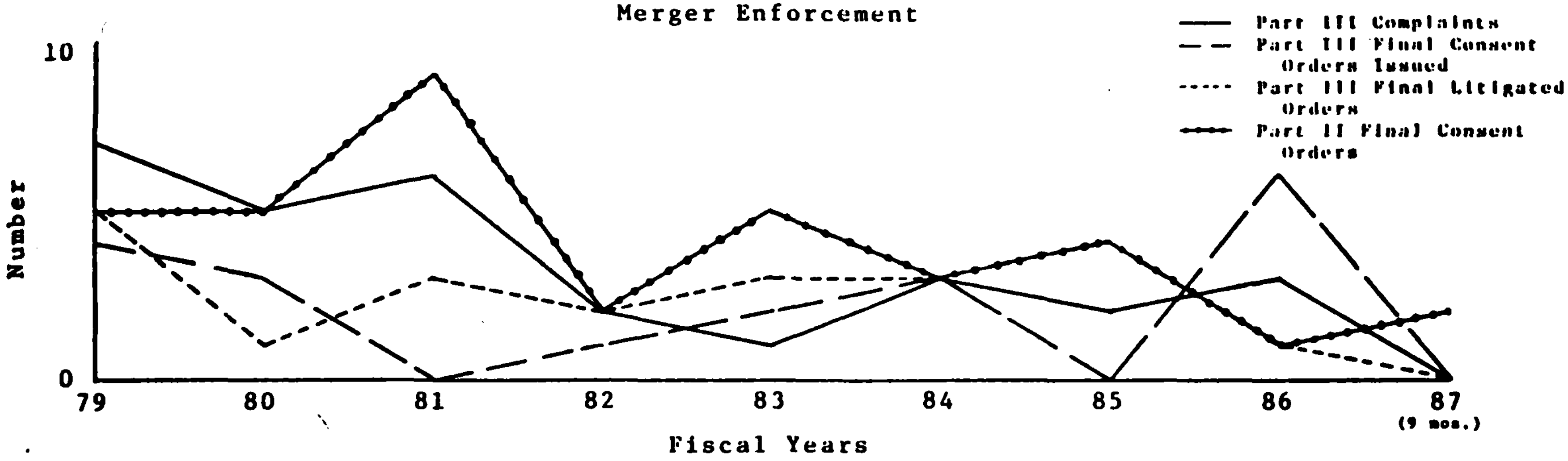


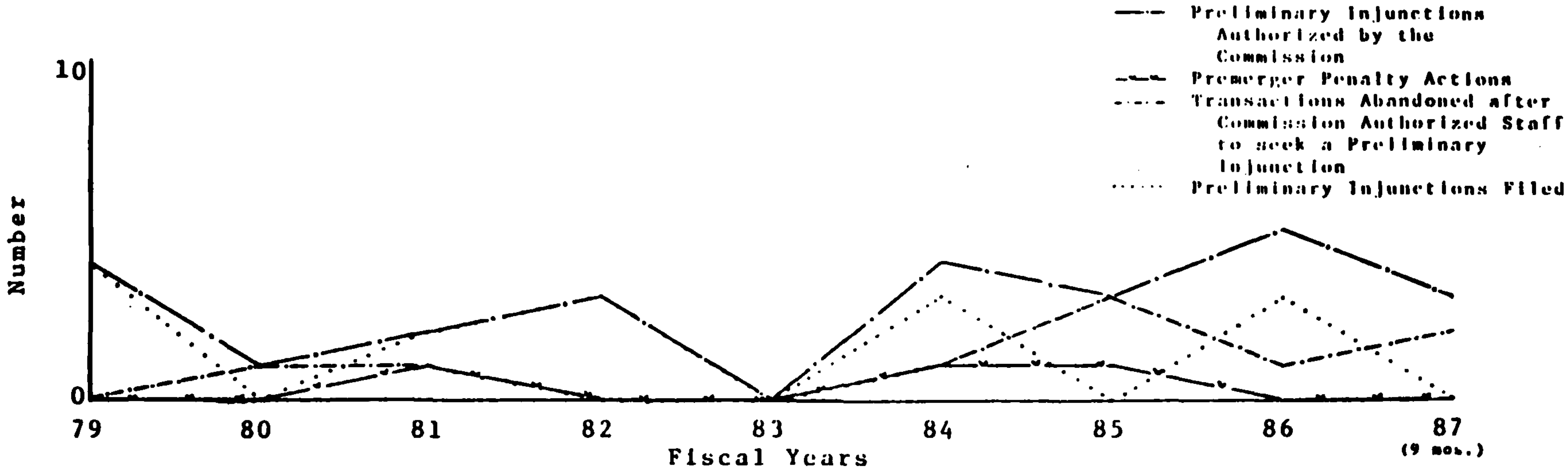
FEDERAL TRADE COMMISSION
Merger Enforcement, Fiscal Years 1979 - 1987*

ACTION	1979	1980	1981	1982	1983	1984	1985	1986	1987*
Part III Administrative Complaints Issued	7	5	6	2	1	3	2	3	0
Part III Final Consent Orders Issued	4	3	0	1	2	3	0	6	0
Part III Final Litigated Orders	5	1	3	2	3	3	4	1	0
Part II Final Consent Orders	5	5	9	2	5	3	4	1	2
Preliminary Injunctions Authorized by the Commission	4	1	2	3	0	4	3	5	3
Premerger Penalty Actions	0	0	1	0	0	1	1	0	0
Transactions Abandoned after Commission Authorized Staff to seek a Preliminary Injunction	0	1	1	0	0	1	3	1	2
Preliminary Injunctions Filed	4	0	2	3	0	3	0	3	0
Transactions Reported	861	784	996	1203	1093	1340	1603	1949	2106
Transactions Withdrawn after the Issuance of Second Requests	15	2	2	6	1	5	2	2	2

* Through July 31, 1987.

Federal Trade Commission
Merger Enforcement





Federal Trade Commission

Transactions Reported and Second Requests Issued, Fiscal Years 1979 - 1987