Testimony of Harold W. Furchtgott-Roth

Before the Antitrust Modernization Commission

December 5, 2005

Summary

I focus on the proper division of responsibilities between antitrust agencies and regulatory agencies in the review of mergers and acquisitions of regulated firms. I have five recommendations:

1. Only one federal agency should review any merger or acquisition for competition reasons;
2. Regulatory agencies should only review mergers for compliance with existing rules;
3. If multiple agencies continue to conduct merger reviews, their proceedings should be strictly separated;
4. Regulatory agencies should avoid company-specific behavioral rules; and
5. Both antitrust agencies and regulatory agencies should set binding time limits on merger reviews.

I. Introduction

A. Qualifications

My name is Harold W. Furchtgott-Roth. Since 2003, I am president of Furchtgott-Roth Economic Enterprises, an economic consulting firm. I have consulted on a variety of topics, including both regulatory and antitrust matters. I am chairman of the board of the Telecommunications Policy Research Conference, one of the primary forums for research on telecommunications issues in the United States. I chair the board of Oneida Partners, a wireless communications company. I am on the board of MRV, a publicly traded telecommunications manufacturing company. I serve on several advisory boards.

From June 2001 through March of 2003, I was a visiting fellow at the American Enterprise Institute for Public Policy Research (AEI) in Washington, DC. At AEI, I completed the manuscript for a book, *A Tough Act to Follow: The Telecommunications Act of 1996 and the Separation of Powers*. This book, which will be released early next year by the AEI Press, examines many of the problems of administering a regulatory agency that combines all of the powers of government.

I was a commissioner of the Federal Communications Commission (FCC) from November 1997 through the end of May 2001. My statements as a commissioner at the FCC have been cited by federal courts. As a commissioner, I voted on approximately two dozen mergers reviewed by the FCC. I testified before the House Judiciary Committee on the FCC's merger review process.

I have worked for many years as an economist. From 1995 to 1997, I was chief economist of the House Committee on Commerce where I served as one of the principal staff members helping to draft the Telecommunications Act of 1996.

From 1988 to 1995, I served as a senior economist at Economists Incorporated where I worked on econometric matters in regulatory, antitrust, and commercial litigation cases. From 1984 to 1988, I served as a research analyst at the Center for Naval Analyses where I conducted quantitative studies on behalf of the Department of the Navy.

My academic research concerns economics and regulation. In addition to the forthcoming book, *A Tough Act to Follow*, I am the coauthor of three books: *Cable TV: Regulation or Competition*, with R.W. Crandall, (Washington, DC: The Brookings Institution), 1996; *Economics of A Disaster: The Exxon Valdez Oil Spill*, with B.M. Owen, D.A. Argue, G.J. Hurdle, and G.R. Mosteller, (Westport, Connecticut: Quorum books), 1995; and *International Trade in Computer Software*, with S.E. Siwek, (Westport, Connecticut: Quorum Books), 1993. I am a frequent commenter on matters before the Federal Communications Commission, and daily newspapers, including the *Wall Street Journal*, have published my opinion pieces. I have a weekly column in the business section of the *New York Sun*. I have testified on many occasions before committees of the U.S. Senate and House of Representatives. I received my undergraduate training at MIT, and I received a Ph.D. in economics from Stanford University. My resume is attached as Appendix A.

B. Assignment

I have been asked to testify about appropriate application of antitrust law to regulated firms as explained in questions in this Commission's "Request for Public Comment" on regulated industries.[1] In general, I believe that antitrust law should be a general body of law that applies to firms in all markets whether regulated or not. Over the past century the federal government has adopted industry-specific rules that regulate practically every industry in the United States. Practically all firms and markets in the United States are subject to multiple layers and multiple forms of regulation. If antitrust law could apply only to unregulated firms in unregulated markets, no market or firm would be subject to antitrust law. Such a result is unnecessary. The economic paradigms for anticompetitive behavior continue to apply to unregulated firms.

