NORTH CAROLINA LAW REVIEW

Volume 42 | Number 3 Article 1

4-1-1964

Conglomerate Mergers and the Curse of Bigness

Richard E. Day

Recommended Citation

Richard E. Day, *Conglomerate Mergers and the Curse of Bigness*, 42 N.C. L. Rev. 511 (1964).
Available at: http://scholarship.law.unc.edu/nclr/vol42/iss3/1

CONGLOMERATE MERGERS AND "THE CURSE OF BIGNESS"

RICHARD E. DAY*

Although a half century has passed since Congress enacted the original section 7 of the Clayton Act,[1] the legal status of mergers remains anything but clear. The evolution of anti-merger law has been marked by Fabian prosecutions, judicial lag and a paucity of authoritative decisions. When decisions have been finally forthcoming, they have often been unexpected and raised more questions than they answered. For example, forty-three years after the statute's enactment, the Supreme Court decided for the first time that original section 7 applied to vertical stock acquisitions, not just to the horizontal acquisition of the stock of a competitor as generally believed, and that a merger should be tested as of the time of suit, rather than the time of merger.[2] Finally, just last term, the Supreme Court decided in *United States v. Philadelphia Nat'l Bank*,[3] again contrary to general belief, that bank mergers are covered by present section 7, as amended by the Celler-Kefauver Anti-merger Act of 1950.[4]

It was eleven and a half years before the Supreme Court, in *United States v. Brown Shoe Co.*,[5] made its first substantive inter-

---

* Assistant Professor of Law, University of North Carolina.

[1] 38 Stat. 731 (1914), as amended, 64 Stat. 1125 (1950), 15 U.S.C. § 18 (1958). The relevant substantive paragraph of original section 7 compares with the present version, as amended in 1950 by the Celler-Kefauver Anti-merger Act, as follows (material in italics was added by the amendment; material in brackets was deleted): "No corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital *and no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets* of another corporation engaged also in commerce, where *in any line of commerce in any section of the country*, the effect of such acquisition may be [to] substantially to lessen competition [between the corporation whose stock is so acquired and the corporation making the acquisition, or to restrain such commerce in any section or community], or *to* tend to create a monopoly [of any line of commerce]."

[2] United States v. E. I. du Pont de Nemours & Co., 353 U.S. 586 (1957).

[3] 374 U.S. 321 (1963).

[4] 38 Stat. 731 (1914), as amended, 64 Stat. 1125 (1950), 15 U.S.C. § 18 (1958).

[5] 370 U.S. 294 (1962). Only two prior cases before the Supreme Court

pretation of amended section 7. Understandably, *Brown Shoe* instantly became the antitrust lawyer's merger bible. Like any good bible, it has provided a field day in controversy regarding its true meaning, containing language sufficiently broad and ambiguous to lend support to almost any position one of its disciples may wish to take. An inkling of the extent of the controversy which it has generated may best be illustrated by a comment by Professor James A. Rahl, following his participation in a panel discussion of the decision, in which he observed that "while one might expect seven different points of view from seven lawyers assembled, it seemed as though there were 14 or 15 different view points expressed during the two-hour session."[6]

The hesitancy and confusion in the development of the anti-merger law is symptomatic of an underlying conflict in antitrust policy. On the one hand, it is stated that our fundamental antitrust policy is the preservation of competition. This objective formed the basis of the enactment of, and case law development under, the original Sherman Antitrust Act of 1890.[7] Concerted restraints of trade, attempts or conspiracies to monopolize and monopolization

were based, in part, on amended section 7. Jerrold Electronics Corp. v. United States, 365 U.S. 567 (1961); Maryland & Va. Milk Producers Ass'n v. United States, 362 U.S. 458 (1960). A detailed analysis of the scope and purposes of amended section 7 was unnecessary to the Court's disposition of the issues raised in those cases.

[6] Rahl, *Current Antitrust Developments in the Merger Field*, 8 ANTITRUST BULL. 493, 507 (1963).

[7] 26 Stat. 209 (1890), 15 U.S.C. §§1-7 (1958). The substantive provisions, sections 1 and 2, of this act provide: "Section 1. Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal.... Every person who shall make any contract or engage in any combination or conspiracy declared...to be illegal shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding fifty thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.

"Section 2. Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding fifty thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court."

For a comprehensive study of antitrust's formative period, see THORELLI, THE FEDERAL ANTITRUST POLICY (1955). See also ATT'Y GEN. NAT'L COMM. ANTITRUST REP. (1955).

were condemned in an effort to keep competition free and open. This policy had its root in an Adam Smith style of laissez faire environment in which it was believed that the "impersonal" forces of a "free" market would adjust supply to meet demand at a price that a "marginal" buyer would be willing to pay to a "marginal" seller. Under this theory, efficient competitors would drive out the less efficient whose costs surpassed the "marginal" cost determined by the forces of supply and demand. As originally propounded, this theory of "pure" or "perfect" competition required mobility of resources and sufficient atomization of the industry to prevent the action of any one seller or buyer to significantly affect the operation of the supply-demand forces. In addition, the competing products must be homogeneous, all buyers and sellers must have complete knowledge of the market and be indifferent as to their customers or suppliers, and entry must be open to new firms at the same costs as those of existing competitors.

It is self-evident that "perfect" competition is an unrealistic concept, useful, if at all, only as an analytical tool or standard of comparison. As one or more of the model requisites are missing in any particular relevant market, competition becomes "imperfect" and less responsive to the "impersonal" supply-demand forces. One example of an element which is commonly lacking is the requirement that all products of competing sellers be precise substitutes for each other. In reality, products tend to be differentiated in varying degrees —physically, or at least by their individual trademarks. When this happens, strictly speaking, every seller has a monopoly of *his particular product.* However, he faces competition to the extent that there are reasonably close substitutes readily available. Neither of the polar concepts of "competition" or "monopoly" fit such a situation, which may more accurately be described by Chamberlin's theory of "monopolistic competition." As explained by Chamberlin:

> To say that each producer in an industry has a monopoly of his own variety of product is not to say that the industry is monopolized. On the contrary, there may be a very intense competition within the industry, not of the sort described by the theories of pure competition to be sure, but different by virtue of the fact that each producer has a monopoly of his own variety of product. Thus every monopolist faces the competition of substitutes, and it becomes clear at once that monopolistic competition embraces the whole theory of monopoly. But it also looks beyond, and considers

the interrelations, wherever they exist, between monopolists who are in some appreciable degree of competition with each other.[8]

In recognition of the invariable market imperfections, such as product differentiation, there has evolved a sort of economic "rule of reason" in the form of "workable" or "effective competition," which "seeks to provide a method for making necessarily less exact but more practical realistic judgments of actual market situations."[9] The law, too, has generally followed the more pragmatic approach, being content only to maintain "effective" competition in a relevant line of commerce determined on the basis of "competitive realities" which would include those products which are reasonably interchangeable.[10]

---

[8] CHAMBERLIN, THE THEORY OF MONOPOLISTIC COMPETITION 205-06 (1960). On the theory of imperfect competition, see also ROBINSON, ECONOMICS OF IMPERFECT COMPETITION (1942).

[9] ATT'Y GEN. NAT'L COMM. ANTITRUST REP. 338 (1955), criticized in, Schwartz, *The Schwartz Dissent*, 1 ANTITRUST BULL. 37 (1955). The descriptive phrase "workable competition" was coined by J. M. Clark. Clark, *Towards a Concept of Workable Competition*, 30 AM. ECON. REV. 241 (1940). Of the voluminous works on the workability of competition and the proper tests to apply see EDWARDS, MAINTAINING COMPETITION, REQUISITES OF A GOVERNMENTAL POLICY (1949); Adams, *The "Rule of Reason": Workable Competition or Workable Monopoly?*, 63 YALE L.J. 348 (1954); Adams, *Competition, Monopoly and Countervailing Power*, 67 Q.J. ECON. 469 (1953); Adelman, *Effective Competition and the Antitrust Laws*, 61 HARV. L. REV. 1303 (1948); Markham, *An Alternative Approach to the Concept of Workable Competition*, 40 AM. ECON. REV. 361 (1950); Mason, *The Current Status of the Monopoly Problem in the United States*, 62 HARV. L. REV. 1265 (1949); Mason, *Monopoly in Law and Economics*, 47 YALE L.J. 34 (1937); Oppenheim, *Federal Antitrust Legislation: Guideposts to a Revised National Antitrust Policy*, 50 MICH. L. REV. 1139 (1952); Smith, *Effective Competition: Hypothesis for Modernizing the Antitrust Laws*, 26 N.Y.U.L. REV. 406 (1951); Stocking, *Economic Tests of Monopoly and the Concept of the Relevant Market*, 2 ANTITRUST BULL. 479 (1956); Stocking, *The Rule of Reason, Workable Competition, and Monopoly*, 64 YALE L.J. 1107 (1955).

[10] United States v. E. I. du Pont de Nemours & Co., 353 U.S. 586, 593-95 (1957). The Court in Brown Shoe Co. v. United States, 370 U.S. 294, 325 (1962), made further refinements on defining the relevant line of commerce, or "product market." According to the Court: "The outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it." However, within these "outer boundaries" may be "well-defined submarkets," the determination of which may include an examination of "such practical indicia as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors." *Cf.* United States v. Guerlain, Inc., 155 F. Supp. 77 (S.D.N.Y. 1957), *judgment vacated on motion of the*

As the Industrial Revolution progressed, it soon became apparent that, even absent any collusion or other restraints of trade or monopolization, efficiencies of size may give rise to growth and consolidation in the relevant market. The problem then became one of rewarding efficiency, the *object* of effective competition, while at the same time preserving competition, the *means* to achieve efficiency. As explained by Judge Hand in his famous *Alcoa* decision, *United States v. Aluminum Co. of America:*[11]

> A single producer may be the survivor out of a group of active competitors, merely by virtue of his superior skill, foresight and industry. In such cases a strong argument can be made that, although, the result may expose the public to the evils of monopoly, the [Sherman] Act does not mean to condemn the resultant of those very forces which it is its prime object to foster: finis opus coronat. The successful competitor, having been urged to compete, must not be turned upon when he wins.[12]

While recognizing the general notion that size alone does not violate the Sherman Act where it is the result of "natural" or "normal" growth, and absent any exclusion of competitors or "wrongful intent," Judge Hand recognized another element in the great debate, *i.e.,* social policy favoring atomization over concentration. According to Judge Hand, Congress "was not necessarily actuated by economic motives alone."[13] He concluded that judicial decisions have shown that one of the purposes of the Sherman Act was: "[B]ecause of its indirect social or moral effect, to prefer a system of small producers, each dependent for his success upon his own skill and character, to one in which the great mass of those engaged must accept the direction of a few."[14]

In *Brown Shoe,* the Court reviewed the legislative history of the Celler-Kefauver Anti-merger Act and noted that: "The dominant theme pervading congressional consideration of the 1950 amendments was a fear of what was considered to be a rising tide of economic concentration in the American economy."[15] Among the considerations cited "were the desirability of retaining 'local control'

United States, 172 F. Supp. 107 (S.D.N.Y. 1959) (defendant's own trademarked perfumes held to constitute relevant market). See also note 37 *infra.*

[11] 148 F.2d 416 (2d Cir. 1945).

[12] *Id.* at 430.

[13] *Id.* at 427.

[14] *Ibid.*

[15] 370 U.S. at 315.

over industry and the protection of small businesses."[16] The Court found throughout the legislative discussions on the amendments, "examples of Congress' fear not only of accelerated concentration of economic power on economic grounds, but also of the threat to other values a trend toward concentration was thought to pose."[17] Original section 7 had received some restrictive judicial interpretations which many felt made it inadequate to curb this trend toward concentration where mergers did not rise to Sherman Act proportions.[18] In particular, while the amendments were under consideration, the Supreme Court decided *United States v. Columbia Steel Co.*,[19] which underscored the limitations of the Sherman Act in curbing such a trend while still in its incipiency. The Sherman Act's application to mergers split the Court five to four. Justice Douglas' opinion, for the dissenters, expressed strong concern regarding the growth of big business, on social and political, as well as economic grounds:

> We have here the problem of bigness. Its lesson should by now have been burned into our memory by Brandeis. *The Curse of Bigness* shows how size can become a menace—both industrial and social.... Power that controls the economy should be in the hands of elected representatives of the people, not in the hands of an industrial oligarchy. Industrial power should be decentralized. It should be scattered into many hands so that the fortunes of the people will not be dependent on the whim or caprice, the political prejudices, the emotional stability of a few self-appointed men. The fact that they are not vicious men but respectable and social-minded is irrelevant. That is the philosophy and the command of the Sherman Act. It is founded on a theory of hostility to the concentration in private hands of power so great that only a government of the people should have it.[20]

The ambivalence resulting from the desire to reach each of the divergent goals—preservation of competition and the protection of small-business competitors—has continued to plague the Court under amended section 7, as illustrated by some of the language in *Brown Shoe:*

> Of course, some of the results of large integrated or chain operations are beneficial to consumers. Their expansion is not rendered

[16] *Id.* at 315-16.
[17] *Id.* at 316.
[18] *Id.* at 318.
[19] 334 U.S. 495 (1948).
[20] *Id.* at 535-36.

> unlawful by the mere fact that small independent stores may be adversely affected. It is competition, not competitors, which the Act protects. But we cannot fail to recognize Congress' desire to promote competition through the protection of viable, small, locally owned businesses. Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets. It resolved these competing considerations in favor of decentralization.[21]

Referring to this statement by the Court, one commentary observed: "No matter how many times you read it, that passage states: Although mergers are not rendered unlawful by the mere fact that small independent stores may be adversely affected, we must recognize that mergers are unlawful when small independent stores may be adversely affected."[22]

As this policy conflict becomes more sharply defined, the emerging issue is which should have priority—the preservation of competition or small competitors. The battle lines have been drawn in recent merger litigation, and the Government, particularly the Federal Trade Commission, has launched a direct attack on "bigness," or more precisely, "conglomerate-bigness." In a two-pronged assault, "conglomerate bigness," *i.e.*, absolute size and diversification, is said to: (1) Result in probable injury to competition or tend toward "monopoly" in the relevant market; and (2) Be contrary to congressional policy favoring small business. The purpose of this paper is to review the theories of each of these premises, as developed in recent decisions, together with brief analytical comments and suggested guideposts for more effective antitrust policy. First, however, it would be well to take a look at the different types of mergers as an aid in understanding the various theories of illegality.

I. Merger Classifications

If there was ever any real doubt, *Brown Shoe* established that amended section 7 embraces all types of mergers—"horizontal, vertical and conglomerate"—where the effect may be substantially to lessen competition or tend to create a monopoly.[23] Even this ap-

[21] 370 U.S. at 344.

[22] Bork & Bowman, *The Crisis in Antitrust,* Fortune, Dec. 1963, pp. 138, 197.

