

negative effects are likely to occur when a merger results in the accumulation of market power sufficient to raise prices or reduce quality or innovation. If the Commission has reason to believe that a merger will create or enhance market power or facilitate its exercise, and there are no countervailing considerations, it is authorized to seek an injunction in federal court to block the merger or to fashion a remedy that will eliminate the competitive problem. If anticompetitive effects are not likely, the Commission will not challenge the transaction.

The framework used by the Commission to analyze mergers is set out in the Merger Guidelines. The Guidelines are a flexible tool designed to be used in all kinds of industries. They anticipate that particular industries have structural and behavioral characteristics that set them apart from other industries, and provide a structure that takes these characteristics into account. The unique characteristics of the defense industry fit into the framework of the Guidelines' analysis, le-nGo(e)6s.46 0Tt 0 Td

defense industry, historical market share statistics may provide an incomplete or inaccurate picture of competitive conditions. Because of declining demand, the nature of the procurement process, and the technological complexity of many new weapons system, the analysis of current market indices in the defense industry must be supplemented by a forward-looking analysis of the relative cost structures and technological capabilities of the market participants. Historically strong performers, for any number of reasons, may not be effective competitors in the future. Conversely, a small company that in the past was not a competitive factor may possess new technology that will enable it to capture major contracts in the future.

b. Conditions of Entry

Once the Commission has defined the relevant market and its participants, it must assess the conditions of entry into that market. If entry is easy, post-merger market participants likely will be unable profitably to increase prices above the pre-merger level. According to the Merger Guidelines, entry is regarded as easy if it would be "timely, likely and sufficient in its magnitude, character and scope to deter or counteract the competitive effects of concern."⁽⁶⁾

In terms of timeliness, the Commission generally uses a two year period. If entry takes longer than that, current market participants may not be deterred from raising prices in the interim. In addition, entry that may occur in the distant future is more uncertain and may not occur at all. In the defense industry, however, the entry period may be shortened or lengthened depending on scheduled procurements. For instance, if the merging parties competed to build fighter aircraft and the next major fighter procurement was scheduled to take place in six months, potential entrants would probably be limited to those companies planning or capable of bidding in six months' time. The likelihood of entry depends on whether the potential entrant would find it profitable to enter after the acquisition. Sufficiency of entry is determined by the ability of new entrants to force a roll back of prices that may have increased after the acquisition.

There are several unusual aspects of entry analysis in the defense industry. The Defense Department has, in the past, provided financial or other assistance to encourage entry by private firms. At other times, the Department has entered into the supply of defense related products or services on its own. Thus, the Department may be uniquely positioned to provide information about entry conditions and potential participants. This information will be considered with that more routinely collected from the merging parties and knowledgeable third parties in order to make the proper determination of the probability of timely, likely and sufficient entry.

c. Competitive Effects

Once the Commission has collected the necessary information on the relevant markets and entry conditions, it must decide whether it has reason to believe that the merger is likely to have anticompetitive effects. That question is likely to be answered in the affirmative if the merger allows the merging firms or post-merger participants in the relevant market to exercise market power. Market power can be exercised by a price increase or can affect non-price aspects of competition, such as product quality, innovation, and timely and efficient performance of contractual obligations. In the defense industry, these non-price indicators may be equally or even more important than price alone.

In many instances, merger analysis focuses primarily on the potential of the post-merger firms to lessen competition through coordinated interaction, either tacitly or through overt collusion. In the defense industry, unilateral anticompetitive effects may be more likely than coordinated interaction. Unilateral effects can occur if the merging firms have the ability to raise prices without the cooperation of other industry participants. The majority of recent merger challenges in the defense industry have been based on a unilateral anticompetitive effects theory. Two scenarios of competitive harm are typical in the defense industry: one, where the merging parties are the only capable bidders for an upcoming procurement,⁽⁷⁾ and two, where the merging parties are the best two potential bidders in terms of cost, technology, or other competitively significant factors.⁽⁸⁾

d. Efficiencies

The determination that a merger may have anticompetitive effects is governed by 12 C.F.R. § 201.20(a)(1)(i)-(ii). The determination that a merger may have efficiencies is governed by 12 C.F.R. § 201.20(a)(1)(iii)-(iv).

likely to raise barriers to entry to potential competitors, foreclose rivals from critical components, or create the potential for anticompetitive exchanges of information.

Analytical differences in horizontal and vertical mergers can be seen most easily in the types of remedies often imposed by the Commission in each instance. Horizontal mergers can often be cured of their anticompetitive potential by divestiture of certain assets that would leave the remaining post-merger firm unable to exercise unjustified market power. In vertical mergers, including a number of recent defense industry mergers, the Commission has imposed conduct remedies sufficient to eliminate potential anticompetitive effects. For instance, where vertical mergers create a concern over the transfer of competitively sensitive information, "firewalls" have been imposed to prevent the exchange of a competitor's proprietary information within the different divisions of the combined firm.

IV. Conclusion

The defense industry is undergoing a period of significant consolidation, spurred in part by significant reductions in the defense procurement budgets. This does not mean that policy makers should acquiesce in anticompetitive mergers. Consolidation can occur in ways that protect the major buyer of weapons systems from the creation of market power in its supp ec6fd1527.88 377 /A