Although I would be pleased to speak at length about the intersection of antitrust law and regulation, I will focus my comments on the last question in the Request for Public Comment: "When a merger or acquisition involves one or more firms in a regulated industry, how should authority for merger review be allocated between the antitrust agencies (DOJ and FTC) and the relevant regulatory agency?"[2]

The courts have not addressed the frailties associated with a government that reviews the competitive effects of mergers and acquisitions through several parallel and often redundant reviews: one by antitrust agencies; another by federal regulatory agencies; and still others by a series of state antitrust and regulatory agencies. Today, I will not address the federalism issue of the boundaries between federal and state reviews

---

[1] 70 Fed. Reg. 28902-28907 (May 19, 2005).

[2] Although reasonable individuals may disagree about the proper role of antitrust law in heavily regulated industries, courts have begun to address this issue at least under specific circumstances. See, *e.g., Verizon v. Trinko*, 540 U. S. 398 (2004).

of mergers. I shall instead focus on the often redundant review of mergers by both federal antitrust and federal regulatory agencies with particular reference to the FCC. I organize my testimony through five recommendations:

1. Only one federal agency should review any merger or acquisition for competition reasons;

2. Regulatory agencies should only review mergers for compliance with existing rules;

3. If multiple agencies continue to conduct merger reviews, their proceedings should be strictly separated;

4. Regulatory agencies should avoid company-specific behavioral rules; and

5. Both antitrust agencies and regulatory agencies should set binding time limits on merger reviews.

1. Only one federal agency should review any merger or acquisition for competition reasons

This recommendation may seem obvious to the staff of the two federal antitrust agencies. The Federal Trade Commission and the Department of Justice's Antitrust Division go to great lengths, with good reason, to ensure than no more than one of these agencies reviews a merger for competition policy. If two grocery stores merge or if two petroleum companies merge, only one federal agency will review the merger for its effect on the marketplace.

Such is not the case for two regulated firms in the communications industry. While only one of the two federal antitrust agencies reviews a merger of regulated firms, other federal agencies may perform a separate, and often duplicative, review of the same merger. My strong preference would be to permit only the antitrust agencies to review mergers for competitive issues, an outcome that I recognize would require statutory changes.

Each regulatory agency has its own set of laws that provide a basis to review mergers independent of the Clayton Act. The FCC, for example, reviews merger pursuant to several sections of the Communications Act of 1934, particularly sections 4, 201, 214, 301, 309, and 310. The FCC also has residual Clayton Act authority to review mergers, but I am not aware that the FCC has in recent memory invoked the Clayton Act. That law would require the FCC, in order to block a merger, to challenge it in court. In contrast, the FCC can block a merger under the Communications Act merely by deciding not to transfer licenses.

Even without statutory changes, federal regulatory agencies could and should participate in the same merger review clearance coordination with the FTC and the DoJ to ensure that no more than one federal agency reviews a merger for anticompetitive changes in market power. Many problems can and do arise with duplicate reviews:

- Lack of uniform, professional standards;
- Unnecessary delays;
- Unnecessary costs; and
- The possibility that a merger may fall between the cracks.

A. Lack of uniform, professional standards

Under current procedures, the federal antitrust agencies and the federal regulatory agencies apply different standards to evaluate the competitive effects of the same merger. The antitrust agencies tend to apply in a predictable manner the concepts of the "Horizontal Merger Guidelines" consistent with an extensive body of federal court cases under Section 7 of the Clayton Act. Large staffs of attorneys and other professionals specialize in the review of mergers and the application of identifiable and predictable standards. If a consent decree cannot be reached, antitrust agencies go to court to block a merger. Dissatisfied parties can and do challenge agency findings in courts where antitrust law is predictably interpreted based on identifiable court precedents.