[23] 370 U.S. at 317. The House Report on the final bill specifically included conglomerate mergers within its coverage. H.R. Rep. No. 1191, 81st Cong., 1st Sess. 11 (1949).

parently simple observation may raise sticky questions of definition and application. The lawyer's innate compulsion to classify in an effort to simplify may break down when a particular merger is attempted to be fitted into one of these ready-made pigeon-holes. In *Brown Shoe,* for instance, "horizontal" was defined to mean "an economic arrangement between companies performing similar functions in the production or sale of comparable goods or services . . . ."[24] What of a merger of two companies engaged in the same line of endeavor, but geographically separated in such a manner that they do not compete? Obviously, more precise definitions are needed to more accurately distinguish the various forms which mergers may take. For example, the Commission has classified mergers involving companies selling the same line in different geographical markets, or to different customer classes, as "market-extension" mergers.[25]

A vertical arrangement was defined by the Court in *Brown Shoe* as one "between companies standing in a supplier-customer relationship . . . ."[26] What about the acquisition of a supplier's supplier, or a customer's customer? Again, more precise categories may be devised, such as "backward-vertical," "forward-vertical," "backward-jump-vertical," and "forward-jump-vertical."[27]

Defining conglomerate mergers presents even more of a problem. Traditionally, this classification has been a catch-all for any merger which is neither conventionally horizontal nor vertical. In the narrowest sense, the conglomerate merger classification would include only mergers between firms engaged in completely dissimilar lines—technologically, functionally and otherwise unrelated.[28] The latter definition may be limited to exclude mergers of companies whose products, management, research, engineering, production, marketing or distribution methods are related. So defined, it may be difficult to imagine a truly conglomerate merger. At the very least,

---

[24] 370 U.S. at 334.

[25] Procter & Gamble Co., No. 6901, FTC, Nov. 26, 1963, at 14; Foremost Dairies, Inc., No. 6495, FTC, April 30, 1962, at 20, 42, 44. See note 97 *infra* and accompanying text.

[26] 370 U.S. at 323.

[27] Definitions of vertical mergers by various authorities are collected in Kessler & Stern, *Competition, Contract, and Vertical Integration,* 69 YALE L.J. 1 (1959).

[28] Conglomerate mergers were defined by Congress as "those in which there is no discernible relationship in the nature of business between the acquiring and acquired firms." H.R. REP. No. 1191, 81st Cong., 1st Sess. 11 (1949). See also note 35 *infra.*

as one commentator has observed, a "true conglomerate is relatively rare."[29]

If the more narrow definition for conglomerate mergers is adopted, further classifications are needed to describe those outside the conventional horizontal, vertical and conglomerate categories. In addition to the "market-extension" classification, the Commission has classified mergers of companies selling in different lines of commerce (goods which are neither identical nor close substitutes) as "product-extension" mergers, where the products are "functionally closely related."[30] The latter classification would include mergers which enabled "significant integration in the production, distribution or marketing activities of the merging firms."[31] This classification suggests the possibility of an entirely different classificatory schema.

For example, the competitive-advantage theory, discussed below, is based on supposed efficiencies resulting from approaching a theoretical optimum size. The size necessary to achieve such efficiencies may vary according to the particular optimum sought, such as: (1) The technological optimum; (2) The managerial optimum; (3) The marketing optimum; and (4) The financial optimum.[32] The economies of optimum scale are not the only growth determinates. Size may magnify the risks involved in fluctuating demand, which may be minimized by smaller but more flexible units. On the other hand, the larger firm may be better able to cope with such risks as obsolescence through technological research and development. Furthermore, the large conglomerate may spread the risks by diversification into other products or services. Of course, size in the relative market-power sense may reduce competitive risks when it reaches monopoly proportions, at least in the short run. This additional factor of risk minimization, as opposed to economies of scale, suggests a possible fifth classification—the risk-minimization or security

[29] Edwards, *Conglomerate Bigness as a Source of Power,* in BUSINESS CONCENTRATION AND PRICE POLICY 331 n.1 (1955). The Commission gave as an "extreme example" of a true conglomerate merger "the purchase of a newspaper kiosk in New York by a bakery in California." Procter & Gamble Co., No. 6901, FTC, Nov. 26, 1963, at 16.

[30] Procter & Gamble Co., No. 6901, FTC, Nov. 26, 1963, at 15.

[31] *Ibid.*

[32] See ROBINSON, THE STRUCTURE OF COMPETITIVE INDUSTRY (rev. ed. 1958).

optimum.[33] Accordingly, all mergers could be classified as: (1) Technological-expansion; (2) Managerial-expansion; (3) Marketing-expansion; (4) Financial-expansion; and (5) Security-expansion. Unlike the traditional horizontal-vertical-conglomerate classifications, these categories are not mutually exclusive, and a single merger may involve more than one type of expansion.[34] While neither the Commission nor the courts have as yet adopted any of these or other possible alternative classifications,[35] they suggest further lines of inquiry and vantage points from which the competitive effects of any particular merger may be more realistically ascertained. However, to minimize confusion, unless otherwise indicated the terms "horizontal," "vertical," and "conglomerate" shall hereinafter be used in their traditional sense—including the broad, catch-all definition of "conglomerate" mergers.

II. Statutory Proscriptions: Incipient Restraints and Trends to Monopoly

Section 7 prohibits only those mergers "in any line of commerce in any section of the country" whose effect "may be substantially to lessen competition, or to tend to create a monopoly."[36] The proper procedure and relevant factors in the application of these statutory standards were explained in *Brown Shoe*. The initial step in any

[33] *Ibid.* See also Stocking, *Comment*, in Business Concentration and Price Policy 352, 353 (1955), commenting on Edwards, *supra* note 29, in which he termed this the "security optimum." Even assuming that the monopoly is complete in the sense that all entry into the industry is foreclosed, the monopolist must be constantly wary of inter-industry competition and obsolescence through technological advancement and "creative destruction." See Schumpeter, Capitalism, Socialism, and Democracy 81 (1942).

[34] The most common approach for "reconciliation," where the various optimums call for different scales of operation, is to attempt to place each function at its individual optimum scale and coordinate them under common control. See Robinson, *op. cit. supra* note 32, at 94. General Motors is an example of the application of this principle. See Drucker, Concept of the Corporation (1946).

[35] Another suggestion has been made that integration may be: (1) "Divergent" when it involves activities which are related at the production level, but the products are distributed through different channels; and (2) "Convergent" when the products manufactured through different processes are sold through the same channels, by the same marketing methods, or to the same customers. Thorp & Crowder, The Structure of Industry (TNEC Monograph No. 27, 1941). See also Edwards, *supra* note 29, at 331 n.1.

[36] 38 Stat. 731 (1914), as amended, 64 Stat. 1125 (1950), 15 U.S.C. § 18 (1958).

anti-merger proceeding is the determination of the "area of effective competition," *i.e.*, the relevant product ("line of commerce") and geographic ("section of the country") markets, because "substantiality can be determined only in terms of the market affected."[37]

Once the relevant markets, or submarkets, have been defined, the Court indicated several factors relevant to a determination of the competitive effect of a merger. First of all, it is clear that the act reaches "incipient monopolies and trade restraints" before they reach Sherman Act proportions.[38] Secondly, while this "incipiency" standard dispenses with a required showing of "clear-cut menaces to competition," it does require a showing of "probable anticompetitive effect," and "ephemeral possibilities" are not enough.[39] Finally, "while providing no definite quantitative or qualitative tests by which enforcement agencies could gauge the effects of a given merger to determine whether it may 'substantially' lessen competition or tend toward monopoly, Congress indicated plainly that a merger had to be functionally viewed, in the context of its particular industry."[40] Thus, while the Court recognized that mar-

[37] 370 U.S. at 324. *Cf.* BARNES, *Legal Issues and Economic Evidence in Cartel Law,* in II CARTEL AND MONOPOLY IN MODERN LAW 816-17 (1961); Barnes, *The Primacy of Competition and the Brown Shoe Decision,* 51 GEO. L.J. 706, 727-30 (1963). Barnes argues that the two-step examination of a merger should be reversed, by first determining the competitive effects of the merger and then delineating the market to determine their substantiality. He suggests that the Court did in fact follow this approach in *Brown Shoe.* Since the Court made it clear that competitive effects can be judged only in terms of the relevant market, it is doubtful that it makes much difference whether the relevant market is determined first or last. The traditional separation of the relevant market into product and geographical markets has also been criticized. See Mann and Lewyn, *The Relevant Market under Section 7 of the Clayton Act: Two New Cases—Two Different Views,* 47 VA. L. REV. 1014, 1015-16 (1961). Barnes would expand the relevant market's dimensions to five: (1) Product; (2) Geographic; (3) Time; (4) Buyers; and (5) Sellers. Barnes, *supra* at 728. The "practical indicia" listed by the Court in *Brown Shoe* for determining the relevant product markets (lines of commerce), 370 U.S. at 325, were taken from those used in prior decisions. See BOCK, MERGERS AND MARKETS, AN ECONOMIC ANALYSIS OF CASE LAW (1960). See also 51 CALIF. L. REV. 597, 600 n.24 (1963). The listing of all of these criteria and selecting those deemed controlling has been criticized as "a somewhat circular process." *Ibid.* Certainly, it provides a temptation for the courts to define the relevant market to conform to a predetermined conclusion of legality, which may be a subconscious application of Barnes' view.

[38] 370 U.S. at 318.

[39] *Id.* at 323.

[40] *Id.* at 321-22. The so-called "quantitative-substantiality" test derives

ket shares are "the primary index of market power," it felt that "only a further examination of the particular market—its structure, history and probable future—can provide the appropriate setting for judging the probable anticompetitive effect of the merger."[41]

The most obvious anticompetitive effect which may be attributed to a conventionally horizontal merger results from an increase in market concentration, *i.e.*, a decrease in the number of competitors in the relevant market and a corresponding reduction in market-share distribution. The Court termed the combined market share, "one of the most important factors to be considered when determining the probable effects of the combination on effective competition in the relevant market."[42] Not only does this statistic show the merger's "immediate impact," but it provides "a meaningful base upon which to build conclusions of the probable future effects of the merger."[43] Because the merger must be "functionally viewed, in the context of its particular industry,"[44] the significance of any particular market share necessarily varies, and there is no magic percentage figure or "quan-

---

from Standard Oil v. United States, 337 U.S. 293 (1949), in which the Court tested the legality of requirements contracts under section 3 of the Clayton Act by the quantity or percentage portion of the relevant market affected. *Cf.* Tampa Elec. Co. v. Nashville Co., 365 U.S. 320, 333-35 (1961). While the quantitative test offers the hope of simplicity, it presents a problem regarding where to draw the line of legality. See KAYSEN & TURNER, ANTITRUST POLICY, AN ECONOMIC AND LEGAL ANALYSIS 133 (1959); Webster, *How to Comply with the Clayton Act,* in 1959 NEW YORK BAR ASS'N ANTITRUST LAW SYMPOSIUM 75, 77; Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics,* 74 HARV. L. REV. 226, 278-79 (1960); Stigler, *Mergers and Preventive Antitrust Policy,* 104 U. PA. L. REV. 176 (1955). By way of comparison, the "qualitative substantiality" test would consider all relevant economic facts of the competitive situation before and after a merger to determine its effects. This was the original approach by the Commission under section 7. Pillsbury Mills, Inc., 50 F.T.C. 555, 571-72 (1953). The Commission, however, did recognize that quantitative factors are properly to be considered together with other qualitative data. Brillo Mfg. Co., 56 F.T.C. 1672, 1674 (1960). In referring to the running debate between the two schools advocating "quantitative substantiality" and "qualitative substantiality," Judge Weinfeld, in United States v. Bethlehem Steel Corp., 168 F. Supp. 576, 603 n.51 (S.D.N.Y. 1958), observed that: "So much has been said by opposing commentators that it has become more of a battle of words than a search for the correct interpretation of § 7." Despite the Supreme Court's rejection of a "quantitative substantiality" test as determinative in all cases, the debate is far from settled. See text accompanying note 45 *infra.*

[41] 370 U.S. at 322 n.38.

[42] *Id.* at 343.

[43] *Id.* at 343 n.70.

[44] *Id.* at 321-22.

titative substantiality" test by which all horizontal mergers may be gauged.[45] In *Brown Shoe,* for example, the Court held that even a combined share as small as five per cent may be too much in a fragmented industry, because such a merger might spur further concentration by competitors seeking equivalent shares, and "the oligopoly Congress sought to avoid would then be furthered and it would be difficult to dissolve the combinations previously approved."[46] Furthermore, where there has been a "history of tendency toward concentration in the industry,"[47] an otherwise insignificant merger may be prevented because, "tendencies toward concentration in industry are to be curbed in their incipiency . . . ."[48]

In *Philadelphia Nat'l Bank,* the Court supplemented its merger-law exegesis contained in *Brown Shoe* by stating that, "elaborate proof of market structure, market behavior, or probable anticompetitive effects" may be dispensed with in testing "mergers whose size makes them inherently suspect" in view of section 7's design to prevent "undue concentration:"[49]

> Specifically, we think that a merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market, is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects.[50]

This rebuttable presumption was said to be consistent with the economic theory that: " '[C]ompetition is likely to be greatest when

[45] See *id.* at 321; United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 365-67 (1963). See also note 40 *supra* and accompanying text.

[46] 370 U.S. at 344.

[47] *Id.* at 345.

[48] *Id.* at 346. In the past, at least, it was generally agreed that horizontal mergers were the most prevalent. THORP & CROWDER, *op. cit. supra* note 35, at 163. Of the 96 cases brought by the Commission and the Department of Justice under the amended section 7 up to January 1, 1942, 61% involved horizontal aspects only, and 25% had both horizontal and vertical aspects. BOCK, MERGERS AND MARKETS 23, 24, 31 (Nat'l Industrial Conference Studies in Business Economics No. 77, 1962). Latest indications are that the current "merger fever" involves a desire to achieve diversification of market extension through conglomerate mergers, rather than horizontal acquisitions. Procter & Gamble Co., No. 6901, FTC, Nov. 26, 1963, at 19. See Wall Street Journal, Feb. 4, 1964, p. 1, col. 6.

[49] 374 U.S. at 363.

