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BEFORE THE U.S. HOUSE OF REPRESENTATIVES JUDICIARY COMMITTEE,
SUBCOMMITTEE ON COURTS AND COMPETITION POLICY

Re:

"TOO BIG TO FAIL?" THE ROLE OF ANTITRUST LAW

IN GOVERNMENT-FUNDED CONSOLIDATION IN THE BANKING INDUSTRY

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I am Albert A. Foer, President of the American Antitrust Institute, an eleven-year old independent non-profit research, education, and advocacy organization that monitors the antitrust scene and supports the strong and sensible enforcement of our antitrust laws to ensure that markets are competitive for the benefit of consumers and the economy as a whole. Our views on a wide range of competition policy issues are set forth in The Next Antitrust Agenda: The American Antitrust Institute's Transition Report on Competition Policy to the 44th President. This book has been provided to Subcommittee Members and is available on our website, www.antitrustinstitute.org.

In the five minutes I have to speak, I will pose five questions and try to answer them very briefly. This written statement contains elaboration.

1. What do we mean by "Too Big to Fail"?

In looking at the problems of the financial services sector and other situations where entities have been declared "too big to fail," the chief issues are not large size alone or even inadequate competition. The problems relate to (1) creation of large organizations that are so deeply embedded in the economy that their failure is likely to have ripple effects which cumulatively are not acceptable to the polity combined with (2) failure of governmental oversight to require relevant disclosure of escalating risks, i.e. the information that would be necessary if government were to determine to inhibit the formation of such organizations or to protect against their failure.

2. Was antitrust policy responsible for allowing the "too big to fail" problem?

First, it is necessary to distinguish "antitrust" from "competition policy" which is broader than "antitrust" and takes into consideration sectors of the economy such as banking that are highly regulated apart from the antitrust regime. It is competition policy that has failed.[1] The more narrowly defined antitrust enterprise (the trio of the Sherman, Clayton, and FTC Acts) was not empowered to stop mergers on the basis of either the absolute size of the resulting institution or a calculation of the systemic consequences of their eventual failure. We have lacked a workable antitrust mechanism for stopping large conglomerate mergers that create giant corporations without reducing competition in specific markets.[2]

Antitrust can be taken to task for allowing many industrial sectors to become very highly concentrated and it is possible that this creates a greater risk that an entire industry could fail at once than if the industry were more fragmented. However, this is not the case in the current financial institution crisis or in the automobile industry.

I would also point out that antitrust has done a poor job of dealing with what might be called "the lemming effect" where a particular merger can be predicted to set off a chain reaction of industry consolidation based on strategic rather than efficiency considerations. [3]

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[1] The financial regulatory agencies have failed to use their authority under the convenience and needs or public interest standard to restrict the creation of institutions that emerge from mergers as too big to fail. The antitrust agencies in their advocacy role have failed to address the issue. Congress should consider adding to the public interest review criteria for agencies a systemic risk element.

[2] Throughout this statement I will use the term "merger" to include acquisitions and other forms of consolidation.

[3] For example, today we are witnessing simultaneous merger proposals in the pharmaceutical industry that may trigger several additional merger proposals. An important industry could be transformed by a series of mergers within a short time into a much more concentrated industry. There is no mechanism for considering whether this wave of consolidation will create a situation creating an unacceptable systemic risk. The antitrust agencies typically say that they can only consider one merger at a time.

I do not fault the antitrust agencies for the recent emergency consolidations which have taken two companies that are deemed too big to fail (e.g. Bank of America and Merrill Lynch) and combined them into one even larger company that is much too big to fail. The decisions were too important to leave to antitrust and had to be made quickly. Such is the nature of a systemic risk. But, as I will argue, this should not be the end of the conversation.

3. Can current antitrust law protect us from future mergers that will create a "too big to fail" problem?

No, not most of the time. Even if the Sherman Act and the Clayton Act were applied more aggressively than they have been in recent years, they can only protect against large mergers that threaten significantly to reduce head-to-head competition in specific product and geographic markets. While very large financial mergers often involve some competitive overlap, the geographic or product markets where these overlaps occur are likely to involve a sufficient number of other competitors and hence these overlaps are not likely to justify a normal antitrust merger challenge. In other words, there is no currently viable or likely theory for stopping conglomerate mergers, which create both large size and conditions of systemic risk but do not significantly reduce competition in specific markets.