The same cannot be said of FCC merger reviews. Merger review standards are not identifiable, much less predictably applied. The FCC does have a "Transaction Team" in the Office of General Counsel, but clear standards of review beyond compliance with existing FCC rules are not identified. Because the statutory basis under the Communications Act for FCC review of the competitive effects of mergers is vague, the standards for agency review are correspondingly vague. Either commissioners or staff negotiate with merging parties on conditions meeting a "public interest" standard. In order for the FCC to transfer necessary licenses and authorizations, the merging parties volunteer to offer the negotiated conditions. Courts are rarely involved. The process invites unpredictable outcomes.

Although the FCC could hypothetically adopt predictable standards for merger review, the result of such formal standards may not necessarily be superior to the current situation. If the FCC adopted standards identical to the Merger Guidelines, the FCC would unambiguously and redundantly replicate the merger review process of the antitrust agencies.

Alternatively, and again hypothetically, the FCC could adopt entirely different standards for evaluation of competition under mergers. Such standards would likely be based on Sections 4, 201, 214, 301, 309, and 310 of the Communications Act. Given the vagueness of these statutory provisions, the FCC would have wide latitude in adopting merger review standards. Standards adopted by the commission in 2005 might be changed by the commission in subsequent years. The stability and predictability of merger review standards under antitrust law has no parallel in communications law. Further, a future commission might decide to review mergers without reference to specific guidelines, much as the FCC has reviewed mergers under a general "public interest" standard over the last two decades.

Although a different review standard for regulatory agencies might provide a defensible basis for separate regulatory agency review of the competitive conditions of mergers, separate reviews can lead to inconsistent results. Merging parties may have their merger approved by one federal agency but not by the other. One agency may require one set of conditions; the other may require a different, even a conflicting, set of merger conditions. Conceptually, it is difficult to understand how the FCC or another regulatory agency could find a merger in the public interest with one set of conditions yet have the Department of Justice find the same merger leads to an unlawful increase in the ability of the merged firm to engage in anticompetitive behavior without an entirely different set of conditions, or vice versa.

B. Unnecessary delays

Neither the FCC nor the antitrust agencies have a predictable schedule for the review of mergers. Any one of these agencies acting on its own might take months or even years to review a merger. When these agencies act in tandem, the time to complete merger reviews is at least as long as the one of the agencies acting on its own; some mergers considered in sequence take much longer.

Usually, the FCC does not complete its review of a merger until after an antitrust agency has completed its review. Consequently, the time for FCC review of mergers, as discussed below, is conditional on an antitrust agency having completed its review.

For several years, the FCC has had a so-called "180-day" clock for merger reviews. In practice, the FCC stops the clock at will for optical purpose of staying within the 180 day clock. Table 1 shows for the period 1997-2002 that the median delay in final review of mergers was 188 days (50 percent of delays were 188 days or less); the average delay was more than 223 days. For mergers requiring Commission-level vote, the delays were approximately twice as long as those decided at the staff level. (Mergers presenting "novel" issues are voted by the full Commission; in practice, larger mergers tend to be voted by the full Commission.) Some mergers took more than one year to review, or more than twice as long as the "180 day" clock. Oddly, the Communications Act suggests that the agency should complete proceedings within 90 days. Although the FCC's timeliness may have improved in recent years, the opportunity for delay remains.

The delays listed in Table 1 are associated with mergers that were also reviewed by one of the federal antitrust agencies, although not all of these mergers necessarily had a second request. In some instances, such as the recent mergers of SBC-AT&T and

Verizon-MCI, the FCC merger review concluded within days of the closing of the antitrust agency merger review. In other instances, however, FCC decisions lagged antitrust agency decisions by several months.

Table 1

Delays Associated with Mergers Reviewed by the FCC
License Transfer Applications
Usually in Tandem with one of Federal Antitrust Agencies
1997–2002

	Number of Mergers	Average Delay in Days	Median Delay in Days
Commission-Level Decisions	25	296.0	248.0
Delegated Decisions	23	144.7	126.5
All Decisions	48	223.6	188.5

Source: *A Tough Act to Follow*, (AEI Press: forthcoming).