[50] *Ibid.*

there are many sellers, none of which has any significant market share'. . . ."[51] The Court did not attempt to delimit the smallest size at which a merger becomes "inherently suspect," but was clear that this test was met by a merger conferring a thirty per cent market share on the acquiring firm and resulting in an increase of more than thirty-three per cent in the market shares of the two largest competitors in the relevant market.[52] It rejected the argument that the merger of the market's third and fourth largest firms did not increase the concentration among the three largest firms, stating that this argument would validate further concentration in an already concentrated market, and, "if concentration is already great, the importance of preventing even slight increases in concentration and so preserving the possibility of eventual deconcentration is correspondingly great."[53]

In *Brown Shoe* the Court stated that the anticompetitive effect which may result from a vertical merger, as in loose-knit vertical arrangements, "results primarily from a foreclosure of a share of the market otherwise open to competitors . . . ."[54] Accordingly, the size of the foreclosure serves as an important factor in determining whether a merger may foreclose competition from a substantial share of the relevant market in violation of section 7. However, the Court emphasized that, except where the foreclosure reaches monopoly proportions or is *de minimis,* the share of the market foreclosed is not alone decisive.[55]

One additional factor which may be considered in predicting a merger's probable competitive effect is its economic purpose. Thus, the Court recognized that the acquisition of a "failing company," or the merger of two "small" companies to enable them to compete with larger companies dominating the market, may not have the proscribed effect.[56] As an evidentiary matter, of course, past behavior may shed light on the economic purpose of the merger.[57] For example,

[51] *Ibid.*
[52] *Id.* at 364-65.
[53] *Id.* at 365 n.42.
[54] 370 U.S. at 328.
[55] *Id.* at 329.
[56] *Id.* at 319, 331. For a recent review of the "failing company" doctrine, see Comment, 66 MICH. L. REV. 566 (1963).
[57] 370 U.S. at 332.

where vertical leverage[58] has been used in the past to foreclose competition, it may be assumed that further vertical integration has a similar purpose and probable result. Here again, as in horizontal mergers, the Court stressed the importance of curbing a "trend" of vertical mergers having a purpose or effect of foreclosure and a resulting trend toward concentration, *i.e.,* oligopoly.[59]

In the case of a conglomerate merger, any effect on competition is indirect in that no present competitor, supplier, or customer is eliminated, and one company merely replaces another in the relevant market. This has led many to assume that a conglomerate merger could never violate section 7.[60] If conglomerate mergers were to be prohibited, new tests had to be devised and adopted. It was necessary to look beyond the structure of the relevant market to satisfy the statutory requirement of probable anticompetitive effect. As explained by the Commission:

> Congress' clearly expressed concern with the conglomerate merger is in striking contrast to the preoccupation of lawyers and economists with tests that look only to the number and size distribution of firms in a single market, and is a challenge to this Commission and to the courts to devise tests more precisely adjusted to the special dangers to a competitive economy posed by the conglomerate merger.[61]

In rising to this "challenge" to devise new tests for conglomerate mergers, the Commission has focused on the extra-market power assertedly derived from absolute size and diversification (conglomerate-bigness) which it believes would have: (1) Quasi-vertical effects, because of the foreclosure of competition through the application of "conglomerate leverage"; and (2) Quasi-horizontal effects by probably restraining competition and tending to concentration in the relevant market, because of the "competitive advantages" of conglomerate-bigness and the elimination of "potential competition."

---

[58] See text accompanying notes 63-95 *infra,* regarding the leverage theory of foreclosure.

[59] 370 U.S. at 332-33.

[60] See, *e.g.,* KAYSEN AND TURNER, *op. cit. supra note* 40, at 131; Adleman, *The Antimerger Act, 1950-60,* 51 AM. ECON. REV. 236, 243 (1961); Adleman, *Acquire the Whole or Any Part of the Stock or Assets of Another Corporation,* 1953 A.B.A. ANTITRUST SECTION 111, 121 (1953); Blair, *The Conglomerate Merger in Economics and Law,* 46 GEO. L.J. 672, 673-74 (1958); Jacobs, *Mergers and the Small Business Man,* 16 A.B.A. ANTITRUST SECTION 83, 85 (1960).

[61] Procter & Gamble Co., No. 6901, FTC, Nov. 26, 1963, at 20.

Recent application of these theories, discussed below, has tended toward the adoption of per se standards in preference to more extended economic inquiry under the rule of reason approach.[62]

A. Conglomerate Leverage

The theory of conglomerate leverage would test probable competitive effect by finding potential foreclosure of a substantial share of the market as a result of the leverage which may be brought to bear in the relevant market from exercising extra-market power derived from absolute size and diversification. Under the "leverage" theory, competition in one line of commerce or relevant market may be foreclosed through the coercive pressure of monopoly or "market" power possessed in another line of commerce or market.[63] Theoretically, this leverage may take several forms, including "tie-ins" and "reciprocity."

1. Tie-ins.—Tying arrangements are based on the idea that "if you want product *A*, you must also buy product *B*," where the seller has market power in *A* (the tying product) and seeks to foreclose competition in *B* (the tied product). Full-line forcing, requirements contracts and exclusive dealing arrangements are variants of tying arrangements, extending the use of the tying product, or products, as a lever to require the purchase of the seller's entire line, to require the buyer to purchase all of his requirements from the seller, or to deal with the seller to the exclusion of the seller's competitors.

Tying arrangements have been singled out for special treatment under the antitrust laws on the theory that they are inherently anticompetitive. Such arrangements may violate section 3 of the Clayton Act where they "tend to create a monopoly in any line of com-

---

[62] It should be noted that the Supreme Court, the lower courts, and the Federal Trade Commission have consistently avowed that they were not applying a per se rule, and that no such rule was applicable in section 7 proceedings.

[63] See Bodner, *Vertical Mergers Under Section 7,* 22 A.B.A. ANTITRUST SECTION 106 (1963); Bork, *Vertical Integration and the Sherman Act: The Legal History of an Economic Misconception,* 22 U. CHI. L. REV. 157, 171-72 (1954); Bowman, *Tying Arrangements and the Leverage Problem,* 67 YALE L.J. 19, 25-27 (1957). See also Hayek, *The Geometrical Representation of Complementarity,* 10 REV. ECON. STUDIES 122 (1942-43).

merce,"[64] or section 1 of the Sherman Act,[65] where they result in unreasonable restraints of trade. In addition they may violate the incipiency standard of section 5 of the Federal Trade Commission Act which embraces violations of the Clayton and Sherman Acts as "unfair methods of competition . . . ."[66]

The tests of their legality under each of these acts were described by the Supreme Court in *Times-Picayune Pub. Co. v. United States:*[67]

> When the seller enjoys a monopolistic position in the market for the "tying" product, *or* if a substantial volume of commerce in the "tied" product is restrained, a tying arrangement violates the narrower standards expressed in § 3 of the Clayton Act because from either factor the requisite potential lessening of competition is inferred. And because for even a lawful monopolist it is "unreasonable, *per se,* to foreclose competitors from any substantial market," a tying arrangement is banned by § 1 of the Sherman Act whenever *both* conditions are met. In either case, the arrangement transgresses § 5 of the Federal Trade Commission Act, since minimally that section registers violations of the Clayton and Sherman Acts.[68]

As subsequently explained by the Court in *Northern Pac. Ry. v. United States,*[69] the requisite "monopolistic position" does not necessarily mean an absolute monopoly, but rather "sufficient eco-

[64] 38 Stat. 731 (1914), 15 U.S.C. § 14 (1958). Section 3 provides: "It shall be unlawful for any person engaged in commerce, in the course of such commerce, to lease or make a sale or contract for the sale of goods, wares, merchandise, machinery, supplies or other commodities, whether patented or unpatented, for use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, or fix a price charged therefor, or discount from, or rebate upon, such price, on the condition, agreement, or understanding that the lessee or purchaser thereof shall not use or deal in the goods, wares, merchandise, machinery, supplies, or other commodities of a competitor or competitors of the lessor or seller, where the effect of such lease, sale, or contract for sale or such condition, . . . tend to create a monopoly in any line of commerce."

[65] 26 Stat. 209 (1890), 15 U.S.C. §§ 1-7 (1958), quoted in part note 7 *supra.*

[66] 38 Stat. 717 (1914), as amended, 52 Stat. 111 (1938), 15 U.S.C. § 45(a)(1) (1958): "Unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce, are hereby declared unlawful."

[67] 345 U.S. 594 (1953).

[68] *Id.* at 609. (Footnote omitted.)

[69] 356 U.S. 1 (1958).

nomic power with respect to the tying product to appreciably restrain free competition in the market for the tied product. . . ."[70]

It is self-evident, as noted by the Commission in its recent *Clorox* decision, *Procter & Gamble Co.*,[71] that "the merger of two firms having common marketing outlets might facilitate tie-in or full-line forcing agreements."[72] In the case of mergers, however, the Commission stated that it would not require the actual utilization of such agreements. This would pyramid the incipiency doctrine of sections 3 and 7 of the Clayton Act by outlawing any merger which "may" *facilitate* the making of such contracts, which, if made, "may" have the proscribed competitive effect. Furthermore it stated that it "need not go so far as to find that leverage of the kind that supports tie-in and full-line forcing arrangements," on the theory that the same effect may be derived, not from "coercion," but through "convenience or expediency" resulting from the advantages in marketing a diversified line.[73] A similar effect may result in merger cases involving a specialized type of leverage—"reciprocity."

2. *Reciprocity.*—As the term implies, reciprocity is the practice of granting mutual concessions in order to gain mutual benefits. Thus, it resembles tying arrangements in that the benefit to be conferred (tying benefit) is conditioned on the receipt of a reciprocal benefit (tied benefit). As in tying arrangements, the effectiveness of the practice depends upon the "power," *i.e.*, desirability, of the tying benefit. Perhaps the most common form of business reciprocity is reciprocal buying, involving the policy of "I'll-buy-from-you-if-you'll-buy-from-me." A review of recent decisions by the Commission and the courts discloses a conflict regarding the status of reciprocity in anti-merger proceedings.

The Commission's recent decision in *Consolidated Foods Corp.*[74]

[70] *Id.* at 6. See also United States v. Loew's Inc., 371 U.S. 38, 45 (1962): "Even absent a showing of market dominance, the crucial economic power may be inferred from the tying product's desirability to consumers or from uniqueness in its attributes."

[71] No. 6901, FTC, Nov. 26, 1963.

[72] *Id.* at 16.

[73] *Id.* at 47.

[74] No. 7000, FTC, Nov. 15, 1962, 49 VA. L. REV. 852 (1963). See generally Donnem, *The Conglomerate Merger and Reciprocity*, 8 ANTITRUST BULL. 283 (1963); Handler, *Emerging Antitrust Issues: Reciprocity, Diversification and Joint Ventures*, 49 VA. L. REV. 433 (1963); Hausman, *Reciprocal Dealing and the Antitrust Laws*, 77 HARV. L. REV. 873 (1964); Stocking

was the first to involve the question of reciprocal buying in a conglomerate merger proceeding. Consolidated, a large diversified processor, wholesaler, and retailer of food products, was held to have violated section 7 by acquiring Gentry, Inc., a company primarily engaged in the production of dehydrated onion and garlic. It was undisputed that the acquisition did not involve any "horizontal" or "vertical" aspects and, according to the Commission:

> The gravamen of this proceeding was that the merger was illegal under Section 7 of the Clayton Act because it created the serious danger that Gentry would acquire a protected market, in which fair competitive opportunities would be denied to other sellers of dehydrated onion and garlic, as a result of the trade practice known as "reciprocity".[75]

The Commission's theory was that a diversified corporation is in a much better position to practice reciprocal buying than a single-line corporation, and the greater the diversification, the greater the *opportunities* to engage in this practice. Therefore, it felt that the change in the industry structure through diversification by conglomerate merger was "likely to lead to the most serious of anti-competitive consequences, viz., to confer upon large, diversified corporations a crushing weapon against small, single-line competitors."[76] This "crushing weapon" was the ability of Consolidated "to reap a profit from sales in one product area . . . on the sheer strength of its buying power in other markets, and not on the basis of 'a better product or lower price'."[77]

Three prior decisions involving section 5 of the Federal Trade Commission Act were noted in which the Commission had held that overt and coercive reciprocity was an unfair method of competition.[78]

& Mueller, *Business Reciprocity and the Size of Firms,* 30 J. Bus. U. Chi. 73 (1957), reprinted in Stocking, Workable Competition and Antitrust Policy 287 (1961); Krash, *Panel Discussion,* New Frontiers in Section 7 Enforcement 13 (A.B.A. Antitrust Section, 1963); Ammer, *Realistic Reciprocity,* Harv. Bus. Rev. Jan.-Feb., 1962, p. 116; Lewis, *The Present Status of Reciprocity as a Sales Weapon,* Dun's Review and Modern Industry, Sept. 1960, p. 32; 39 Notre Dame Law. 185 (1964).

[75] No. 7000, FTC, Nov. 15, 1962, at 3-4.

[76] *Id.* at 13.

[77] *Ibid.*

[78] California Packing Corp., 25 F.T.C. 379 (1937); Mechanical Mfg. Co., 16 F.T.C. 67 (1932); Waugh Equip. Co., 15 F.T.C. 232 (1931). See Stocking & Mueller, *supra* note 74. Three recent cases brought by the Justice Department charge violations of the Sherman Act through reciprocity: Complaint, United States v. General Motors Corp., Civil No. 63 C 80, N.D. Ill.,

While these cases would be precedent for ordering Consolidated to cease and desist from the overt practice of reciprocity in violation of section 5, the present inquiry was focused on the probable anticompetitive effects of the change in the "market or industry structure" in violation of section 7. As explained by the Commission, Consolidated buys products of food processors for resale, and food processors in need of dehydrated onion or garlic may choose to buy from Gentry, because they "are anxious to sell or to continue to sell their products to Consolidated . . . ."[79] Thus, the overt reciprocity formula of "I'll-buy-from-you-if-you'll-buy-from-me" was recast into what one commentator has termed "psychological"[80] reciprocity, the unspoken hope that "If-I-buy-from-him-he'll-buy-from-me." It was thought that, "the causal relationship between the merger and the injury to competition implicit in reciprocal buying . . . [was] patent."[81] This was so because, "merely as a result of its connection with Consolidated, and without any action on the latter's part, Gentry would have an unfair advantage over competitors enabling it to make sales that otherwise might not have been made."[82] In fact, the Commission felt that an order enjoining overt or coercive reciprocity by Consolidated, "would do nothing to eliminate the anticompetitive effect inherent in the corporate structure created by the merger."[83] Noting that reciprocal buying and tying agreements are closely analogous in competitive effect, and that the merger gave Consolidated a basis on which to tie its purchases from its suppliers to their purchases from Gentry, it was concluded that "it is difficult to see how the quasi-tying-agreement effect of reciprocal buying fostered by the union of Consolidated and Gentry can be anything but anticompetitive."[84]

Although the foreclosure of competition in a vertical merger is analogous to the potential foreclosure in a conglomerate merger resulting from the exercise of "conglomerate leverage" of the tying or reciprocity type, the conglomerate merger presents a greater problem

Jan. 14, 1963; Indictment, United States v. General Motors Corp., Cr. No. 61-CR-356, S.D.N.Y., April 12, 1961, *transferred,* Cr. No. 61-CR-340, N.D. Ill., June 7, 1961; United States v. General Dynamics Corp., Civil No. 62 Civ. 3686, S.D.N.Y., Nov. 8, 1962.

[79] No. 7000, FTC, Nov. 15, 1962, at 4.

[80] Krash, *supra* note 74, at 16.

[81] No. 7000, FTC, Nov. 15, 1962, at 14.

