Antitrust Modernization Commission
Hearings on the FTC-DOJ Clearance Process
Statement by John M. Nannes*
November 3, 2005

The FTC-DOJ clearance process is an odd duck. Virtually everyone agrees that it does not make sense for both the Federal Trade Commission ("FTC") and the Antitrust Division of the Department of Justice ("Division") to review the same proposed merger under the Clayton Act or to investigate the same potential violation of the Sherman Act. Yet, the clearance process used by the agencies to avoid such duplication is shrouded in a process that is not transparent, provides sometimes perverse incentives, and leads occasionally to inexplicable results that undermine public confidence in the process. While virtually everyone agrees that we should do better, the painful fact is that various attempts have been made over the years to improve the process, with only limited success. If the AMC can advance that process, it would be a meaningful contribution to the cause of antitrust enforcement.

The absence of transparency makes it difficult to assess how the clearance process is working at any given time, or over time. Investigational responsibility is supposed to be assigned primarily on the basis of agency expertise, which is reflected in an allocation of commodities[1] to one agency or the other. In a substantial majority of circumstances, this makes for simple, consistent, and timely clearance decisions. However, as our economy evolves, lines that were once clear can become less so, making application of

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* Former Deputy Assistant Attorney General (1998-2001) and Acting Assistant Attorney General (2001), Antitrust Division, Department of Justice.

[1] In this context, the term "commodities" is used to include products and services.

traditional allocations more difficult and clearance disputes more frequent and contentious. That is especially so in high-profile industries that are converging, which often involve highly visible transactions presenting cutting-edge antitrust issues.

When those disputes arise, the agencies use a system for determining each agency's expertise with respect to the commodity involved by looking at the number, extent, and nature of each agency's previous matters involving that commodity. There is a continuum for weighing expertise, ranging from preliminary investigations through to litigated cases, that is used for this purpose. On the surface, this makes sense: an agency that has conducted multiple and/or far-ranging investigations of a particular commodity is more likely to have expertise than an agency that has conducted only a few short preliminary investigations.

In some instances, however, such a system can actually create perverse incentives by penalizing, rather than rewarding, agency efficiency. Suppose an agency has a sufficient understanding of a commodity that it can customarily resolve competitive issues presented by transactions involving that commodity within the initial HSR waiting period. Ironically, that agency gets less "credit" on the "expertise meter" than if it had issued second requests, which can be important in a later clearance dispute regarding that commodity. Such a process can also encourage gamesmanship. Suppose an HSR filing is made by parties in an industry involving a commodity in which one agency (the "expert agency") has substantially more expertise than the other (the "non-expert agency"). The expert agency may be able to conclude quickly that the transaction does not present significant competitive issues and be willing to sign-off quickly; but if the non-expert agency puts in a claim, the expert agency has a dilemma. If it clears the

matter and the non-expert agency does some kind of investigation -- especially if the non-expert agency issues a second request -- then the non-expert agency will be able to cite to that investigation as an indication of expertise when the next transaction involving that commodity arises. Thus, the expert agency has an incentive to put in a claim and conduct a substantial investigation even though it is convinced early on that the transaction is not competitively problematic.

The system can break down in other ways. There have been widely publicized instances in which the agencies have been at loggerheads well into the waiting period and thus have felt compelled to issue second requests that may well have been unnecessary if the merger had been cleared to one agency early in the waiting period. It is hard for anyone outside the agencies to know how frequently this occurs, but the word in the antitrust press and on the street is that there have been two transactions very recently in which clearance disputes ran well into the third and fourth week of the waiting period and second requests were issued. These kinds of turf-battles are impossible to explain to clients and do not well serve the public perception of antitrust enforcement.

Solutions, though, are hard to come by. At various times over the years, many bright and well-meaning officials from both agencies have attempted various fixes. Some have worked better than others and some not at all, but such efforts should be a high priority for the agencies. I offer the following suggestions:

1. My impression is that the clearance process works for a substantial majority of commodities. Where it does not – often due to converging industries -- tinkering with the commodity allocations should reduce the number of clearance disputes. Tim Muris and

Charles James tried that three years ago and, although their efforts were not successful, such an approach made sense then and would make sense now.[2]

2. Active participation by senior officials is necessary to make sure that the potentially perverse incentives don't take over the process. I fully understand the practical difficulties with this suggestion. Every new senior official at the FTC or the Division wants to "support the staff." No new senior official wants to be seen as "giving away the store." But the tone must be set at the top. An agency head can tell staff that gaming the process will not be permitted, that unfounded claims for matters should not be made, and that decisions should be made on the merits. They can select clearance officials who will follow through with this philosophy, and they can make sure that they do so. But, if this is going to work, both agencies must make that commitment and follow through with it.