C. *Unnecessary costs*

The duplicate review of mergers leads to higher costs for the merging parties. Part of the cost is the visible legal expenses for merging parties that must engage in proceedings before or two or more agencies.

The much larger cost of duplicate reviews is associated with the uncertainty surrounding the timing of closing the merger. Time delays and uncertainty of timing are particularly costly for mergers and acquisitions for at least three reasons. First, the acquiring party must keep substantial financial assets tied up while an acquisition is pending. The cost of capital for idle assets is much greater for a merger that takes 12 months as a result of regulatory than one that takes only 6 months. Second, firms acquire other businesses for the purpose of putting in place new business plans. Every day that a merger is delayed in closing is a delay in the implementation of a business plan. Many business decisions may cascade from the delay in closing an acquisition, such as the purchase date for new equipment, or lease arrangements for new office space, or contracts for new advertising campaigns.

Third, during the period between the announcement of an acquisition and the closing of the acquisition, morale at the acquired company often suffers. The acquired company often drifts aimlessly, new programs are delayed until the acquisition closes. Key employees look around for other opportunities. Those who leave are rarely replaced. The longer the acquisition takes to close, the fewer key employees are left to run the acquired company.

Businesses engaged in mergers and acquisitions are aware of the uncertainty surrounding the timing of repetitive regulatory reviews and consequential uncertainty of the timing of closing deals. Of course, government agencies should take the time necessary to determine whether a merger or acquisition complies with federal law and whether the merger or acquisition will lead to an unlawful increase in market power. Government agencies, however, should also be aware that unnecessary delays in reaching a decision have costs—at times extraordinarily large costs—on the merging parties.

D. The possibility that a merger may fall between the cracks

Duplicate reviews may paradoxically lead to some mergers falling in the cracks between agencies and receiving little review from either agency. Each reviewing agency has limited staff resources, and occasionally, one or both agencies may divert resources away from a merger under the assumption that a different agency will take a hard look at it. I have heard anecdotes of such instances, but for obvious reasons, it is impossible to document the level of care each agency takes in reviewing mergers and acquisitions. A single agency reviewing mergers in an industry would be inescapably responsible for all acquisitions in that industry.

2. Regulatory agencies should only review mergers for compliance with existing rules

When regulated firms are restructured through a merger or acquisition, a regulatory agency reasonably would review the change in the structure of assets of the restructured regulated entity. Such a review need not necessarily include an examination of changes in competition or market power. Three principles should guide a regulatory agency's review of a merger or acquisition:

- Narrow review to confirm compliance with existing agency rules;
- Nondiscriminatory review; and
- Review not confounded with issues unrelated to the merger.

A. Narrow review to confirm compliance with existing agency rules

It is entirely appropriate for a regulatory agency to review a merger for compliance of the merging parties with existing agency rules for at least two reasons. First, regulatory agencies review many aspects of firm behavior on a periodic rather than a continuous basis. A merger review is an appropriate time for a government agency to update all matters of regulatory review for the merging entities. Such a review might include an evaluation of compliance with previous merger conditions.

Second, while two entities separately may comply with all agency rules, a merger of the entities may result in per se violations of agency rules. It is entirely appropriate for a regulatory agency to review a merger for potential violations of existing agency rules. Thus, for example, the Securities Exchange Commission reviews mergers for compliance with federal securities law, but not for effects on market competition. Over the years, the FCC has had many rules setting numerical limits on the ownership of certain licenses. It is both reasonable and necessary for the FCC to review mergers for continued compliance with these rules, regardless of competitive effects in the market.

b. Non-discriminatory review

Regulatory agencies should review all mergers in a non-discriminatory manner rather than just a review of selected mergers. For example, practically all firms of a significant size hold some FCC licenses, even those firms not primarily operating in the communications sector. Yet the FCC has a tendency to review carefully only those mergers involving firms that it closely regulates. Table 2 lists major mergers of firms holding FCC licenses from 1997 to 2001 that the FCC did not review.