[82] *Ibid.*

[83] *Ibid.*

[84] *Id.* at 20.

in predicting "substantiality," *i.e.*, size of the share of the market foreclosed, which *Brown Shoe* stated was an important factor in determining the probable competitive effect.[85] In *Consolidated Foods*, substantiality was found in the fact that approximately twenty-five per cent of the onion and garlic produced by the industry was purchased by firms that both sold to Consolidated and bought in volume from Gentry. Therefore, psychological reciprocity stood to influence at least one-fourth of the available market, and the "latent force of Consolidated's buying power" was said undoubtedly to influence a great deal more, resulting in not only a significant, but an "exceptionally large" potential market foreclosure.[86]

In *United States v. Ingersoll-Rand Co.*,[87] the Third Circuit affirmed the district court's adoption of the Commission's reciprocity theory in issuing a preliminary injunction against the proposed acquisition by Ingersoll-Rand, the nation's fourth-largest general industrial machinery manufacturer, of three manufacturers of a variety of face and underground coal mining machinery and equipment. In rejecting the defense that there had been no showing of competition between two companies to be acquired, the courts pointed out that section 7 proscribes adverse competitive effects of conglomerate mergers, including the possibility of injury to competition through the practice of reciprocity. Carrying the theory further than the Commission's "If-you-buy-from-me-I'll-buy-from-you" approach, they visualized a sort of "round-robin" reciprocity in that: (1) Ingersoll-Rand is a large purchaser of steel; (2) Steel companies are large purchasers of coal; therefore (3) "It is not overly speculative to assume that the judicious use of its steel-purchasing power by Ingersoll-Rand could immeasurably increase the sales by the acquired companies of machinery and equipment to the coal mining companies which acutely need the continued goodwill of the steel industry."[88] This is reciprocity with a flair. Furthermore, it was felt that the mere possession of this purchasing power might be psychologically sufficient in itself, without overt effort by defendants, "as sophisticated businessmen are quick to see the advantages in securing the goodwill of the possessor."[89]

---

[85] 370 U.S. at 328.
[86] No. 7000, FTC, Nov. 15, 1962, at 16.
[87] 218 F. Supp. 530 (W.D. Pa. 1963), *aff'd*, 320 F.2d 509 (3d Cir. 1963).
[88] 218 F. Supp. at 552, *quoted and aff'd*, 320 F.2d at 524.
[89] *Ibid.*

This theory of "psychological" reciprocity was rejected in *United States v. Penn-Olin Chem. Co.*,[90] where the Delaware District Court dismissed a complaint charging that violations of section 7 of the Clayton Act and section 1 of the Sherman Act resulted from a 1960 joint venture by defendants Pennsalt Chemicals Corporation and Olin Mathieson Chemical Corporation in forming a third corporation, Penn-Olin, to produce and sell sodium chlorate in the southeastern United States. Olin and Pennsalt did not compete in the manufacture and sale of sodium chlorate, although they were substantial competitors on a nationwide scale in the production and sale of calcium hypchlorite.

The Government took the position that the combined financial resources of defendants, as compared with Penn-Olin's competitors in the southeastern market, Hooker Chemical Corp. and American Potash and Chemical Corp. (AmPot), were so great as to give them a competitive advantage which might lead to market domination by Penn-Olin. This contention was based largely on the theory of reciprocal buying. The court noted that Pennsalt had admittedly engaged in overt reciprocity, using "marketing coordination" in advancing its sales efforts.[91] It was questionable whether Olin followed this policy too. Neither did the record disclose whether Hooker and AmPot had or would attempt to use their buying power as a lever to gain sales. Regardless, the court concluded that "whatever advantage Penn-Olin might be able to obtain through reciprocal arrangements because of the combined size of the defendants scarcely warrants the conclusion that as a matter of reasonable probability Penn-Olin will ultimately dominate the sodium chlorate market."[92] In arriving at this conclusion, the court considered the fact that AmPot and Hooker had a virtual monopoly in the Southeast and a

[90] 217 F. Supp. 110 (D. Del. 1963), *appeal docketed*, 32 U.S.L. Week 3119 (U.S. Sept. 27, 1963) (No. 503). An interesting innovation in the Government's theory was that the joint acquisition of the stock of Penn-Olin, on a fifty-fifty basis, "was tantamount to an indirect acquisition by Pennsalt and Olin of the assets of the other" within the meaning of section 7. *Id.* at 114. The court did not directly consider the question whether section 7 would apply to joint ventures, because it found that the joint venture did not have the competitive effect proscribed by that section, whether or not it was applicable. Nor did the court get to the alternative Sherman Act issue, since "the anticompetitive standard imposed by Section 7... is less stringent than that of the Sherman Act." *Id.* at 115.

[91] *Id.* at 126.

[92] *Ibid.*

formidable competitor was needed to make inroads on their entrenched positions. In addition, it was noted that Pittsburgh Plate Glass Company had announced that it intended to construct a sodium chlorate plant in the southeastern market, and that none of these competitors was likely to be disadvantaged simply because of defendants' size.[93]

COMMENT.—In the case of conglomerate leverage of the tying variety, the Commission would compound the incipiency standards of sections 3 and 7 of the Clayton Act to infer: (1) "Sufficient economic power" in one market; (2) That "may" be exerted in another; thereby (3) Resulting in a "probability" of "probable" injury to competition. Furthermore, the "probable" foreclosure resulting from the "probability" of the exertion of the "probable" power may be based on nothing more than the psychological effect of the mere existence of the assumed power which, in turn, is based solely on the existence of conglomerate bigness. This already incipid incipiency test may theoretically be raised to the nth power by the addition of the incipiency test of section 5 of the Federal Trade Commission Act to those of the Clayton Act sections 3 and 7, on the theory that section 5 includes "minimally" the incipient incipiency violations of the other antitrust laws.[94]

The same flaw is evident in the reciprocity theory. Starting with the proposition that coercive reciprocity "may" have the proscribed effect under section 5, the Commission would proceed to find a "probability" of such a "probable" restraint whether or not exerted, merely from the "psychological" effect of the existence of conglomerate bigness. In *Ingersoll-Rand,* this theory was extended even further to include "secondary psychological reciprocity"[95] on the theory that the diversified firm may "psychologically" foreclose competition in its acquired company's sales to a supplier of the conglomerate's supplier. Whether either or both of these theories will be upheld in preference to the contrary views expressed in *Penn-Olin* is a question yet to be resolved.

---

[93] *Id.* at 126-27.

[94] See Day, *Exclusive Territorial Arrangements Under the Antitrust Laws —A Reappraisal,* 40 N.C.L. REV. 223, 229 n.10 (1962).

[95] See Krash, *supra* note 74, at 15; Ammer, *supra* note 74.

B. Potential Competition

A problem even greater than that of finding foreclosure of a substantial share of the market as a guide in predicting the probability of anticompetitive effect under the tying or reciprocity theories is encountered in testing conglomerate mergers under the other theories of illegality. The Commission's attempted solution is to find a quasi-horizontal effect from the elimination of "potential competition." As explained in *Foremost Dairies, Inc.*[96] (a "market-extension" merger proceeding), "when such established firms enter new markets by acquiring the leading independent firms, they destroy potential competition in two ways: they eliminate the acquired company as a competitor in the acquired firm's markets, and the acquired firm is removed as a potential entrant in the acquiring firm's markets."[97] This theory takes one more backward step from requiring a showing of actual injury to competition. When combined with the Clayton Act's incipiency test of "probable injury to competition," the test becomes one of "probable injury to potential competition."

---

[96] No. 6495, FTC, April 30, 1962.

[97] *Id.* at 49. The per se tenor of this language is weakened by the fact that in condemning Foremost's acquisition of Philadelphia Dairy Products the Commission pointed to the fact that there was an overlap in the merging companies' marketing areas which resulted in the elimination of some actual competition between the two firms. In addition, the Commission expanded the potential competition theory to include the elimination of the mere existence of a potential competitor as a healthy brake on oligopoly behavior in the relevant market. It was felt that the psychological fear of a powerful potential competitor would act to inhibit the use of market power by oligopolistic sellers, and the elimination of this threat of potential competition would result in a probable lessening of actual competition. This same view was expressed in *Clorox*. No. 6901, FTC, Nov. 26, 1963, at 61-62. In still another attack on the theory of potential competition, the Commission held in *Clorox* that the elevation of entrance barriers by a conglomerate merger would diminish the potential competition of other would-be entrants. *Id.* at 49-50. Indeed, the Commission went so far as to say that the acquisition of Clorox resulted in the optimum size for effective advertising being elevated to a point that would discourage potential competition, *i.e.*, new entry. *Id.* at 65. This is a novel theory in that the economic optimum sizes are, theoretically at least, static. *Cf.* National Tea Co., No. 7453, FTC, April 5, 1963, where a hearing examiner upheld market extension acquisitions in the face of an attack based on the elimination of potential competition. See also complaints in Continental Baking Co., No. 7880, FTC, May 5, 1960, *consent order of divestiture,* May 11, 1962; Campbell Taggart Associated Bakeries, Inc., No. 7983, FTC, June 14, 1960; Kroger Co., No. 7464, FTC, April 1, 1959; Beatrice Foods Co., No. 6653, FTC, Oct. 16, 1956; Borden Co., No. 6652, FTC, Oct. 16, 1956.

The application of this theory represents a turn-about by the Commission. In its first conglomerate merger decision, *Union Carbide Corp.*,[98] it took the opposite view, stating:

> We would, of course, prefer to see more than three producers competing in the sale of cellulose sausage casings, but this aspect of market control is beyond our power. Here one competitor has been replaced by another. The competitive picture is essentially as it was before the acquisition except for the aforementioned increase in the economic backing of the Visking casing business.[99]

Because it felt that the "competitive picture" had not been changed by Carbide's acquisition of Visking's sausage casing business, the Commission concluded that it could issue a new complaint if future developments indicated that the effect of the merger was anticompetitive.

So far, the courts have rejected the theory that the elimination of a potential competitor is sufficient cause to condemn a conglomerate merger. The granting of defendants' motion for dismissal at the close of the Government's case in *United States v. Continental Can Co.*,[100] culminated an attack on the acquisition of Hazel-Atlas Company, the nation's third-largest glass container manufacturer, by Continental, the nation's second-largest metal can manufacturer, which had begun with an abortive attempt by the Government to invoke a 1950 consent decree to block the merger. The court found the United States to be the relevant geographical market, and the metal can industry, the glass container industry, and containers for the beer industry (composed of glass bottles and cans) to be separate lines of commerce. It concluded that the merger did not involve the usual pattern of horizontal or vertical combination, but was "basically" a conglomerate acquisition by a member of two industries, can and plastic containers, of a member of a third industry, glass containers, for the purpose of diversification.[101] Despite the fact that Hazel-Atlas had already manufactured limited quantities of beer and soft drink bottles, products of Continental, it was held that the "possibility" that it might have undertaken at some undetermined future time to become a "significant" competitor

---

98 No. 6826, FTC, Sept. 25, 1961.

99 *Id.* at 16.

100 217 F. Supp. 761 (S.D.N.Y. 1963), *appeal docketed,* 32 U.S.L. WEEK 3078 (U.S. Aug. 13, 1963) (No. 367), *juris. noted,* 375 U.S. 893 (1963).

101 *Id.* at 782.

in these two lines of commerce was mere speculation which did not meet the test of reasonable probability.[102]

In *Penn-Olin,* the court rejected the Government's contention that because Pennsalt and Olin were financially able and otherwise competent to enter the relevant market and to compete on an individual basis, the joint venture destroyed potential competition in violation of section 7. Not only was it improbable that each would have entered the market individually, but it was held that even if this contingency could be established it would not automatically condemn the joint venture:

> Such an interpretation would cut the heart out of Section 7. The section denounces a substantial "lessening" of competition. "Lessening" is a word of comparison. It demands that the competitive situation which the challenged transaction has brought about be compared with that which otherwise would have existed.[103]

The court rejected the further contention that whether or not each would have entered the market individually but for the joint venture, the fact that they were capable of doing so would condemn the merger, whatever the competitive effect of the joint venture may be "in the light of relevant economic factors."[104] As the court viewed it, the Government,

> would substitute a conclusive presumption that *any* combination specified in Section 7 between companies having the overall capability to go into business alone has a pernicious effect on competition and lacks any redeeming virtue; it would make *any* such combination illegal *per se*.[105]

It was concluded that, "no precedent supports the Government's position and its lack of logic condemns it."[106] Furthermore, it was thought to be "more reasonable" to assume that competition was greater than it would have been if either had decided to enter the market individually instead of through Penn-Olin.[107]

Most recently, the per se application of the potential competition theory was rejected by the three-judge district court decision in

[102] *Id.* at 796, 799.
[103] 217 F. Supp. at 130-31.
[104] *Id.* at 124.
[105] *Ibid.*
[106] *Ibid.*
[107] *Id.* at 131.

United States v. Crocker-Anglo Nat'l Bank.[108] As a basis for its motion for a preliminary injunction against the merger of Crocker-Anglo, of San Francisco, with the Citizens National Bank, of Los Angeles, the Government claimed that the merger would lessen potential competition between the merging banks on the theory that Crocker-Anglo would expand its operations into Citizens' area through "de novo branches" if the merger were prohibited. The existence of such potential competition was said to be a question of fact, involving "a forecast of probabilities."[109] It was "not something to be taken for granted," and "there must be proof to support an inference to that effect."[110] Specifically, the court stated that:

> We think it is plain that before a merger may be condemned merely because its effect may be to lessen *potential* competition it must be ascertained that the potential competition is a reality, that is to say, that there is a reasonable probability of such potential competition.[111]

The court refused "to speculate upon the basis of mere possibility,"[112] and concluded that the evidence failed to establish a reasonable probability that Crocker-Anglo would have entered Citizens' market but for the merger.[113]

In support of its decision on the application of the theory of potential competition, the court quoted from *Columbia Steel.* Although that case involved an alleged violation of sections 1 and 2 of the Sherman Act prior to the Celler-Kefauver amendment to section 7, it was believed to be "still good law as to the *quality of evidence* required to prove the probability of potential competition."[114] The Supreme Court there agreed that potential competition "may be

---

[108] 223 F. Supp. 849 (N.D. Cal. 1963).
[109] *Id.* at 855.
[110] *Ibid.*
[111] *Id.* at 855-56.
[112] *Id.* at 856.
[113] In addition to the section 7 question, the Government also argued that the effect of the merger was the same as if Crocker-Anglo and Citizens had entered into an agreement not to compete within the other's market, which would be a per se violation of the Sherman Act, and therefore the merger was likewise per se illegal. The court termed this "a complete *non sequitur*" and stated that it could just as well have been argued that if each had continued operating exclusively in its own territory the effect would likewise be the same as an agreement to divide the territory and therefore such *nonaction* would violate the Sherman Act. This was termed "a manifest absurdity." *Id.* at 860.
[114] *Id.* at 856 n.7.

taken into consideration in weighing the effect of any acquisition of assets on restraint of trade,"[115] but went on to say that,

> The government's argument, however, takes us into highly speculative situations.... Looking at the situation here presented, we are unwilling to hold that possibilities of interference with future competition are serious enough to justify us in declaring that this contract will bring about unlawful restraint.[116]

COMMENT.—Neither *Brown Shoe* nor *Philadelphia Nat'l Bank* involved the issue of potential competition, but their emphasis on testing the probable effect of a merger in the relevant market by looking first to actual foreclosure or increased market concentration would appear to argue against its application. This prognosis receives some support by *Brown Shoe's* footnote regarding the extent to which a market-extension merger is proscribed:

> To illustrate: If two retailers, one operating primarily in the eastern half of the Nation, and the other operating largely in the West, competed in but two mid-Western cities, the fact that the latter outlets represented but a small share of each company's business would not immunize the merger *in those markets in which competition might be adversely affected.* On the other hand, that fact would, of course, be properly considered in determining the equitable relief to be decreed.[117]

The implication of the Court's illustration is that where there is some market overlap, *i.e.,* horizontal effect, the merger may be proscribed and appropriate relief granted *as to those overlapping markets.* The negative implication is that where there is no market overlap, *i.e.,* merely "potential competition," the merger lacks the proscribed adverse competitive effects and no equitable relief is needed.