3. Occasions should be sought for inter-agency cooperation, consultation, and co-ordination. Despite the common mission of the two agencies, my sense is that the agencies do not get together frequently to discuss issues of common interest, although I understand this may be changing. Opportunities expressly dedicated to finding ways to work more closely together could have significant benefits. At a minimum, they could serve to dispel misimpressions that the agencies may have about one another. Beyond

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[2] At the time, I felt that the new allocation favored the FTC – the FTC gained some new commodities, such as electricity, in exchange for essentially merely acknowledging that the Division had the greater expertise in media and entertainment – but that the new clearance agreement was clearly an improvement over the status quo and thus was a reasonable compromise. I wrote an article to that effect for the National Law Journal, "The New Antitrust Clearance Process," but it never appeared in print because the new agreement was abandoned before the article could be published. I never thought it would see the light of day, but given continuing interest in the clearance process, I am attaching it to this Statement.

that, the process might produce some innovative reforms. I have wondered, for example, whether it would be possible for the FTC and the Division to detail lawyers or economists from one agency to the other in a particular matter in order to take advantage of expertise. Right now, an agency has little incentive to share expertise for fear that it will simply be making it easier for the other agency to claim the next transaction that comes along. There are obviously some hurdles to such an exchange, but it seems worth exploring. Presumably those more knowledgeable in the interworkings of the agencies can come up with even more.

It must certainly be true that no Assistant (or Deputy Assistant) Attorney General or FTC Commissioner (or Director of the Bureau of Competition) assumed his or her duties proclaiming that a priority during their tenure would be reform of the clearance process. Indeed, I know of many such former officials who will readily admit that clearance disputes were one of the worst parts of their jobs. But it also true that without a commitment to reform at the top, there is no reason to expect improvement. And that, alone, is reason to try.

Nannes
DRAFT 5/1/02

The New Antitrust Clearance Process

By John M. Nannes*

The Antitrust Division and the Federal Trade Commission have drawn some criticism for their recent agreement that spells out the criteria they will use to determine which of the two agencies will investigate a particular merger or potentially anticompetitive non-merger conduct. Government agencies are criticized – and rightly so – when they play bureaucratic games to protect their jurisdictional "turf" or put parochial self-interest ahead of the public interest in the exercise of their often considerable powers. Yet, the irony in this instance is that the agencies are being attacked for an agreement that represents good government: agencies forsaking "turf" in exchange for improving procedures that advance the public interest in timely and effective enforcement of the nation's antitrust laws.

For reasons owing more to history than logic, the United States has two agencies at the federal level that enforce the antitrust laws: the Antitrust Division of the Justice Department and the Federal Trade Commission. While the merits of

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* Mr. Nannes is a partner in the Washington, D.C. office of Skadden, Arps, Slate, Meagher & Flom LLP. He served as a Deputy Assistant Attorney General in the Antitrust Division of the Department of Justice between 1998 and 2001 and as Acting Assistant Attorney General of the Division during the first five months of the Bush Administration.

having two agencies with largely overlapping jurisdiction can be debated, no one seriously argues that both agencies should be investigating the same merger or the same allegations of anticompetitive non-merger conduct in a particular industry. Thus, long ago the agencies worked out a clearance agreement for coordinating with one another so that duplicative investigations would be avoided.

The guiding principle of the clearance agreement was straightforward: the agency with the greater expertise in a particular industry should do the investigating. To this general rule there were some qualifications. Some areas fell outside the scope of the FTC's statutory jurisdiction, so the Antitrust Division had to handle investigations in those industries, such as telecommunications and airlines. Also, if a matter involved potential criminal behavior, the Antitrust Division, as part of the executive branch, would investigate because the FTC does not have the power to prosecute criminal charges. And, there were occasionally times when one of the agencies was so resource-constrained relative to the other that a matter would be cleared to one agency even though the other had greater expertise. As a general matter, however, clearance according to expertise made sense because it furthered an important goal of law enforcement: consistency in the application of the law.

The clearance agreement worked well enough for many years, but changes in the marketplace sometimes blurred what at one time had seemed like clear lines. The Antitrust Division developed expertise in electricity, and the FTC developed exper-

tise in gas pipelines. Which agency should investigate mergers between electric utilities and gas pipelines? The Antitrust Division developed expertise in telecommunications, and the FTC developed expertise in cable. Which agency should investigate mergers between telecommunications companies and cable companies? The Antitrust Division developed expertise in licensing of performance rights, and the FTC developed expertise in musical records. Which agency should investigate joint ventures for the distribution of music via the internet?

This breakdown in traditional lines of demarcation – and convergence of formerly different industries – put stress on the clearance agreement. The problem was most observable to the private bar and business community in the context of mergers. Parties to large mergers generally have to give the agencies 30 days notice before consummation, during which time the agencies have to decide whether to let the parties proceed or to subject the merger to more extended review (at considerable cost to the parties). During that 30-day period, the agencies first have to decide which one of them will conduct the review. Increasingly, there were instances in which both agencies could credibly claim some relevant expertise and wanted to conduct the investigation.