Table 2

Major Mergers from 1997 to 2001 that were not Reviewed by the FCC

Exxon-Mobil
Chevron-Texaco
Georgia-Pacific–Fort James
Pepsico-Quaker
Tribune–Times Mirror
Citibank-Travelers
Hewlett Packard–Compaq
Boeing–McDonnell Douglas
Dow Chemical–Union Carbide
El Paso Energy–Coastal Corporation
SmithKline–Glaxo Wellcome
Philip Morris–Nabisco Holdings
Pfizer–Warner Lambert
TV Guide–Gemstar
Daimler-Chrysler

Source: *A Tough Ac to Follow: The Telecommunications Act of 1996 and the Separation of Powers,* (Washington: American Enterprise Institute) forthcoming.

During the same period of time, the FCC reviewed dozens of mergers, but only of firms heavily regulated by the FCC. Several of the firms in Table 2, however, had more licenses than those whose mergers were reviewed by the FCC.

C. Review not confounded with issues unrelated to the merger

The FCC has reviewed and imposed conditions on many mergers over the past decade. Some of these conditions have had little to do with the specific effects of the mergers and much more to do with general policy preferences of the FCC that could not easily be imposed outside of the circumstances of the merger. For example, in 2000, the FCC imposed reporting conditions on the newly merged firms Verizon and SBC. These reporting requirements had much to do with the policy directions of the FCC and little to do with the mergers. If the FCC had concerns that the mergers would have substantially reduced competition or harmed consumers, other conditions such as divestitures should have been imposed. The reporting requirements ultimately raised the costs of doing business for SBC and Verizon but did little to affect competitive conditions in the market. Many merger conditions imposed by the FCC have this characteristic.

3. If multiple agencies continue to conduct merger reviews, their proceedings should be strictly separated

The federal government may never decide to limit reviews of the competitive effects of mergers, even those involving regulated industries, to just one federal agency. Under that circumstance, which is the present state of law, federal agencies should take care with administrative procedures for the handling of information related to merger reviews. In particular, agencies should keep information in merger review proceedings carefully separated from one another so as not to contaminate the bases for administrative decisions in each agency. Sadly, the common practice over the past decade has been for different federal agencies reviewing the same merger to share information informally, although commenting parties in an agency proceeding are left unaware of the full range of information available to that agency.

Federal agencies make decisions based on information collected under the Administrative Procedures Act and under specific statutory authority of each agency. Each federal agency tends to have slightly different procedures for the acquisition of information, for the protection of business-sensitive information, and for public access to collected information. At one extreme are the antitrust agencies which collect substantial volumes of information, particularly in a second request, from merging parties. This information typically is protected by non-disclosure agreements, and access to this information is tightly restricted and is certainly not available to the general public. At the other extreme, the FCC makes most of its decisions based on a public record. Although the FCC can and does protect business-sensitive information from dissemination, at least part of the record in every major merger has been publicly available.

In several merger proceedings, the FCC staff appears to have informally coordinated with the staffs of antitrust agencies reviewing the same merger. Coordination can range from the timing of decisions to the sharing of collected information to the assignment of which agency will most effectively impose conditions on a merger.

Although conducted with the best of intentions and under the presumption of public interest, coordination and sharing of information in adjudicatory proceedings between separate reviewing agencies is ultimately detrimental to the integrity of the administrative process of each agency. Parties submit information requested by one of the antitrust agencies in a merger review under the reasonable assumption that the antitrust agency will properly protect the information and use it only for purposes of the merger review. Parties will be reluctant to submit information to one of the antitrust agencies if the parties have reason to believe that some or all of the submitted information is made available, directly or indirectly, to one or more other government agencies that are not direct parties to the antitrust review.