The Federal Trade Commission Act offers somewhat more flexibility than the Sherman and Clayton Acts, but given the conservatism of the federal courts on antitrust matters and the question of whether systemic risk is an appropriate subject for antitrust, there is too much doubt to rely on an expansion of the FTC's ability in this area.

We should recognize that there may be a small set of very large institutions, probably financial in nature, that will be both necessary and too big to be allowed to fail, where downsizing remedies will for one reason or another not work. Stronger

regulatory oversight and greater restrictions on the scope and risk of such enterprises will be necessary.

4. Can current antitrust law be used to break up financial service or other organizations that are now deemed "too big to fail"?

No. It would be necessary to demonstrate both that such an organization possesses monopoly power and that it acquired or maintained its monopoly power in ways that can only be remedied by substantially restructuring it into smaller independent units or enjoining it from engaging in exclusionary behavior that harms competition.[4] It is highly unlikely that there is any basis under current law for such actions against any of the "too big to fail" entities that are the central source of concern.[5]

5. What, then, should Congress do?

Here are four proposals.

First, Congress should create within the Department of Justice Antitrust Division and should appropriately budget a new position: Deputy Assistant Attorney General for Emergency Restructuring. This person, who should be approved by the Senate[6] and would report to the Assistant Attorney General for

[4] Keep in mind that a monopoly case usually takes at least five years and creates a degree of uncertainty during that time. This time frame would not work when there is a crisis at hand.

[5] Recall that the Public Utility Holding Company Act that Congress adopted in the1930's brought about (with SEC supervision) the restructuring of the investor-owned public utility industry after the collapse of the holding company structure that had controlled the industry.

[6] Senate confirmation is not normally required for a Deputy Assistant Attorney General, but it would elevate the status in this case so that the person would carry additional weight in policy deliberations.

Antitrust, should have the articulated mission of participating in all aspects of national policy relating not only to financial institutions and their regulation but to all other components of financial recovery planning and legislation that may impact competition.

The reason for this proposal is simple: decisions that have already been made and are going to be made this year and perhaps for years into the future will create major changes in the structure of our key industries. Given the reduced consumer demand that is the essence of a deep recession, there will likely be efforts to effectuate policies that have the effect, if not the intent, of causing consolidation, cartelization, and constraints on trade that will be both anti-competitive and anti-consumer. If we care about preserving a competitive economy in the long run, we need today an authoritative voice for competition policy at the negotiating table in order to assure that we do not go down a road of permanent consolidation except where it is absolutely necessary to do so.

Second, Congress should emphasize that competition policy concerns be taken into account during a recession and even during emergency consolidation situations. Mergers are generally irreversible and in light of recent Supreme Court cases such as *Trinko*, *Credit Suisse*, and *LinkLine*, it will be particularly difficult for antitrust laws to be applied where there is even a fig leaf of regulatory jurisdiction involved. In the context of emergency bailout consolidations, attention should be given to (a) assuring ultimate divestability of the components and (b) not expanding the "failing company" defense beyond its traditional narrow limits. Consolidation in time of crisis is not likely to be remedied by market forces when the economy rebounds because entry barriers will be high and lenders and entrepreneurs are likely to be cautious for years to come.

Third, Congress should consider creating legislation that will give the government an opportunity to stop the formation of new organizations that are too big to fail. How should this be done?

I would be reluctant to impose an antitrust Maginot Line of either absolute size or market share, beyond which an entity would not be allowed to grow. There are many problems with this approach, including that one size will not fit all. Rather, I would suggest something more flexible and targeted, along the following lines:

In ordinary (non-crisis) economic times, either the Antitrust Division or the FTC would be empowered to declare a merger or acquisition that it has investigated pursuant to the Pre-Merger Notification Act as "potentially creating or exacerbating an unreasonable systemic risk;" or a regulatory agency with jurisdiction over an aspect of a merger transaction could make a similar declaration. Flexible guidelines would define the conditions to be taken into consideration in making a declaration.[7] Such declaration would carry with it an automatic suspension of the merger for a period of ninety days, during which the Treasury Department would consult with the antitrust agencies, the Federal Reserve Board, and other national and international authorities that may have views on the effects of a future failure of the merged entity. The Treasury Department would then prepare a report to the President, taking into account likely beneficial effects as well as risks. If the report does not recommend a presidential decision, the merger could proceed. If it does recommend stopping the merger, the President would have thirty days to make a final decision.