The question of potential competition is currently before the Supreme Court in the pending appeal in *United States v. El Paso Natural Gas Co.*[118] The district court dismissed the complaint charging that El Paso's acquisition of Pacific Northwest Pipeline Corporation violated section 7. Both companies were engaged in the pro-

---

[115] 334 U.S. at 528.

[116] *Id.* at 528-29.

[117] 370 U.S. at 337 n.65. (Emphasis added.) See generally Rogers and Litvack, *Brown Shoe: The Guidance of a Footnote,* 1963 WASH. U.L.Q. 192.

[118] TRADE REG. REP. (1962 Trade Cas.) ¶ 70,571 (D. Utah 1962) *appeal docketed,* 32 U.S.L. WEEK 3002 (U.S. March 19, 1963) (No. 944 1962-63 Term; renumbered No. 94, 1963-64 Term), *juris. noted,* 373 U.S. 930 (1963).

duction, purchase, transportation and sale of natural gas, and the Government contended that Pacific Northwest would have expanded into El Paso's market as a competitor if it had not been acquired. The lower court ruled that the acquired company was not in a position, financially, and lacked adequate gas reserves to compete effectively with El Paso. During the arguments before the Court on appeal, Justice Steward commented that the district court's opinion indicated that Pacific Northwest would not only not win the race but "wasn't even going to get on the track."[119] Justice Goldberg queried Government counsel whether he was not "arguing on the basis of conjecture as to what might have happened."[120] The decision may shed some light on the proper place of the theory of potential competition in section 7 cases.

C. Competitive Advantage

1. *The "Deep Pocket" or Economic Subsidization.*—As the name suggests, the "deep-pocket" or "economic-subsidization"theory is founded in the belief that a wealthy company is able to engage in price and non-price competition to a greater extent and for longer periods than its less affluent competitors, merely because of its "deep pocket." Where did the wealthy company get this "war chest?" What happens when the bottom of the "deep pocket" is reached as a result of competitive drain? The answer to these questions lies in the theoretical premise that a "big conglomerate," engaged in more than one geographical market or line of commerce, may "subsidize" its competitive efforts in one market or product by "monopoly profits" from another market or product.[121]

A recent application of the deep-pocket theory is found in *Reynolds Metals Co. v. FTC.*[122] In 1956, Reynolds, a fully integrated giant in the aluminum industry and the world's largest producer of aluminum foil, paid about five hundred thousand dollars for the assets of Arrow Brands, Inc., a converter of aluminum foil into a decorated foil product for the florist trade. The acquisition was

---

[119] BNA ANTITRUST & TRADE REG. REP. A-2 (March 3, 1964).

[120] *Ibid.*

[121] The subsidization theory that power in one market may be shifted to another was frequently asserted in vertical integration cases. See Bork, *Vertical Integration and the Sherman Act: The Legal History of an Economic Misconception,* 22 U. CHI. L. REV. 157 (1954). See also DIRLAM & KAHN, FAIR COMPETITION 147 (1954).

[122] 309 F.2d 223 (D.C. Cir. 1962).

therefore vertical—Arrow did not compete with Reynolds, but was a Reynolds customer for aluminum foil. However, the specialized florist foil converter industry accounted for an insubstantial share of domestic converted aluminum foil shipped in 1956, and neither the Commission nor the court rested its finding of a section 7 violation on the "minor anticompetitive effect" of foreclosing Reynolds' competitors from selling aluminum foil to Arrow.[123] Instead, the proscribed effect was found in the resulting shift of economic power to Arrow vis-à-vis its smaller florist foil competitors. Prior to the acquisition, the florist foil industry was structurally symmetrical, consisting of eight or ten small firms of roughly equivalent size, with intense competition. According to the Commission and the court, this competitive picture was materially altered when Reynolds purchased Arrow's assets.

The hearing examiner had noted that, following the acquisition, Reynolds built a new plant for Arrow and substantially increased its advertising. Commenting on this, he stated:

> One of this group of small businesses now has behind it over 600 million in resources, with nearly 40 million set aside for general expansion, with a $500,000 new plant having production facilities beyond those of any other, built with funds supplied by respondent. The financial statements of Arrow Brands, Inc., at the time of acquisition negate any possibility of such an undertaking. In addition, respondent has materially increased Arrow Brands, Inc.'s advertising budget providing at least two spot commercials on its nation-wide television programs. From their financial statements in the record, none of Arrow's competitors can afford any such promotional efforts.[124]

Interestingly, although the D. C. Circuit also applied the deep-pocket theory to nullify the merger, it did not mention either the subsidization of Arrow's advertising or new plant, but relied on the third leg of the Commission's finding—the resulting ability of Arrow to cut prices:

> Arrow's assimilation into Reynolds' enormous capital structure and resources gave Arrow an immediate advantage over its competitors who were contending for a share of the market for florist foil. The power of the "deep pocket" or "rich parent" for one of the florist foil suppliers in a competitive group where previ-

[123] *Id.* at 229.

[124] Reynolds Metals Co., No. 7009, FTC, March 2, 1959, at 21, *adopted, as modified,* Reynolds Metal Co., No. 7009, FTC, Jan. 21, 1960.

> ously no company was very large and all were relatively small opened the possibility and power to sell at prices approximating cost or below and thus to undercut and ravage the less affluent competition.[125]

This statement of the deep-pocket theory, coupled with the court's insistence that the Commission need go no further than to show such "capacity or potentiality" of the acquisition to lessen competition,[126] comes very close to stating a per se illegal rule for any acquisition by a "big" company of a "small" company in an industry which is symmetrically composed of "small" competitors. However, mindful of the Supreme Court's rejection of a per se test for vertical mergers in *Brown Shoe,* the court carefully disclaimed any intimation "that the mere intrusion of 'bigness' into a competitive economic community otherwise populated by commercial 'pygmies' will *per se* invoke the Clayton Act."[127] Specifically, the court picks up some rather puzzling language from *Brown Shoe* in theorizing that there may be such a merger which would be upheld because it produced "countervailing competitive, economic or social advantages."[128] Just what such "countervailing advantages" might be, and how they could absolve an otherwise illegal merger, was not explained by the Supreme Court, and, needless to say, the court of appeals made no attempt to give a concrete illustration, stating only that, "no comment on these possibilities is required here."[129]

The statement of the deep-pocket theory in *Reynolds* left open the question of what effect might result from the acquisition of a dominant company in an asymmetrical industry. This situation was presented in *Union Carbide,* which involved the 1956 acquisition by Union Carbide, the nation's second largest chemical company and largest producer of polyethylene resins used in making polyethylene film, of Visking Corporation, the nation's largest producer of poly-

---

[125] 309 F.2d at 229-30.

[126] *Id.* at 230. This dictum by the court is somewhat attenuated by the fact that there was evidence of what the court termed "predatory" price cuts by Arrow following the merger which had reduced the sales of five of its seven competitors by 14 to 47%, while Arrow's sales had increased 18.9%. Thus, the court's per se language must be read in the light of this post-acquisition evidence. See also note 181 *infra.*

[127] *Ibid.*

[128] *Ibid.*

[129] *Ibid.*

ethylene film and a major polyethylene resin customer of Union Carbide.

In addition to the vertical acquisition of Visking as a customer of its polyethylene resins, which the Commission held violated section 7, Union Carbide also acquired Visking's business of manufacturing synthetic sausage casings. As to this business, Visking was neither a competitor nor a customer or supplier of Union Carbide. In 1956, Visking accounted for approximately sixty per cent of the total sales of this product, with only two competitors, each of which had been a licensee under Visking's patents. While the expiration of the Visking patents in 1953 had opened the field to new entrants, the record contained no evidence regarding the economic and technological requirements for entry. The Commission affirmed the hearing examiner's dismissal of the complaint's section 7 challenge to this aspect of the merger, rejecting the application of the deep-pocket theory:

> This aspect of the acquisition is purely conglomerate and the worst thing that can be said of it is that the Visking Cellulose sausage casings now have the backing of Union Carbide's one and one-half billion dollars instead of Visking's thirty-eight million. This showing alone will not support a finding that a lessening of competition is the probable result of Union Carbide's emergence as a sausage casing seller. Such an unfavorable prognosis must be based upon more solid ground.[130]

The recent *Clorox* opinion, following appeal from the hearing examiner's second initial decision, is the most exhaustive (seventy-plus pages) treatment of the "conglomerate merger problem."[131] Commissioner Elman condemned Procter's 1957 acquisition of

---

[130] No. 6826, FTC, Sept. 25, 1961, at 10.

[131] See No. 6901, FTC, Nov. 26, 1963, at 18. The Commission's opinion seemed less concerned with the particular facts of the merger than with an extensive presentation of its broad economic views, drawn from selective writings which it deemed to be "generally accepted as authoritative in the field." *Id.* at 23 n.19. Included in the Commission's bibliography were: BAIN, BARRIERS TO NEW COMPETITION (1956); BAIN, INDUSTRIAL ORGANIZATION (1959); CHAMBERLIN, THE THEORY OF MONOPOLISTIC COMPETITION (7th ed. 1956); FELLNER, COMPETITION AMONG THE FEW (1949); KAYSEN & TURNER, ANTITRUST POLICY (1959); MACHLUP, THE ECONOMICS OF SELLERS' COMPETITION (1952); NAT'L BUREAU OF ECON. RESEARCH, BUSINESS CONCENTRATION AND PRICE POLICY (1955). Reliance on such secondary sources was felt to be justified by the Supreme Court's repeated citation of economic analyses in *Philadelphia Nat'l Bank*. *Id.* at 23-24.

Clorox Chemical Co. with a broadside attack which drew on every theory of illegality in the Commission's arsenal.

Procter, the nation's leading producer of soap and detergent products, acquired Clorox, manufacturer of the leading brand of household liquid bleach, through an exchange of stock valued at approximately thirty million dollars. As in *Union Carbide,* this was an acquisition of a wealthy, dominant company in an asymmetrical industry.

The primary basis for the examiner's ruling was the alleged competitive advantage accruing to Clorox as a result of the merger, including repeated references to size and financial strength. He emphasized that it was not necessary that the conglomerate occupy a dominant position in any industry, but that: "[T]he test of conglomerate power is whether a corporation is able to concentrate its competitive efforts at one point by shifting its financial resources and competitive strength from one industry or market to another."[132] He concluded that Procter possessed this "power and ability" to engage in such selective subsidization.

Referring to the hearing examiner's description of the merger as "conglomerate," Commissioner Elman recognized that traditionally this meant only that it was neither "conventionally" horizontal nor vertical. Looking more closely, he determined that the Clorox acquisition most appropriately fell into the "product-extension" category, because Clorox bleach is used complementarily with Procter & Gamble's most important line of commerce—packaged detergents—and are marketed through the same channels, using the same merchandising and distribution methods. This functional relationship was said to extend also to the other products manufactured by Procter—food, paper and toilet products—inasmuch as these are also "low-cost, high-turnover household consumer goods which are sold largely, although not entirely, through grocery stores and are heavily advertised and promoted."[133]

Clorox is sold on a broad national scale, as opposed to the regional efforts of its competitors, and Procter has a widely diversified product line. It was argued that Procter's accumulated "surplus" and "monopoly profits" from one or more of the other lines might sub-

---

[132] No. 6901, FTC, Initial Decision, Feb. 28, 1962, at 62.
[133] No. 6901, FTC, Nov. 26, 1963, at 17.

sidize advertising and promotional expenses for Clorox, and, concomitantly, Clorox's "monopoly profits" in one geographical market might subsidize the promotion of Clorox in another market where it is faced with competition.[134] Such subsidization, according to the Commission, may be undertaken quite unconsciously, and without predatory intent, because of the greater pricing "flexibility" possessed by the diversified-product firm. This "possibility" was explained in a quote from Edwards:

> A concern that produces many products and operates across many markets need not regard a particular market as a separate unit for determining business policy and need not attempt to maximize its profits in the sale of each of its products, as has been presupposed in our traditional scheme. It may classify its products into such categories as money-making items, convenience goods, and loss leaders, and may follow different policies in selling the different classes.[135]

Even assuming that this "power" to subsidize Clorox sales promotion is never invoked, consciously or unconsciously, the Commission held that its mere existence was enough to inhibit competition or entry of potential competitors,[136] because "market behavior is determined by the state of mind of the firms in the market."[137] Carrying this line of reasoning to its ultimate, the Commission stated that:

> Even if such strength has not been proved to reach the level at which monopoly profits or other fruits of great market power are forthcoming, it is relevant to the psychological response of the members of the liquid bleach industry to [*sic*] Procter as a competitor. To the extent that Procter is thought by them to be not only a large and affluent firm, but also a powerful firm, in terms of market power enjoyed in related markets and possibly transferable into the bleach market, its prowess as a competitor gains an added and even sinister dimension in the eyes of its liquid

[134] *Id.* at 42-43, 47-48, 62-63. It should be noted that the Commission's definition of "monopoly profits" is something less than those obtained through monopoly, and includes "profits attributable to market power short of outright monopoly. . . ." *Id.* at 62.

[135] *Id.* at 48-49, quoting Edwards, *Conglomerate Bigness as a Source of Power,* in BUSINESS CONCENTRATION AND PRICE POLICY 331-32 (1955).

[136] *Id.* at 49-51, 63. See also BAIN, BARRIERS TO NEW COMPETITION 166, 201-02 (1956). Compare Kessler & Stern, *Competition, Contract, and Vertical Integration,* 69 YALE L.J. 1, 19 n.75 (1959).

[137] No. 6901, FTC, Nov. 26, 1963, at 49.

bleach rivals—a factor of considerable importance to the impact of the merger on competition in the bleach industry.[138]

The Commission rejected the argument that the merger would not alter the competitive picture inasmuch as the liquid bleach market was already dominated by Clorox prior to the merger, stating that: "The short of it is that a conglomerate merger involving firms which have dominant power in their respective markets tends to reinforce and augment such power."[139] Indeed, respondent's argument boomeranged in that the acquisition of Clorox was said to enable Procter to subsidize the promotion and sale of its other lines of commerce, thereby adversely affecting competition in the lines of both the acquired and the acquiring companies.[140]

2. *Efficiencies of Conglomerate-Bigness.*—As already noted, economic efficiencies may result from more closely approaching a theoretical optimum size and shape of operation. Past merger decisions have held that where the proscribed competitive effects are established, it is no *defense* to assert the benefits derived from efficiencies made possible by the merger.[141] However, the Commission's *Clorox* decision is the first promulgation of this factor as a *basis* for outlawing a conglomerate merger.

Procter sought, and obtained, marketing efficiencies in its acquisition of Clorox. According to the Commission, household liquid bleaches are chemically identical, are low priced, have a high rate of turnover, and are sold mainly to housewives through grocery stores. Successful marketing depends upon the manufacturer's ability to "pre-sell" his product "by means of attractive packaging, a low price, advertising and sales promotion efforts, or otherwise."[142] The successful marketing of Procter's other lines—soaps, detergents,

[138] *Id.* at 63.
[139] *Ibid.*
[140] *Id.* at 59-60, 63.
[141] For example, in United States v. Bethlehem Steel Corp., 168 F. Supp. 576 (S.D.N.Y. 1958), after finding the horizontal merger of the second and sixth largest steel corporations would violate section 7, the court rejected the "benefits" defense, concluding: "If the merger offends the statute in any relevant market then good motives and even demonstrable benefits are irrelevant and afford no defense." *Id.* at 617. See also Crown Zellerbach Corp. v. FTC, 296 F.2d 800, 825 (9th Cir. 1961), *cert. denied,* 370 U.S. 937 (1962).
[142] No. 6901, FTC, Nov. 26, 1963, at 8. See also *id.* at 17.

cleansers, and food, paper and toilet products—likewise apparently depend upon pre-selling through advertising and sales promotion.

