Antitrust Law -- United States v. General Dynamics: Toward an Analytical Approach to Post-Acquisition Evidence

Raymond M. Bernstein

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NOTES

Antitrust Law—United States v. General Dynamics: Toward an Analytical Approach to Post-Acquisition Evidence

It has been suggested by some of the more audacious legal commentators that the Government cannot lose a suit under section 7 of the Clayton Act.¹ The antitrust enforcement agencies have an unfair advantage over the section 7 defendant, it is urged, because under the time-of-suit doctrine² they may utilize evidence of events that have occurred between the time of the challenged acquisition and trial to establish the probable anti-competitive effect³ of the acquisition, while such post-acquisition evidence tending to reflect favorably upon the corporate defendant's position has been held to be of limited probative value.⁴ One of the primary justifications advanced for the disparate treatment accorded post-acquisition evidence is that defendants are likely to refrain deliberately from engaging in anti-competitive conduct prior to the time the suit is filed to establish the lack of future anti-competitive potential of the acquisition.⁵


   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 substantially to lessen competition, or tend to create a monopoly.

2. See text accompanying notes 29-33 infra. For a fuller discussion of this doctrine see Barnes, Competitive Mores and Legal Tests in Merger Cases: The Du Pont-General Motors Decision, 46 Geo. L.J. 564 (1958); Subcommittee on Section 7, The Backward Sweep Theory and the Oligopoly Problem, 32 ANTITRUST L.J. 306 (1966).

3. In view of the Clayton Act's purpose of arresting mergers when the trend toward a lessening of competition in a line of commerce is in its incipiency, the standard for establishing a violation of the Act is one of "probability." See Brown Shoe Co. v. United States, 370 U.S. 294, 317-18 (1962); S. REP. No. 698, 63d Cong., 2d Sess. 1 (1914).


The United States Supreme Court recognized this consideration in *United States v. General Dynamics Corp.*, but at the same time criticized the past approach as giving the Government a "heads-I-win, tails-you-lose" advantage over section 7 defendants. In upholding a merger exclusively on the basis of post-acquisition evidence, the Court indicated that such evidence diminishing the probable anti-competitive effect of an acquisition may be given controlling significance when it reflects substantial changes in market structure, not likely to have been the product of the defendant's deliberate manipulation.

**THE GENERAL DYNAMICS CASE**

*General Dynamics* arose out of a 1959 horizontal merger in the Midwestern coal industry, that occurred when Freeman Coal Mining Corporation acquired United Electric Coal Company. In 1967 the Justice Department sued under section 7 of the Clayton Act, charging that Freeman's acquisition had the probable effect of substantially lessening competition in the production and sale of coal in the relevant geographic markets. As evidence of the violation, the Government relied primarily upon statistics indicating that the merged company controlled a market share comparable to those that had been found in prior cases to be violative of section 7. The statistics also revealed a marked trend toward industry concentration in the relevant markets.

A sharply divided Supreme Court, while acknowledging the past instances in which statistical showings comparable to the one offered by the Government were sufficient to make out a case requiring divestiture, held by a vote of five to four that the Freeman-United Electric merger did not pose a substantial threat to competition at the time of

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7. Id. at 506.
8. "A horizontal merger involves the acquisition by one company of all or part of the stock or assets of a competitor which offers the same goods or services in the same market area." E. KINTNER, AN ANTITRUST PRIMER 88 (1964).
9. Shortly thereafter Freeman was acquired by defendant General Dynamics, but the legality of this acquisition was never at issue.
10. These markets consisted of the State of Illinois and the Eastern Interior Coal Province Sales Area (EICP). The EICP is one of four major coal distribution areas recognized by the coal industry, comprising Illinois, Indiana, and parts of Kentucky, Tennessee, Iowa, Minnesota, Wisconsin, and Missouri. 415 U.S. at 490.
11. See note 24 infra. For a more detailed review of some of these cases and the criteria generally relied upon in assessing the competitive effect of a merger see note 23 infra.
12. See note 24 infra.
13. 415 U.S. at 496.
suit, "[i]rrespective of the markets within which the acquiring and the acquired company might be viewed." In reaching this conclusion, the majority relied heavily on factors relating to the structure and prevailing business customs of the coal industry, with particular emphasis on post-acquisition evidence of United Electric's depleted coal reserves.