Such legislation should carve out mergers approved by the President during an economic emergency, when the President judges that there is not time for the process to fully operate. [8]

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[7] This declaration would not affect the antitrust agency's jurisdiction to continue its antitrust investigation of anticompetitive effects. The guidelines should be the work product of a joint agency task force that includes both the antitrust agencies and financial regulators.

[8] Again, this is not intended to suspend merger policy during a recession. Actual practice during this recession, however, has been to severely truncate any antitrust analysis while decisions are being made at the political level. Presumably the antitrust agencies have the jurisdiction to revisit emergency recession mergers at a later date even though their normal ability to seek a preliminary injunction was

Why place this discretion in the hands of the President? Time is likely to be of the essence and both the Congress and the federal courts are likely to draw out the process. Congressional decision-making will necessarily be highly political. The courts would be acting without political responsibility in an area that is necessarily discretionary. The President, acting on information and analyses developed by his administration, can act quickly and can take into account the overall context of emergency developments. Moreover, the President will be held responsible for the overall results. [9]

Let me state up front that the necessary analysis and predictions that the process would entail would be extremely difficult. Whether a failure would be tolerable may depend on when it occurs, what other commercial entities might do in the future (i.e., the actions of others such as upstream suppliers could contribute to a systemic risk), future international risks, and the psychology of the times (since a failure when the economy is strong may be much less worrisome than at a time when the economic world seems to be falling apart. I would not expect this process to be invoked very often, but it is also important not to hamstring the government by requiring too high a standard for the prediction. We should err on the side of not generating new risks of substantial catastrophe even if the probability of occurrence is low.

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overrun by events. As noted in the text, post-consummation divestitures have been rare.

[9] It can be argued that a better repository of this decision would be the independent Federal Reserve Board, but because so many interests in addition to those of the financial community are at stake, the decision should probably be that of the nationally elected leader. There is some precedent in the Exon-Florio Amendment for the President to make a non-reviewable decision to stop a merger (a takeover of a U.S. firm by a foreign firm), although this is in the national security context where the President can claim virtually all the relevant expertise. See Section 5021 of the 1988 Trade Act (50 USC Section 2170).

Fourth, Congress should create a process for re-thinking where we are and where we want to be after the current crisis has settled down. I have in mind the establishment of a special commission similar to the Temporary National Economic Committee ("TNEC") of the 1930's. Let's temporarily call it "TNEC-Two." It would include key members of Congress as well as key government officials and academics, would be well-staffed and representative of a wide range of interests, and would take several years to review the evidence on how our economy has changed and what structural changes are needed to assure that markets will be competitive, that systemic risks will be minimized, and that the regulatory structure will be appropriate.

Among other topics, the TNEC-Two should consider whether we should simplify the regulation of financial conglomerates by breaking them into smaller single-industry units; whether we should require a downsizing of financial service companies that have now been deemed "too big to fail;" whether new governmental institutions are needed to deal with the emerging financial services sector; whether the extant "10% cap" on nationwide domestic deposits remains a viable limitation[10]; whether new law is needed for the special oversight of organizations that are deemed "too big to fail" and which cannot reasonably exit from that category; and whether new rules are needed for entities that are not within the financial services sector but represent systemic risks, such as a clarification that the likely triggering of a consolidation wave may be taken into account in an antitrust merger analysis.

About a year ago, the Antitrust Modernization Commission ("AMC") published its report. Lest there be a misimpression that the TNEC-Two already occurred in the form of the AMC, it should be pointed out that the AMC did not consider or report on the types of questions that are posed here, which go beyond a

[10] The cap has major loopholes, such as not including intrastate mergers or mergers with thrift institutions, or mergers with "distressed banks," which have called its efficacy into question.

standard review of the antitrust laws that was prepared before there was concern about a deep recession.

We are today in an emergency climate. Many major changes are taking place and more will likely take place. Because we do not know how deep this recession will be or what changes in the economy or its regulation will be entailed, it is premature to answer the kinds of questions the TNEC-Two. When matters calm down, like a community after a severe hurricane, we will need to take inventory and develop a consensus both on where we are and where we want to be. Consolidation that is occurring during the crisis should not necessarily be considered either inevitable or permanent, even though it may be very difficult to unwind at a later date. Therefore, we need to put into motion a process to assure that in the longer run we and our children still remain in charge of our destiny. A TNEC-Two should be part of the process.

Thank you for your attention.