Procter is one of the nation's leading advertisers. In 1957, with total domestic sales of approximately nine hundred million dollars, it was the largest advertiser—spending over eighty million dollars in advertising, principally on television—and spent an additional forty-seven million dollars for domestic sales promotions. By combining the same amount of money Clorox spent on television prior to the merger with Procter's normal rate of television advertising, Clorox would qualify for a reduced quantity-discount rate which would permit it to receive at least one-third more network television advertising. Additional flexibility and economies resulted from the fact that Procter could engage in joint advertising and sales promotions of its diversified product lines distributed on a national scale. Procter also added the advantage of its broad experience and techniques in sales promotion and advertising to the marketing of Clorox. These advantages resulting from marketing efficiencies were said to inhibit competition and raise a barrier to the entry of potential competitors.[143]

The Commission also pointed out that Procter had its own direct-sales force for its other products and, although it had not yet utilized this method of distribution in selling Clorox, it was felt that if it ever did, "distinct promotional advantages would probably result."[144] These advantages presumably would result from more aggressive "pushing" of Clorox, viz., in the constant competitive struggle for shelf space and product display. The use of direct distribution was said to be "a device that may be fully efficient only for a multi-product firm."[145]

So far, with the exception of *Ingersoll-Rand*,[146] the courts have not

[143] On the question of freedom of entry, see BAIN, BARRIERS TO NEW COMPETITION (1956); BOCK, MERGERS AND MARKETS, AN ECONOMIC ANALYSIS OF CASE LAW 63-64 (1960); EDWARDS, MAINTAINING COMPETITION 186-88 (1949); KESSLER & STERN, *supra* note 136.

[144] No. 6901, FTC, Nov. 26, 1963, at 46.

[145] *Id.* at 47.

[146] "From a preliminary view, it would seem clear that the economies of scale (volume purchasing and volume production) which may be effected by Ingersoll-Rand after the proposed acquisition potentially could place the remaining sellers of continuous miners, face coal mining machinery and equipment and underground coal mining machinery and equipment at a distinct competitive disadvantage. The continued existence of these smaller

adopted the competitive-advantage theory as a *basis* of illegality. In the *Rome Cable* case, *United States v. Aluminum Co. of America*,[147] the trial court held that Alcoa's 1959 acquisition of Rome Cable Corporation, primarily a producer of copper wire and cable, did not violate section 7. The Government's civil suit sought divestiture and an injunction against further acquisitions, claiming the proscribed competitive effect principally in wire and cable products.

In its consideration of the competitive effect of the acquisition, the court conceded the obvious fact that Alcoa is "large in size, both physically and financially," with "varied and extensive" activities,[148] but cautioned:

> Care however must be taken not to exaggerate its influence because of its size alone, especially in the absence of evidence of the abuse of the power which goes with size.... The mere intrusion of "bigness" into a competitive market will not in itself violate the statute.[149]

The court found that Alcoa acquired Rome in "an effort to overcome a market disadvantage rather than to obtain a captive market for its product or to eliminate a competitor."[150] Alcoa's aluminum market share and its return on invested capital had steadily declined; it needed to diversify; it lacked the "know-how" which Rome possessed to manufacture certain complicated types of insulated wire and cable; the time and expense necessary to acquire such competence internally was prohibitive; and competition between Rome and Alcoa was limited to four wire and cable products which Rome produced in insignificant amount.[151]

The court conceded that an integrated company *may* enjoy advantages over non-integrated competitors, but pointed out that such advantages do not *necessarily* inure to the benefit of the relevant

---

companies, some only a fraction of the size of Ingersoll-Rand, could be seriously threatened unless they too can achieve the economies of large scale operation. In order to achieve these operating economies, these smaller companies may also be forced to merge among themselves as a defensive measure, thus further increasing the degree of economic concentration in an already highly concentrated industry." 218 F. Supp. at 554.

[147] 214 F. Supp. 501 (N.D.N.Y. 1963), *appeal docketed*, 32 U.S.L. WEEK 3004 (U.S. June 11, 1963) (No. 1176, 1962-63 Term; renumbered No. 204, 1963-64 Term), *juris. noted*, 375 U.S. 808 (1963).

[148] *Id.* at 515.

[149] *Ibid.*

[150] *Id.* at 512.

[151] *Ibid.*

line of commerce: "The financial outlay required, the obtaining and holding of the required skills, the constant research and experimentation, which are required of the seller of intermediate products, are burdens which the fabricator avoids but the integrated producer must carry."[152] Furthermore, it was pointed out that: "The arraying of the integrated companies on one side and the non-integrated companies on the other overlooks entirely the active and vigorous competition among the integrated companies."[153] Viewing the conglomerate nature of the acquisition by an aluminum company of "an essentially copper manufacturing company,"[154] the court concluded:

> Such an acquisition implies advantages to the acquiring company. Such advantages are not to be condemned unless they portend or approach monopoly proportions. It is the loss to competition rather than the advantage gained that invokes the statute here. Alcoa gained an increase in its scientific knowledge and ability in insulating techniques and a diversification of its line of salable products. This would seem to be a legitimate end in the face of its declining market.[155]

In *Continental Can*, the court rejected the Government's arguments as to how the merger "might" adversely affect competition. Regarding the competitive advantage theory—advanced by the Government as sufficient by itself to support a finding of illegality—the court stated:

> The Government views with alarm every advantage which Continental or Hazel-Atlas might gain as a result of the merger and sees in each the spectre of anti-competitive effects. But the mere fact that the competitive position of acquiring or acquired companies may be improved by a merger does not establish that the merger is harmful or has any of the proscribed anti-competitive effects.
>
> The test is not whether, as a result of a merger, either the acquired or acquiring company obtains advantages which help it to compete more effectively. Obviously were this so, any merger permitted under the Act could have no sound business justification. The object of the Clayton Act is not to discourage businesses from taking steps to compete more effectively but to keep competition vigorous and effective. Opportunities to offer improved products, to make cost reductions or to give better service to

[152] *Id.* at 517.
[153] *Ibid.*
[154] *Id.* at 519.
[155] *Ibid.*

> customers are not in themselves indications of anti-competitive effects. These are all legitimate business objectives. "It may well be that by effecting a better arrangement for a more profitable undertaking ... competition would be stimulated rather than lessened."[156]

Emphasizing the necessity of showing anticompetitive effects from the merger, rather than merely that there were resultant competitive advantages accruing to one or both of the merging companies, the court concluded that no such showing was made.

In another merger decision during the past year, *United States v. FMC Corp.*,[157] a district court quoted with approval the language in *Continental Can* rejecting per se illegal application of the competitive-advantage theory.[158] The court denied the Government's motion for a preliminary order enjoining the acquisition of operational assets of American Viscose Corporation (Avisco), the nation's leading producer of continuous filament rayon yarn and viscose rayon staple and second-largest producer of acetate rayon, by FMC, a widely diversified industrial company, ranked tenth largest chemical company in the country and also manufacturing and selling machinery and defense equipment. The court termed the proceeding "novel," as the first attempt by the Government to secure an interlocutory injunction in a conglomerate acquisition,[159] and an attack on "bigness" per se.[160] According to the court, the purpose of the acquisition was to permit Avisco to dispose of assets diminishing in value, owing to a loss of ground to newer manufactured fibers, with the effect of merely substituting one company for another as a competitor in that industry.[161]

COMMENT.—The full impact of the competitive-advantage theory

[156] 217 F. Supp. at 785-86. (Footnotes omitted.)

[157] 218 F. Supp. 817 (N.D. Cal. 1963), *appeal dismissed*, 321 F.2d 534 (9th Cir. 1963), *application for interlocutory injunction denied by Mr. Justice Goldberg in chambers*, 84 Sup. Ct. 4 (1963).

[158] *Id.* at 822.

[159] *Id.* at 818.

[160] *Id.* at 821.

[161] The court also rejected the Government's contention that the acquisition would substantially lessen competition in the sale of carbon bisulfide and caustic soda, which are manufactured by FMC and used in the manufacture of rayon and cellophane by Avisco. FMC's sale of these two products to Avisco were termed "essentially incidental and de minimis in relation to the entire transaction," and the acquisition was classified as "conglomerate." *Id.* at 822.

is yet to be felt, but its emerging importance is evidenced by the Commission's most recent conglomerate-merger complaint[162] against the acquisition of the S.O.S. Company, the dominant producer of household steel wool, by General Foods Corporation, one of the nation's largest manufacturers of packaged grocery products. The complaint reads almost like an abstract of the subsequently issued *Clorox* decision, charging, *inter alia,* that

> "S.O.S." household steel wool now has the backing of respondent's substantial financial resources, economic power, and demonstrated merchandising expertise and ability to advertise, promote and sell high volume, rapid turnover packaged grocery products. Said acquisition has upset and realigned adversely, and threatens to upset and realign further, the competitive structure of the household steel wool industry.[163]

The indiscriminate application of the competitive-advantage theory could spell an end to conglomerate mergers involving a substantial company, whatever their social benefits or effect on competition may be. The idea that a wealthy parent may use its "deep pocket" and "monopoly profits" from one line or market to subsidize competition in another is neither new nor unique.[164] Monopoly power of the type which would provide a "war chest" may violate the Sherman Act: Its mere existence may support a charge of "monopolization" and its use in an attempt to subsidize competition in selected markets may be an illegal "attempt to monopolize" under sec-

[162] General Foods Corp., No. 8600, FTC, Sept. 30, 1963.

[163] *Id.* at 5. By way of contrast, a hearing examiner dismissed the Commission's complaint in Grand Union Co., No. 8458, FTC, Oct. 4, 1963, just four days after the issuance of the complaint in *General Foods.* He did not, however, have the benefit of the Commission's subsequently issued *Clorox* decision. In upholding Grand Union's 1958 "market-extension" acquisitions of two grocery chains, the examiner emphasized the admonition of *Brown Shoe* that section 7 is concerned "with the protection of *competition,* not *competitors.*" *Id.* at 41. In answer to the contention that respondents "gained advantages through a wider use of trading stamps, advertising and the procuring of good locations for their stores," he quoted extensively from *Continental Can* and concluded that there was more competition in the relevant markets at the time of his decision than there was prior to the challenged acquisitions. *Id.* at 42-43. The competitive-advantage theory is not new to section 7 complaints. One economist found that 56 of the 76 merger complaints issued under section 7 by November 1960 contained allegations that the mergers would result in a competitive advantage to the merging firm. Adelman, *The Antimerger Act, 1950-60,* 51 AM. ECON. REV. 236, 238 (1961).

[164] See, *e.g.,* United States v. Swift & Co., 286 U.S. 106, 116 (1932).

tion 2.[165] Geographical price discrimination may also violate the Robinson-Patman Act.[166] Where subsidization was effectuated as a result of a merger, the incipiency test of section 7 would take one step back from requiring a showing of actual competitive effect and require only "reasonable probability" of competitive injury. This, however, is a far cry from a geometrical progression of assumptions which would condemn a merger *ab initio* solely on the basis of conglomerate-bigness. Such an application of the subsidization theory suffers from the same pyramiding of assumptions as the conglomerate-leverage theory, discussed above, each of which are likewise subject to disproof: (1) That "monopoly profits" may be derived from one line of commerce or market; (2) That these profits may be used as a "war chest" to subsidize competition in another line of commerce or market; resulting in (3) The probability of the proscribed anticompetitive effect.[167]

The theory that the efficiencies of conglomerate-bigness result in anticompetitive advantages comes even closer to a candid adoption of a small-business "protectionist" philosophy. Simply put, this theory would condemn a conglomerate merger because it results in efficiencies of scale, despite the avowed object of competition to promote just such efficiencies. Certainly, under the traditional antitrust policy of promoting competition, the courts in *Rome Cable, Continental Can* and *FMC* were correct in holding that such advantages may result in more effective competition and "are not to be condemned unless they portend or approach monopoly proportions."[168] Neither *Brown Shoe* nor *Philadelphia Nat'l Bank* contains anything that would support a per se application of the competitive-advantage

[165] 26 Stat. 209 (1890), as amended, 15 U.S.C. § 2 (1958). See generally ATT'Y GEN. NAT'L COMM. ANTITRUST REP. 43-60 (1955); NEALE, THE ANTITRUST LAWS OF THE UNITED STATES OF AMERICA 95-159 (1960).

[166] 49 Stat. 1526 (1936), 15 U.S.C. § 13(a) (1958) (providing the basis for civil injunctive and treble damage action); 49 Stat. 1528 (1936), 15 U.S.C. § 13a (1958) (providing criminal sanctions). See generally ROWE, PRICE DISCRIMINATION UNDER THE ROBINSON-PATMAN ACT (1962).

[167] The element of causation may be crucial. See, *e.g.*, Shore Gas & Oil Co. v. Humble Oil & Ref. Co., 224 F. Supp. 922, 925-26 (D.N.J. 1963). *Cf.* New Grant-Patten Milk Co. v. Happy Valley Farms, Inc., 222 F. Supp. 319 (E.D. Tenn. 1963). See also Bork, *supra* note 121, at 183-84; Bork & Bowman, *The Crisis in Antitrust*, Fortune, Dec. 1963, pp. 138, 197.

[168] United States v. Aluminum Co. of America, 214 F. Supp. 501, 519 (N.D.N.Y. 1963).

theory. In *Brown Shoe,* the Court did consider the horizontal effect of supposed competitive advantages which the entry of a large, integrated, national chain may have in the fragmented, shoe-retailing industry.[169] However, this was merely one consideration in predicting the merger's probable effect, which was thrown onto the scale, *inter alia,* with evidence of actual concentration increases in the relevant submarkets and a "history of tendency toward concentration in the industry."[170] Although the Court expressed a desire to preserve "fragmented industries and markets," and concomitantly, "viable, small, locally owned businesses," it emphasized that: "It is competition, not competitors, which the Act protects."[171] Specifically, the Court recognized that such efficiencies may benefit consumers and the entry of more efficient competitors does not render the merger "unlawful by the mere fact that small independent stores may be adversely affected."[172]

D. Rule of Reason v. Per Se Illegality

In spearheading the attack on conglomerate mergers, the Federal Trade Commission has departed by one hundred eighty degrees from its initial view that the legality of mergers depends upon an extensive economic analysis of their probable competitive effect. While it denies any attempt to invoke any general per se application of section 7, each of the theories discussed above would infer the proscribed competitive effect from absolute size and degree of diversification, without regard to any change in the number of competitors or their respective market shares—the traditional tests of market power and market concentration. Simply put, the new departure equates conglomerate-bigness, or a trend to conglomerate-bigness, with probable injury to competition, or trend to monopoly.