Specifically, the majority noted that electric utility companies today consume the great bulk of the coal produced in this country. Moreover, the flow of coal from the mines to these utilities is largely governed by long-term "requirements contracts," often lasting for as long a period as the parties remain productive. In rejecting the Government's prima facie case based on past coal production statistics, the majority reasoned that the true indicator of a coal company's ability to affect competition lay in its ability to negotiate new long-term contracts with the utilities. The fact that a coal company accounts for a large percentage of the production in a particular market proves nothing about its ability to affect prices if the bulk of such production is already committed at a constant price under existing long-term contracts. The majority accepted the district court's finding that at the time the suit was brought United Electric's coal reserves were depleted to the extent that it lacked the resources necessary to compete for future long-term contracts and that new reserves were unavailable for acquisition. It followed that its divestiture would not affect the vigor of competition in any market.

14. Id. at 511. Interestingly, the Court did not reach the market issues in its opinion. For that reason an analysis of the relevant product and geographic markets is outside the scope of this note. Suffice to say that it is highly unusual for a determination of the competitive effect of a merger to be made without a prior determination of the markets in which to judge such effect.
15. Id. at 499. See generally R. Moyer, Competition in the Midwestern Coal Industry 41 (1964).
16. Due to the large capital investment required in the construction of a power generating plant, it is essential to the electric utility that a flow of coal sufficient to meet its needs be guaranteed in advance to the greatest extent practicable. Requirements contracts similarly benefit the coal producer by assuring an outlet for his production.
17. 415 U.S. at 503.
18. Id. at 509. Since United Electric was a strip mining company, the majority discounted the availability of deep reserves in reaching this conclusion.
19. The Government contended that this "weak reserve" argument was essentially a "failing company" defense and that the defendants should have been required to conform to the strict limitations placed on its use. The failing company defense, first espoused by the Supreme Court in International Shoe Co. v. FTC, 280 U.S. 291 (1930), is an affirmative defense that, if sustained, will validate a merger, despite anti-competitive effects, if the acquired company faces a grave probability of business failure unless the merger takes place and if it can be shown that no other prospective purchaser was available. See Citizen Publishing Co. v. United States, 394 U.S. 131 (1969). The majority rejected this contention, however, on the grounds that the failing company defense
Finally, and most significantly, the majority rejected the assertion that its reliance on United Electric's weak coal reserves at the time of suit placed undue emphasis on post-acquisition evidence.\textsuperscript{20} While recognizing an "obvious" need for a limitation on the weight accorded such evidence, the majority felt that the practical considerations underlying this limitation were inapplicable to the present case.\textsuperscript{21} The evidence of weak reserves, it was held, "could not reflect a positive decision on the part of the merged companies to deliberately but temporarily refrain from anti-competitive actions."\textsuperscript{22} Thus, by upholding the merger, the Court indicated that a defendant's post-acquisition evidence may be given controlling weight in defending a merger subjected to section 7 attack. This result was reached notwithstanding the fact that had post-acquisition evidence not been considered, the Freeman-United Electric merger almost certainly would have been dissolved under the criteria generally relied upon to determine a section 7 violation.\textsuperscript{23} The Government's undisputed statistical showing casts con-
siderable light on this conclusion.24

POST-ACQUISITION EVIDENCE AND "COMPETITIVE EFFECTS"

The role that post-acquisition evidence has played in assessing whether a merger poses a substantial threat to competition has been a source of controversy. Some feel that such evidence is the best evidence available at the time of suit, and, therefore, both parties should be permitted to use it to remove section 7 determinations from the realm of speculation.25 On the other hand, this evidence has been discounted as of little probative value to either side,26 and, in any case, contrary to the specific probative language of section 7, which defines a violation in terms of the initial acquisition, and not in terms of what later occurred.27 While the state of the law prior to General Dynamics represented neither of these extremes, it has pleased few legal commentators and even fewer corporate defendants.28

The Supreme Court in United States v. E. I. du Pont de Nemours & Co.29 first sanctioned the Government's use of post-acquisition evidence by holding that the probability that an acquisition is likely to restrain competition is viewed as of the time of the antitrust suit rather