These clearance disputes took time to resolve. The staff of each agency would prepare memoranda detailing that agency's expertise in the industry and exchange claims with one another. When the respective staffs of the two agencies

felt so strongly about a matter that clearance couldn't be resolved at the staff level, the process worked its way up to senior officials – occasionally even up to the Assistant Attorney General and the Chairman – all while the 30-day clock was ticking. Sometimes, to break the log jam, a matter would be cleared to one agency on the condition that it agree not to cite the matter as a basis for claiming expertise in any later clearance dispute that arose involving that industry. (These "conditions" were called "caveats," and I hated them. While they sometimes helped the agencies resolve clearance disputes, they turned the whole rationale of the clearance system upside down: they required the agencies to ignore actual industry expertise even though that was supposed to be the very foundation of the clearance process.) And there were even times when the matter wasn't cleared by one agency to the other until so near the end of the initial 30-day waiting period that the agency receiving the matter had to extend the review just to buy the time necessary to determine whether there was a serious competitive problem justifying a comprehensive investigation.

The clearance agreement also applies, however, to civil non-merger investigations, and here, too, it came under stress. Unlike mergers, such investigations are ordinarily not subject to the 30-day notice requirement, which ironically can reduce the pressure on the agencies to resolve such clearance disputes promptly. For example, the agencies had a lengthy disagreement over which one would investigate a potentially significant joint venture. The dispute lingered for many months at the

staff level. Bob Pitofsky and I tried to resolve it before Tim Muris and Charles James arrived so that they wouldn't be thrown into a contentious clearance dispute right out of the box. We couldn't work it out – one of the greatest problems with the agreement was that there was no effective mechanism for resolving a genuine impasse between the agencies – and apparently neither could they. It has been reported that they ultimately turned to a local law professor to referee the dispute. He did, but the mere fact that the agencies had to go outside to resolve a clearance dispute simply drove home the point that the system was in need of repair.

Attempts had been made before to revamp the clearance agreement, including as recently as a few years ago. Joel Klein and Bob Pitofsky tried after the uniquely contentious dispute between the agencies over which one would review the AOL-Time Warner merger, but they hadn't been able to work something out because staff couldn't agree upon the compromises necessary to reach agreement. Charles James and Tim Muris asked four former senior agency officials – two of whom had worked at the Antitrust Division and two of whom had worked at the FTC – to look at the clearance agreement and see if they could recommend modifications that would more clearly delineate areas of responsibility for each agency.

These former agency officials made a series of recommendations that were used by the Antitrust Division and the FTC as a basis for changes to the clearance agreement. The changes include some important terms that will improve and

expedite the inter-agency review process. With respect to commodity allocations, in most respects the new agreement merely reaffirmed allocations that had prevailed under the old clearance agreement, such as assigning financial services to the Antitrust Division and pharmaceuticals to the FTC. In certain respects, it clarified the situation by assigning to one agency an area in which both agencies had some experience but where one clearly predominated, such as assigning media and entertainment to the Antitrust Division notwithstanding the FTC's review of the AOL-Time Warner merger. And, in other respects, significant changes were indeed made, some of them quite painful for the agency ceding primary responsibility (such as the assignment of all energy and health care to the FTC).

I don't think there can really be any serious disagreement that clarification of the clearance agreement promotes the public interest. Clarification promotes certainty by allowing parties to know which agency will review their conduct and how their conduct will be analyzed. It promotes consistency and soundness in application of the antitrust laws to a particular industry by assuring that the staff most knowledgeable in an industry will do the investigating. And, it promotes efficiency by eliminating time-consuming internal clearance disputes.

Eleven former senior antitrust officials who served during Republican and Democratic administrations have written in support of efforts to refine the clearance process. They know – as only people who have been on the inside can – the delays,

frictions, and inefficiencies that had come to characterize the old clearance process. Each probably has a different opinion about whether the particular allocations in the new clearance agreement are ideal. I personally think that the FTC did a little better – it gained some things it never had, such as electricity and assignment of all of health care (except insurance), in exchange for acknowledging that the Antitrust Division had the greater expertise in media and entertainment – but that's really beside the point. The point is that something had to be done and that virtually any reasonable compromise was better than continuation of the status quo. This was certainly a reasonable compromise.

There are some people who see a hidden agenda in the new agreement, an effort, perhaps, to use the allocation of commodities as a way of deliberately influencing substantive outcomes. I don't believe that for a second. Charles James and Tim Muris did not manufacture a "problem" to serve as a smoke-screen for a "deal." They inherited a problem that their predecessors had tried unsuccessfully to solve and found a way to solve it. As a result of their efforts, antitrust enforcement will be more consistent, timely, and efficient. This is a result that should be applauded by those who support sound application of our antitrust laws.