Emphasizing the "preventive philosophy" of section 7, the Commission's current reasoning is based on the premise that section 7 is meant to "arrest the anti-competitive effects of market power in their incipiency."[173] According to the Commission, two corollaries of this premise are: (1) The burden of proof is less strict than under the Sherman Act; and (2) "[E]vidence of market behavior, as

[169] 370 U.S. at 344.
[170] *Id.* at 345.
[171] *Id.* at 344.
[172] *Ibid.*
[173] Procter & Gamble Co., No. 6901, FTC, Nov. 26, 1963, at 34.

opposed to evidence of market structure, is not a necessary ingredient of the prima facie case."[174] The most obvious effect of the new effort to achieve "clear and relatively simple rules" and to narrow the "scope of permissible legal inquiry"[174a] is in the treatment of post-merger evidence.

In the past, post-merger evidence has been considered key evidence in predicting probable competitive effects in conglomerate mergers. This was the approach the Commission took in *Union Carbide,* its first conglomerate merger determination. In adopting a wait-and-see attitude, it noted that: "If this competitive picture should at any time in the future alter in a manner which would indicate that our decision here is in error, a new complaint based upon the new facts inherent in the changed situation can be speedily issued."[175]

The importance of post-acquisition evidence in determining the probable effect of a conglomerate merger was also emphasized in the Commission's first *Clorox* decision, which remanded the case to the hearing examiner for further post-acquisition evidence on the ground that the record evidence was insufficient to support the section 7 violation.[176]

In its second *Clorox* decision, the Commission reversed its previous reliance on post-acquisition evidence, ruling that the admission of post-acquisition evidence is proper only in the unusual case where it would show that "the structure of the market has changed radically since the merger," such as where the market share of the merged firm has diminished to "insignificance," or the adverse effects of the merger have already become apparent.[177] The Commission

[174] *Ibid.*

[174a] *Id.* at 38. According to Commissioner Elman, "Not surprisingly, the less sophisticated in economic matters a lawyer is, the more 'thorough' a job of economic inquiry he is likely to believe necessary." *Id.* at 36. Presumably, the ultimate in this new sophistication would call for an across-the-board application of a per se rule of illegality, which even the Commission has thus far rejected.

[175] No. 6826, FTC, Sept. 25, 1961, at 16.

[176] Procter & Gamble Co., No. 6901, FTC, June 15, 1961.

[177] Procter & Gamble Co., No. 6901, FTC, Nov. 26, 1963, at 38. A table in the second initial decision by the examiner showed that Clorox's market share of household liquid bleach had increased from 48.8% during the two months prior to the merger in 1957, to 51.5% for the same two month period in 1961. During the same periods, Clorox's major competitor's (Purex) share decreased from 14.7% to 14.2%. Furthermore, the examiner stressed that Clorox's dominant position had been even more substantially enhanced in at

expressed the fear that, to hold otherwise, the merging companies "may deliberately refrain from anti-competitive conduct—may sheathe, as it were, the market power conferred by the merger—and build, instead, a record of good behavior to be used in rebuttal in the proceeding."[178] Thus, unless the merger proves to be a spectacular failure, post-acquisition evidence can only be considered where it operates against the legality of the merger. This "heads-I-win-tails-you-lose" approach is based on the theory that post-acquisition evidence is immaterial where the merger results in or "aggravates" a "market structure conducive to non-competitive practices or adverse competitive effects . . . ."[179]

A similar disdain for post-acquisition evidence was evident in the *Consolidated Foods* decision, where the Commission stated that the fact that no competitor had been driven from the field or hampered in its sales was not controlling, because the "probable effect" of the merger was the discouragement of new competition by creating for Gentry, the acquired company, a protected market which others could not penetrate even with a better price, quality or service, whether or not Gentry expanded its market share.[180]

The Third Circuit in *Ingersoll-Rand*, was the first court to dis-

least four of the nine sections of the country included in the table. For example, Clorox's market share in the New England region had increased from 56% to 67.5% during the four years following the acquisition. No. 6901, FTC, Feb. 28, 1962, Table I, at 19.

[178] No. 6901, FTC, Nov. 26, 1963, at 38.

[179] *Id.* at 39. Furthermore, the Commission felt that a wait-and-see policy would prevent effective relief, because "an order divesting corporate assets that were acquired a long time before the issuance of the order rarely advances the policies of Section 7." *Id.* at 39. While the Commission may issue a complaint on the basis of post-acquisition evidence, it has refused to reopen proceedings merely on the allegation that post-acquisition evidence justified alteration of its order against a merger. Reynolds Metals Co., 56 F.T.C. 1680 (1960).

[180] No. 7000, FTC, Nov. 15, 1962, at 19. For this reason, the Commission rejected Consolidated's argument that the post-merger decline in Gentry's share of the garlic market proved the ineffectiveness of reciprocity. According to the Commission, it was not apparent that its share would not have fallen still farther had it not been for the influence of reciprocal buying. Furthermore, in a footnote, the Commission rejected the contention that any business gained as a result of reciprocity was offset by business lost as a result of competitors of Consolidated not wishing to patronize one of its divisions. According to the Commission, this merely indicated "that the merger has lent additional rigidity to the market by establishing a class of customers immune to Gentry's sales efforts," thereby further restraining the "free play of competitive forces." *Id.* at 20 n.11.

count the importance of post-acquisition evidence as an aid in predicting the probable competitive effect of a merger. This circuit may have more to say on the subject in its second review of *Scott Paper Co. v. FTC*,[181] a merger case remanded to obtain more post-acquisition data on market shares. The Commission had originally made a market survey to determine market shares for the years 1950 and 1955. Although the survey showed that Scott's share had increased substantially during that period, the Third Circuit accepted Scott's argument that the survey was deficient because it did not show when the market share increase was achieved, nor that the increase was due to the challenged acquisitions. The Commission was therefore ordered to include market share data for the intervening years 1951 through 1954.

On remand, the Commission was unable to come up with evidence that Scott's market shares increased significantly in the year following its first use of the new productive capacity obtained by the acquisitions, but took the position that this should not be controlling under its newly adopted position that post-acquisition evidence is not only unessential, but "rarely . . . of much probative value."[182] The Commission concluded that, although Scott's relatively stable post-acquisition market position was consistent with an inference that the merger did not enhance its market power, it was "equally consistent" with an inference that the merger enabled it to *maintain* its relatively high market shares.[183]

COMMENT.—As already noted, the Supreme Court has stated

[181] 301 F.2d 579 (3d Cir. 1962). Although dicta in *Reynolds* imply that post-acquisition evidence is not necessary under the deep-pocket theory, there was post-acquisition evidence there that Arrow had engaged in "predatory" price cutting following its acquisition by Reynolds, with a resultant injury to competition. See note 126 *supra*. The views expressed in *Ingersoll-Rand* must also be read in light of the fact that the decision involved horizontal and vertical aspects in addition to the conglomerate merger question.

[182] Scott Paper Co. v. FTC, TRADE REG. REP. (1964 Trade Cas.) ¶ 16,706, at 21,637 n.16 (Dec. 26, 1963). "It is now clear, as it may not have been when this proceeding was commenced, that evidence of post acquisition anti-competitive effects is not essential to a finding of a Section 7 violation. If an acquisition increases market power in the degree forbidden by the section, it is unlawful whether or not the anti-competitive effects of the increase are immediately apparent in changed market shares; and this principle holds true whether the challenged acquisition be classified as 'horizontal,' 'vertical,' 'conglomerate,' or other, since the legal test of Section 7 is identical for all corporate acquisitions." *Id.* at 21,637.

[183] *Ibid.*

that, "statistics reflecting the shares of the market controlled by the industry leaders and the parties to the merger are... the primary index of market power...."[184] But the Court was careful to point out that Congress did not provide any "quantitative substantiality" test by which such market shares would apply automatically to determine the legality of all mergers.[185] Between the extremes of market foreclosure approaching "monopoly proportions"[186] and "foreclosure of a *de minimis* share of the market,"[187] the percentage share of the market foreclosed in a vertical merger "cannot itself be decisive."[188] Under such circumstances, "only a further examination of the particular market—its structure, history and probable future—can provide the appropriate setting for judging the probable anticompetitive effect of the merger."[189] Similarly, the combined market shares in a horizontal merger "provide a graphic picture of the immediate impact of... [the] merger, and, as such, also provide a meaningful base upon which to build conclusions of the probable future effects of the merger."[190] Here also, "such a prediction is sound only if it is based upon a firm understanding of the structure of the relevant market...."[191]

While the Court rejected any per se, or quantitative substantiality, test for judging mergers, it recognized the problems inherent in a "too-broad economic investigation."[192] For this reason the Court concluded that "in any case in which it is possible, without doing violence to the congressional objective embodied in Section 7, to simplify the test of illegality, the courts ought to do so in the interest of sound and practical judicial administration."[193] Therefore, in "certain cases" the Court felt that it could dispense "with elaborate proof of market structure, market behavior, or probable anticompetitive effects":[194]

---

[184] Brown Shoe Co. v. United States, 370 U.S. 294, 322 n.38 (1962); see Bodner, *Vertical Mergers Under Section 7,* 22 A.B.A. ANTITRUST SECTION 106, 116 (1963).
[185] *Id.* at 321.
[186] *Id.* at 328.
[187] *Id.* at 329.
[188] *Ibid.*
[189] *Id.* at 322 n.38.
[190] *Id.* at 343 n.70.
[191] United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 362 (1963).
[192] *Ibid.*
[193] *Ibid.*
[194] *Id.* at 363.

> Specifically, we think that a merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market, is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects.[195]

Apparently, the Commission took this as a carte blanche to judge conglomerate mergers purely on the basis of industry structure, without benefit of any "immediate impact" of increased market concentration or foreclosure to use as a "meaningful base upon which to build conclusions of the probable future effects of the merger."[196] Furthermore, it would ignore post-acquisition evidence as "not necessary" or "rarely . . . of much probative value."[197] Thus, by some kind of inverse logic, the Commission would test a conglomerate merger solely in light of industry structure data (in the conglomerate-bigness sense), ignoring market concentration or foreclosure percentages, in lieu of the Court's sometime reliance on the latter to the exclusion of the former. In launching its attack on conglomerate mergers without the aid of the "meaningful base" of market concentration or foreclosure percentages, it necessarily relied instead on the pyramid of incipiencies, assumptions, and inferences contained in the various theories of conglomerate leverage, potential competition, and competitive advantage. As noted in the discussions of each of these theories, whether the proscribed anticompetitive effect may result from a conglomerate merger is highly conjectural. Under such circumstances it may be conceded that post-acquisition evidence may not have probative value—but for a different reason than that advanced by the Commission: Any increase in market shares by the merging companies may be attributable to circumstances other than the merger. The presumption should be in favor of legality, rather than illegality, and conglomerate mergers should be upheld absent some "meaningful base" in post-acquisition market changes resulting from the merger, sufficiently substantial to make the proscribed anticompetitive effects reasonably probable.

Assuming that post-acquisition evidence does demonstrate an

---

[195] *Ibid.*

[196] Brown Shoe Co. v. United States, 370 U.S. 294, 343 n.70 (1962).

[197] Scott Paper Co. v. FTC, TRADE REG. REP. (1964 Trade Cas.) ¶ 16,706, at 21,637 n.16 (Dec. 26, 1963).

increase in market shares or concentration as a direct result of a conglomerate merger, the question remains open regarding the point at which the percentage share of the relevant market controlled by the merging firms becomes "undue" or the resulting increase in concentration becomes "significant" so that a prima facie violation of section 7 is established. In *Philadelphia Nat'l Bank* the Court noted "more rigorous" percentage tests suggested by several commentators, but declined to intimate a view on the validity of such tests.[198] However, it referred to *Brown Shoe* in commenting that, "needless to say, the fact that a merger results in a less-than-30% market share, or in a less substantial increase in concentration than in the instant case, does not raise an inference that the merger is *not* violative of § 7."[199] Therefore, it may be concluded from a reading of *Brown Shoe* and *Philadelphia Nat'l Bank* together that the Court: (1) Locked the door on the quantitative substantiality test as a *validating* standard where the market shares or percentage increase in concentration approach *de minimis* proportions (permitting other evidence, including industry trends,[200] to tip the scale against the merger in spite of the small percentage of foreclosure or increase in concentration, viz., the five per cent market share in *Brown Shoe*); but (2) Left the back window open for the quantitative substantiality test to establish a prima facie case where the percentage market shares or concentration increases become "undue" or "significant," viz., the thirty per cent market share in *Philadelphia Nat'l Bank.* It remains to be seen how small such percentages may be for a prima facie case, or the nature and quality of the evidence necessary for its successful rebuttal.

---

[198] 374 U.S. at 364 n.41. The market-share percentages suggested as tests of prima facie unlawfulness were: KAYSEN & TURNER, ANTITRUST POLICY (1959) (20%); Markham, *Merger Policy Under the New Section 7: A Six-Year Appraisal,* 43 VA. L. REV. 489 (1957) (25%); Stigler, *Mergers and Preventive Antitrust Policy,* 104 U. PA. L. REV. 176 (1955) (20%). The Court also noted a suggested test for percentage increase in market concentration: Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics,* 74 HARV. L. REV. 226 (1960) (7 or 8%).

[199] 374 U.S. at 364-65 n.41.

[200] The Court emphasized the importance of trends throughout its opinion in *Brown Shoe.* See 370 U.S. at 301, 317, 331-32, 334, 345-46. Compare *id.* at 369, 373 (concurring opinion of Harlan, J.). For criticism of the equation of trends with the incipiency standard of section 7, see Bork, *Anticompetitive Enforcement Doctrines Under Section 7 of the Clayton Act,* 39 TEXAS L. REV. 832, 835-36 (1961). See also notes 47 & 59 *supra.*

III. Public Policy

A. Economic Concentration

It is frequently asserted that competition is inhibited by "economic concentration." The precise meaning of this term of art has been obfuscated to the point that it may mean one or a combination of several things, depending on how it is used. Technically, "economic concentration" refers to the concentration of industrial assets within the economy as a whole, as distinguished from concentration within specific industries or relevant markets, *i.e.*, "market concerntration."[201] As already noted, the Commission has criticized "the preoccupation of lawyers and economists with tests that look only to the number and size distribution of firms in a single market . . . ."[202] As a result, the emphasis has shifted to an attack on "conglomerate bigness" by looking beyond "market concentration" to "economic concentration."

Unfortunately, for analytical purposes, the market-economic-concentration dichotomy has not been clearly recognized in the decisions, and the concepts have been blurred and their application blended to a point of utter confusion, as illustrated by *Clorox*. At one point the Commission emphasizes the traditional market-concentration approach by giving its version of the teaching of Adam Smith. It compares competitive behavior in an atomized market, containing one hundred sellers of roughly equal size, with an oligopolistic market, containing only three sellers of equal size. According to the Commission, competition in its purest form reigns supreme in the atomized market:

> No one seller in such a market is so powerful that he can retaliate effectively against a competitor who cuts prices or otherwise attempts to increase his market share; there are too many firms for deliberately interdependent pricing and other policies to be feasible (actual agreement, of course, would violate Section 1 of the Sherman Act); and no one seller's competitive behavior, however vigorous, is apt to endanger seriously the market share of any of his competitors, or even be apparent to them, since even if one seller increases his market share by 50%, the *pro rata*

[201] See Grether, *The Impact of Present Day Antitrust Policy on the Economy*, 23 A.B.A. Antitrust Section 292, 310-13 (1963); Rosenbluth, *Measures of Concentration*, in Business Concentration and Price Policy 57 n.1 (1955).