24. At the time of the merger the two firms produced 12.4% of the coal mined in the EICP market and 23.2% in the Illinois market. This is a far larger market share than the 5% found illegal in Brown Shoe, and in Illinois it approaches the 30% share found presumptively illegal in United States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963). The Government bolstered its case by introducing post-acquisition evidence of a substantial increase in concentration in the market as well. The number of coal producing firms in Illinois decreased a dramatic 73% between 1957-1967, from 144 producers to 39. 415 U.S. at 494-95. Although unmentioned by the Government the once easy access of new firms into the coal industry no longer exists. The capital requirements necessary for entry have increased, as the existing firms have become increasingly mechanized and concentrated in fewer and fewer hands. Desirable reserves are also less accessible than they once were. See Kennecott Copper Corp. v. FTC, 467 F.2d 67, 77 (10th Cir. 1972); R. Moyer, supra note 15, at 119.


26. See Proctor & Gamble Co., 63 F.T.C. 1465, 1534 (1963) (2d opinion of the FTC), aff'd, 386 U.S. 568 (1967). The Commission mounted a multi-faceted attack on the use of post-acquisition evidence by either party, citing the possibility of frequent remands for further such evidence until the proceedings became so protracted as to preclude effective relief. Id. at 1559.


than the time of the acquisition itself. Since the Clayton Act has no applicable statute of limitations, the time of suit can be thirty years after the acquisition, as was the case in DuPont. Thus, DuPont implicitly recognized that the Government may make use of post-acquisition evidence in claiming that an acquisition, apparently harmless to competition when made, has since threatened to pose the prohibited "substantial anti-competitive effect." While this rule has been criticized, it has been justified as advancing the avowed Clayton Act policy of curbing monopolistic trends in their formative stages, regardless of how long after an acquisition such a trend becomes apparent. Critics feel, however, that a double standard is in operation because the courts and the FTC have consistently held that post-acquisition evidence may not be accorded substantial weight when it is used by the defendant to show the lack of anti-competitive consequence of the merger. This disparity is not intended as an arbitrary handicap to section 7 defendants: there are four justifications for its continued viability.

In FTC v. Consolidated Foods Corp. the Supreme Court acknowledged that the use of post-acquisition evidence by a defendant was not totally precluded, but it reversed a lower court decision for placing undue emphasis on market conditions as they existed after the challenged merger had been consummated. In this decision the Court emphasized that the prohibition of section 7 is determined by probabilities, not by what later transpired. If the existence or non-existence of actual anti-competitive effects were allowed to override the probability of such an occurrence existing at the time of suit, the policy of curbing such effects in their incipiency would be frustrated.

Consolidated Foods further pointed out that "once the two companies are united, no one knows what the fate of the acquired company and its competitors would have been but for the merger." Thus, even if competitive market conditions do not appear to have been ad-

30. See id. at 607.
31. Id. at 620 (Burton, J., dissenting).
32. S. REP. No. 698, supra note 3.
36. Id. at 598; see FTC v. Proctor & Gamble Co., 386 U.S. 568, 576-77 (1967).
38. 380 U.S. at 598. But see id. at 606 (Stewart, J., concurring).
versely affected by a merger, the possibility exists that competition would have been better off had there been no merger at all. Since post-acquisition evidence would shed little light on what market conditions would have been but for the merger, its defensive use should be limited.

A third justification for limiting the probative value of post-acquisition evidence is the "best-behavior" rationale. If it were within the power of the defendant not to engage in anti-competitive conduct up to the time of suit, he should not be able to point to the absence of such conduct, which may be of limited duration, in order to validate the acquisition.