If, for example, the Antitrust Division predictably shared information with the Internal Revenue Service, parties before the Antitrust Division might reasonably be reluctant to submit information related to taxes. Similarly, parties with matters before the FCC might be reluctant to submit information related to FCC licenses to the Antitrust Division if there were a belief that the Antitrust Division would share that information with the FCC.

In a parallel manner, many parties before the FCC expect the agency to make decisions based on a public record that has clearly been presented to the agency. It would be inappropriate for the FCC to make decisions based partly on information not in the public record and not directly submitted to the FCC, but merely shared from an antitrust agency. Decisions based even in part on information not part of the public record would diminish the value of the FCC's public notice and comment process.

In most mergers in the communications sector, the antitrust agency reaches a consent decree or other decision before the FCC issues an order regarding the merger. Consequently, the FCC is left in an awkward position to apply additional remedies for competitive purposes after a federal antitrust agency has already applied antitrust remedies to address presumably all anti-competitive concerns. Yet, in many mergers in the communications sector over the past decade, the FCC has applied conditions far beyond those applied by a federal antitrust agency reviewing the same merger.

Even more troubling than either the sharing of information or the layering of additional conditions on a merger is the potential for a coordination of decisions among agencies. One sees clear evidence, at least on the timing of merger decisions. For example, one of the antitrust agencies will issue a consent decree with the merging parties, followed by an FCC order within days. The coincidence of the timing is remarkable.

There is at least an opportunity, if not an observed practice, of coordination of conditions on mergers. Government agencies widely recognized that it is much easier for the FCC than for the antitrust agencies to impose conditions. The FCC need never go to court to block a merger; it can simply refuse to transfer licenses accept under conditions that it may require.

4. Regulatory agencies should avoid company-specific behavioral rules.

Regardless of whether conditions are imposed by an antitrust agency or by a regulatory agency, merger conditions on regulated firms should be permanent structural conditions rather than temporary behavioral conditions. In contrast, the vast majority of merger conditions imposed by the FCC over the past decade have been temporary behavioral conditions. Two recent examples are the company-specific behavioral rules adopted as conditions on the recent SBC-AT&T and Verizon-MCI mergers. Each newly merged firm with behavioral conditions has legal requirements that are different from those of any other firm. Because practically every major firm in the communications sector has been through at least one major merger over the past decade, the net result has been a unique set of legal rules for each major firm in the sector.

The FCC adopts behavioral rules for at least two reasons. First, because the merging parties technically request the conditions for license transfers so as to avoid the possibility of a court challenge to the merger conditions, the merging parties negotiate the conditions with the FCC. Faced with a choice of a behavioral rule that will unlikely be enforced or a divestiture that will be lost forever, most merging firms rationally choose the behavioral rule. The merger-related behavioral rules appear to be enforceable only by the FCC, and these the FCC rarely if ever enforces. Second, many of the behavioral rules incorporate provisions for rules that some commissioners have sought to impose on the industry at large but had yet to promulgate such industry rules. The behavioral rules of merger conditions thus reflect rules for which either a legal basis or a political will to extend them to the entire industry is lacking.

5. Mergers should have time limits for reviews.

Finally, the governmental review of all mergers and acquisitions, including those of regulated firms, should have time limits. The government is under no obligation to approve a merger within a specified time limit. There are many legitimate reasons that a government agency may be unable to approve a merger within a fixed time period including the following circumstances: a merger may be anticompetitive or the relevant information necessary for the government to reach an informed decision may be too complex to digest in a short time period.

Many mergers that are ultimately approved languish under government review for endless months neither because they are anticompetitive nor because the necessary information is too voluminous. Instead, many mergers wait in long queues for government review because some government agencies have little incentive for expeditious review. As discussed earlier, merger reviews by multiple agencies can lead to unnecessarily lengthy delays; these delays and the uncertainty surrounding them have large costs on merging parties. Even when a single agency reviews a merger, these delays and uncertainty have large costs. Greater clarity on the timing of merger reviews would benefit all parties concerned.