[202] Procter & Gamble Co., No. 6901, FTC, Nov. 26, 1963, at 20.

> effect on each other seller's share will be only 1/200th. For these reasons, each seller is likely to establish his business policies in disregard of the actions of any individual competitor.[203]

Conditions in the oligopolistic market of three equal-sized sellers is said to be very different:

> If one cuts prices so as to increase his market share by 50% (i.e., to 50% of the market), each of his rivals will experience a 25% diminution in his respective market share. Unless they can operate profitably with their output thus curtailed, they must meet the price cut of their competitor. If there is active price cutting in such a market, the prices of all sellers will soon be forced down to the point at which they equal or barely exceed marginal cost—and no firm will be making a profit. Rather than incur price warfare that is bound to be mutually disadvantageous, each seller in a market of few sellers (an oligopolistic market) is likely tacitly to renounce price competition, and perhaps other forms of rivalry as well.[204]

As a result of this psychological fear of retaliation in an oligopolistic market, an "unnaturally" high price and "deadening" of competition is said to result. "Price leadership, 'conscious parallelism', excess capacity, emphasis on heavy advertising in lieu of technological innovation, and 'administered prices', are some of the symptoms of oligopoly."[205]

How does the theory of "economic concentration," or conglomerate-bigness, compare with the Commission's "market concentration" theories? Adopting the Commission's own figures, suppose there are one hundred diversified companies which own all of the nation's industrial assets. Suppose further that each of these companies has an equal share of each of the diversified markets it occupies in common with the others. By the Commission's own standards, there would be no interdependence of action because no one possessed a sufficient market share or retaliatory power to significantly affect the competitive position of the others. Assume

---

[203] *Id.* at 24.

[204] *Id.* at 24-25.

[205] *Id.* at 25. According to the Commission, a market may be oligopolistic even though asymmetrical, "oligopoly behavior" does not require any specific "size relation" among the dominant firms, and there need not be more than one dominant firm in the market, where that firm has the "market power" to compel the smaller competitors to fear retaliation and to "opt for peaceful coexistence." *Id.* at 26-27.

further, again using the Commission's figures, that only three companies owned all of the nation's industrial assets. This would then be analogous to the oligopoly situation described by the Commission, and the effect in any one market would be the same as under the conventional "market concentration" theory—the "economic concentration" theory adding nothing new or different. Suppose, however, that the economic structure is altered so that one hundred conglomerate companies own equal shares of all industrial assets in all but one symmetrically atomized industry composed of one hundred "small," single-line, companies. Under the Commission's reasoning this would violate section 7 under one or a combination of the competitive-injury theories already discussed, even though the acquiring company did not "dominate" any market or the economy as a whole, and there remains in every market a large number of sellers, none of which has a greater market share than the others. The supposed "probable injury to competition" must lie, therefore, solely in the disproportionate absolute size and diversification of the acquiring conglomerate. This conclusion was impliedly recognized in *Clorox:*

> It should be very clear that, in deeming Procter's size a pertinent consideration in the decision of this case, we are most emphatically *not* adopting any view that bigness *per se* is anti-competitive or undesirable and should be attacked under Section 7 or any other antitrust statute. Procter's size is significant in this case only insofar as it is hugely disparate compared with the size of the firms in the relevant market. Disparity of size, not absolute size, has importance in a merger case of this kind.[206]

If size *disparity* is the controlling consideration, then why not permit, indeed encourage, the other ninety-nine conglomerates in the hypothetical to acquire their counterparts in the "small-business" industry, to countervail the disproportionate size of the first-merging conglomerate? This would seem to be a particularly desirable solution because it would not only eliminate size disparity, without altering the number or market shares of the competitors, but it would also permit the presumed efficiencies of conglomerate-bigness without a resultant "competitive advantage" in any one company. The answer, of course, is found in the policy dilemma: The schizoid desire to preserve not only competition, but *small competitors.* The

[206] *Id.* at 57.

latter policy is highlighted in the Commission's statement that: "Precisely this phenomenon, the transformation through mergers of a small-business into a big-business industry, was at the heart of Congress' concern with what it conceived to be an accelerating trend toward excessive concentration of economic power."[207]

COMMENT.—As already noted, in discussing the horizontal effect of the merger in *Brown Shoe,* the Court stated a concern for "the protection of viable, small, locally owned businesses."[208] Is this statement really in conflict with the contextual statement that "it is competition, not competitors, which the Act protects?"[209] Unless the Supreme Court is to be charged with engaging in some rather crude double-think and double-talk, there must be some rational accommodation of these two desiderata. In point of fact, the Court did not rest its decision alone on the competitive advantage possessed by a large, vertically-integrated, national chain in the fragmented shoe retailing industry. Nor was it based on "economic" concentration or "bigness" as such. The combined market shares of the merging companies ranged upwards from five per cent in the cities comprising the relevant submarkets, and it was feared that, "if a merger achieving 5% control were now approved, we might be required to approve future merger efforts by Brown's competitors seeking similar market shares."[210] Thus, it was a trend towards *market* concentration which concerned the Court. This conclusion is inherent in the Court's observation that: "The *oligopoly* Congress sought to avoid would then be furthered and it would be difficult to dissolve the combinations previously approved."[211] Furthermore, the probability of this result was augmented by the history of an industry trend toward such *market* concentration.[212]

[207] *Id.* at 56. Many authorities maintain that there has been no significant increase in either market or economic concentration in recent times, including one of the economists on which the Commission relied elsewhere. BAIN, INDUSTRIAL ORGANIZATION 189 (1959), states, "from about 1935 up roughly to the present, business concentration has remained relatively stable both within the economy as a whole and within the principal sectors." See Adelman, *The Measurement of Industrial Concentration,* 33 REV. ECON. & STATISTICS 269 (1951). *But see* Rischin, *A Note on Trends in Industrial Concentration in the United States, 1948-1956,* 4 ANTITRUST BULL. 514 (1954).

[208] 370 U.S. at 344.

[209] *Ibid.*

[210] *Id.* at 343-44.

[211] *Id.* at 344.

[212] *Id.* at 345.

Therefore, while the Court may be guilty of judicial alchemy in its transmutation of the statutory "tend to create a monopoly" into "tend to create an oligopoly," it did not go so far as to outlaw any merger whose effect was to "tend to create a big-business industry" without regard to *market* power or concentration.[213]

B. Beneficial Competition

Perhaps the most unique aspect of the Commission's *Clorox magnum opus* is its attack on brand differentiation and persuasive advertising. While recognizing the social desirability of marketing, as well as production and distribution economies, Commissioner Elman approvingly quotes an economist's statement that a point may be reached, "at which product differentiation ceases to promote welfare and becomes wasteful, or mass advertising loses its informative aspect and merely entrenches market leaders."[214] His social benefit theory deserves more than a paraphrase to suggest the trauma it must have caused on Madison Avenue:

> Advertising performs a socially and economically useful function insofar as it educates the consumer to the broad range of product alternatives that he should consider in seeking to make an optimal allocation of his necessarily limited economic resources. Advertising, then, should stimulate competition and, by increasing the sales of the advertised product, lower the unit cost of that product. But this process is distorted in the case of a homogeneous product, such as household liquid bleach, produced under conditions of oligopoly, such as obtain in the liquid bleach industry. Since there is no reason (save cheapness and availability) for a consumer to prefer one brand of liquid bleach over another, there is no real need for the various manufacturers to incur as heavy advertising expenses as they do—except to protect their market shares. Heavy advertising, under such conditions, does not, in any meaningful sense, serve to broaden the consumer's range of product alternatives. Moreover, since oligopolists typically refrain from price competition, large advertising expenditures in the liquid bleach industry have not resulted in a lower unit price to the consumer. (Clorox, the most extensively advertised liquid bleach, is also the most expensive for the consumer.) Thus we have a situation in which heavy advertising

[213] *Id.* at 333, 344; United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 367 (1963).

[214] No. 6901, FTC, Nov. 26, 1963, at 66, quoting Dirlam, *The Celler-Kefauver Act: A Review of Enforcement Policy,* in ADMINISTERED PRICES: A COMPENDIUM ON PUBLIC POLICY 103 (1963).

> benefits the consumer, who pays for such advertising in the form of a higher price for the product, not at all.[215]

The Commission concluded that such "brand competition" is not "socially useful," because it is "beneficial" only to the seller and not to the consumer.

COMMENT.—It is understandable that the Commission would be concerned with the proper function of advertising. It expends a great deal of time and energy protecting the public from false and misleading advertising, and enforcing informative labeling and advertising statutes for certain designated products. However, in *Clorox* the Commission went beyond the call of duty in its attack on persuasive advertising under the anti-merger statute. Assuming, arguendo, that persuasive advertising and brand competition is bad, and even assuming that such advertising and competition could be filtered out without restricting informative advertising and "beneficial" competition, several questions remain, including: (1) Whether the problem should (or *can* jurisdictionally) be met *sua sponte* by administrative legislation, and (2) Whether the anti-merger statute is the proper vehicle for effective enforcement.[216]

IV. CONCLUSION

This necessarily limited review of the emerging conglomerate-merger picture suggests a surrealistic montage in which it is difficult to determine which side is "up." On the one hand, it is asserted that the Celler-Kefauver amendment to section 7 did not seek to deal with "ephemeral possibilities," while on the other hand there has been a tendency to pyramid assumptions, inferences and possibilities in search of "potential" injuries to "potential" competition, or to quest for an illusive "spirit" of the antitrust law in

[215] No. 6901, FTC, Nov. 26, 1963, at 66.

[216] In a recent speech, Commissioner Elman suggested that "monopolistic competition" in an oligopolistic industry may be unfair within the meaning of section 5 of the Federal Trade Commission Act. Address by Commissioner Elman, *Antitrust in an Expanding Economy,* THIRD ANTITRUST CONFERENCE OF THE NATIONAL INDUSTRIAL CONFERENCE BOARD 15-16 (Mar. 5, 1964). If the Commission should adopt this view, persuasive advertising and brand competition may be attacked as unfair competition. The Commission's current investigation into the possibility of promulgating labeling and advertising rules for the tobacco industry, to require a warning of health dangers, may portend further efforts by the Commission to expand its traditional regulatory activities.

the form of "beneficial competition." Furthermore, in almost the same breath, it is stated that the purpose of the act is: (1) To protect *competition,* not *competitors;* and (2) To prevent tendencies or incipient trends to oligopoly and economic concentration, *i.e.,* conglomerate-bigness, in order to protect "small" competitors and preserve a "small-business" industry structure.

Despite any disclaimer to the contrary, the current attack on conglomerate mergers is fraught with overtones of anti-bigness. Insofar as it is centered in a presumed congressional policy favoring "small" over "big" business, aside from questions of market power, foreclosure, or concentration, the war on bigness may be lost through preoccupation with the conglomerate-merger skirmish. There is no reason to believe that small business may be protected from more efficient competitors merely by outlawing conglomerate mergers. Assuming there are inherent economies of scale and diversification, the prevention of a wealthy conglomerate from entering an industry through merger would only create a temporary obstacle which may be circumvented through internal expansion. If this egalitarian utopianism is to be our national policy, it would require either some kind of governmental subsidization of less efficient small businesses, or a general limitation on the size and diversification which any corporation may achieve, with a concomitant fragmentation of those companies which have already exceeded the theoretical limits, or both. Not only does the statutory language and legislative history negate such a per se approach for section 7, but Congress has so far rejected all urgings to enact such a pervasive regulatory scheme.[217]

---

[217] Commissioner Elman recently made the novel proposal that the Commission undertake industry-wide investigations and rule-making proceedings in which the Commission would establish rules or standards defining "the lawful limits of merger activity in the industry." Elman, *supra* note 216, at 19. "Such rules or standards would, for example, (a) specify particular markets in which concentration had reached a critical point and in which further merger activity should be forbidden; (b) identify not only the class of firms which by reason of their size or other characteristics should be forbidden to make further acquisitions, but also the class which should be permitted or even encouraged to engage in merger activity; and (c) in general, define permissible limits of vertical and conglomerate, as well as horizontal, merger activity." *Id.* at 19-20. Violation of these rules would subject the offender to section 7 proceedings in which it was proposed that the Commission could rely on the rules and findings made in the rule-making proceeding and thereby obviate "prolonged and complex litigation." *Id.* at 20. The nation's limited experience in the farm price-support program suggests some of the problems inherent in such a policy.

While the arguments pro and con a protectionist policy are beyond the scope of this article, it is clear that its piecemeal inculcation through administrative or judicial mutation of section 7 would be ineffectual, at the least, and quite possibly detrimental to its intended beneficiaries. Specifically, the strict enforcement of this policy might hurt, rather than help, small business. It would overlook the benefits which may inure to a small business through merger with a wealthy conglomerate, and deny it the right to take advantage of such opportunities which may confront it. Combined with the already tight restrictions on horizontal and vertical mergers, the small businessman may be faced with the alternative of fighting for his business life with more efficient rivals, or merging on someone else's terms only when he qualifies as a "failing company."[218] Finally, and perhaps most importantly, the public would have to pay the price of supporting the inefficient while being denied any benefits which may flow from encouraging the efficient. Hopefully, the legal status of conglomerate mergers may be more clearly defined following decision of cases pending before the Supreme Court.[219]

---

[218] By restricting the "ease of exit," a potential competitor may be discouraged from entering the industry "by raising doubts as to the liquidity of his investment and by impairing his ability to obtain adequate financing." Scott, Antitrust and Economic Growth, Remarks at a National Industrial Conference Board meeting, at 14 (1964).

[219] United States v. El Paso Natural Gas Co., TRADE REG. REP. (1962 Trade Cas.) ¶ 70,571 (D. Utah 1962), *appeal docketed,* 32 U.S.L. WEEK 3002 (U.S. March 19, 1963) (No. 944, 1962-63 Term; renumbered No. 94, 1963-64 Term), *juris. noted,* 373 U.S. 930 (1963); United States v. Aluminum Co. of America, 214 F. Supp. 501 (N.D.N.Y. 1963), *appeal docketed,* 32 U.S.L. WEEK 3004 (U.S. June 11, 1963) (No. 1176, 1962-63 Term; renumbered No. 204, 1963-64 Term), *juris. noted,* 375 U.S. 808 (1963); United States v. Continental Can Co., 217 F. Supp. 761 (S.D.N.Y. 1963), *appeal docketed,* 32 U.S.L. WEEK 3078 (U.S. Aug. 13, 1963) (No. 367), *juris. noted,* 375 U.S. 893 (1963); United States v. Penn-Olin Chem. Co., 217 F. Supp. 110 (D. Del. 1963), *appeal docketed,* 32 U.S.L. WEEK 3119 (U.S. Sept. 27, 1963) (No. 503).

[The *Consolidated Foods* case, discussed previously by the author has subsequently been reversed. Consolidated Foods Corp. v. FTC, TRADE REG. REP. (1964 Trade Cas.) ¶ 71,054 (7th Cir. March 24, 1964) Ed.]