A final and somewhat weaker justification was advanced by the FTC in Reynolds Metals Co. The Commission refused to reopen a divestiture case to consider post-acquisition evidence on the grounds that "[e]ven though subsequent events may show that future competitive conditions are not as anticipated, this would not make legal that which was illegal... as of the time of trial." Faced with this background and with a merger that was apparently illegal in 1959, the essential question before the Supreme Court in 1974 was whether to take cognizance of significant changes in market structure that had occurred in the fifteen year interim, apparently beyond the control of the defendants, tending to indicate that at the time of suit there no longer existed a threat to competition as a result of the 1959 merger. As seen, the Court gave controlling weight to these post-acquisition changes, in the form of United Electric's depleted reserves and its inability to negotiate new long term contracts as a result. In doing so, the Court indicated that relevant economic data unrelated to the defendant's post-acquisition behavior will not be subjected to the usual limitations merely on the basis of its classification as post-acquisition evidence. In this respect, the General Dynamics holding is a sound one, for there is no justification for a restriction on

39. See text accompanying note 5 supra.
40. See Note, 46 N.C.L. Rev., supra note 5; text accompanying note 47 infra.
41. 56 F.T.C. 1680 (1960).
42. Id. at 1681. If the evidence sought to be introduced is viewed as bearing on the probability of a substantial lessening of competition at the time of suit, then the FTC's reasoning is circular. Evidence proving that the merger was in fact legal at the time of suit is inadmissible contends the Commission, since the merger was illegal.
43. The dissent emphasized that post-acquisition evidence can be used at most to influence the time of acquisition findings, but that none were ever made by the district court. 415 U.S. at 524 (Douglas, J., dissenting).
44. See Note, 46 N.C.L. Rev., supra note 5, at 378.
the use of post-acquisition evidence absent the usual reasons for applying such a restriction.

In the General Dynamics setting, the Court felt that it was beyond United Electric's power to remedy its depleted reserves, a circumstance the company was unlikely to have created intentionally. Accepting this factual premise, the "best-behavior" rationale for limiting the probative value of the depleted reserve evidence loses its force since it presupposes conditions capable of the defendant's manipulation in his own self interest. However, when manipulative capabilities exist the defendant's use of post-acquisition evidence may be discounted for reasons analogous to the suspicion with which self-serving statements are generally viewed. At the same time, however, the efficacy of the "best-behavior" rationale should be viewed in terms of an analytical distinction between the case in which the source of an acquisition's probable anti-competitive effect lies in the defendant's ability to engage in specific prohibited conduct and the case in which such source lies in a more general effect on market structure as a whole. In the former situation the newly acquired potential to engage in anti-competitive behavior makes the acquisition illegal, regardless of the defendant's motive or actual conduct. Here it should avail the defendant little to point to the absence of actual anti-competitive behavior after the acquisition, because of the likelihood that he has been on his "best behavior."

The "best-behavior" rationale has little applicability, however, to the case in which an acquisition violates section 7 by contributing to an increasingly oligopolistic market structure. Here the defendant's good behavior is irrelevant because the Government's case is not dependent on his particular opportunity to engage in anti-competitive

45. See text accompanying notes 15-19 supra.
46. But see note 22 supra.
48. This concern is most often encountered with conglomerate mergers, where the acquiror enters a new market for the first time by acquiring an already existing competitor in that market. Since obviously there is no effect on market shares or concentration as a result of such a merger, specific anti-competitive practices become the focus of the section 7 charge. See, e.g., FTC v. Proctor & Gamble Co., 386 U.S. 568 (1967) (predatory pricing); FTC v. Consolidated Foods Corp., 380 U.S. 592 (1965) (reciprocity); Reynolds Metals Co. v. FTC, 309 F.2d 223 (D.C. Cir. 1962) (price leadership).
49. Violations of section 7 are most often found on the basis of changes in market structure in horizontal and vertical mergers, where the merging firms were involved in the same market prior to merger, either as competitors (horizontal) or as suppliers or customers of one another (vertical).
conduct. Rather, the violation stems from a sound recognition that oligopolistic market structure tends to cause all the firms in a market to engage in economic cooperation rather than competition. Thus there is no need to apply the "best-behavior" rationale to limit the defendant's post-acquisition evidence of his own good behavior; it is sufficient that the use of such evidence as a defense fails to meet the thrust of the Government's attack.

The Supreme Court in *General Dynamics* looked carefully at the context in which the Freeman-United Electric merger took place in finding inapplicable still another rationale for limiting its consideration of post-acquisition evidence. Although this evidence apparently established United Electric as a non-viable competitive force at the time of suit, the acquisition of which could not adversely affect competition, the majority refused to adopt placidly the argument that had the merger never taken place competition might have been even more vigorous than it was. The problem with this approach, as the majority asserted, is that the factors that relegated United Electric to its present position were the product of inevitable forces on the coal industry throughout the country. Therefore, the Court could conclude with some confidence that the structure of the market would not have been significantly different had the merger never occurred.

The peculiar factual context of *General Dynamics* renders inapplicable another often cited reason for limiting the probative value of post-acquisition evidence. Generally, it is true that, if the lack of concrete anti-competitive effects could be relied upon to defeat a divestiture action, the policy of curbing monopolistic trends before they manifest themselves in actual monopolistic action would be frustrated. The post-acquisition evidence relied upon by General Dynamics, however, had nothing to do with the absence of past anti-competitive symptoms. Rather, the evidence of depleted reserves bore on the probability of a future lessening of competition at the time of suit, irrespective of the fact that had the Government acted promptly in bringing suit in 1959, the merger might have been found illegal at that time. Thus, an important distinction to apply in determining the weight of the defendant's post-acquisition evidence is whether this evidence bears on the future probabilities existing at the time of suit, or merely on what occurred prior to the suit, but after the acquisition.

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50. See text accompanying notes 15-19 supra.
51. 415 U.S. at 506.
52. Id.
There was nothing theoretically objectionable about the Court's reliance on post-acquisition evidence in *General Dynamics* from the standpoint of the policies underlying the restrictions generally placed on the probative value of such evidence. Indeed, courts ought to be more analytical in their approach to post-acquisition evidence and less prone to rely on rules that limit the value of this evidence without regard to the circumstances of the particular case. The inquiry should not be ended, however, by a determination that the reasons for generally limiting the probative value of post-acquisition evidence are not present. Cases may arise in which, despite the absence of objections to the use of post-acquisition evidence, the value of this evidence is outweighed by other factors indicating that general antitrust policies would be furthered by an order of divestiture. One such cogent policy is the need to prevent oligopoly in a natural resource extraction industry, where demand is constant, but the supply is capable of being tightly controlled, as the oil producing nations recently illustrated. In the *General Dynamics* context, perhaps the Supreme Court should have considered the possibility that the trend toward oligopoly in the coal industry would be enhanced by Freeman's acquisition of the substantial assets of United Electric, regardless of the latter's ability to compete independently in the market. Generally, however, when antitrust policies do not militate against the merger, post-acquisition evidence supporting it should be capable of being accorded controlling weight in appropriate circumstances.

While the Supreme Court in *General Dynamics* may have signalled the adoption of a new approach to post-acquisition evidence in section 7 cases, it may have inadvertently issued another signal to would-be oligopolists. Those who may have been deterred by past Government success in section 7 litigation may now proceed with questionable mergers in the hope that fortuitous events outside the control of the parties will later occur to validate these mergers. Prudent businessmen will take a careful look at the unusual facts of *General Dynamics* before embarking on such a course. The Government is not always going to wait long enough before attacking a merger to allow later occurrences to validate it.

**Conclusion**

In preserving competition by curbing oligopolistic market struc-

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tute, the Government should be able to utilize whatever evidence is available in bringing suit under section 7 of the Clayton Act. Practical as well as policy considerations, however, prevent a section 7 defendant from enjoying a similar latitude. This in itself does not mean that the Government enjoys a “heads-I-win, tails-you-lose” advantage over its adversaries, for often the restrictions placed on the defendant’s use of post-acquisition evidence will be completely justifiable, for reasons not applicable to similar use by a prosecuting authority. Where courts have automatically applied restrictive shibboleths to the defendant’s use of such evidence, however, this criticism has had some validity. Hopefully the Supreme Court in General Dynamics has abdicated such a rigid approach for the future, in favor of a more discriminating analysis.

RAYMOND M. BERNSTEIN

Constitutional Law—Gilmore v. City of Montgomery: Is There More to Equal Protection Than State Action?

Ratification of the fourteenth amendment in 1868 guaranteed that “[n]o State shall . . . deny to any person within its jurisdiction the equal protection of the laws.” Fifteen years later the United States Supreme Court in the Civil Rights Cases “embedded in our constitutional law” the principle “that the action inhibited by the . . . [equal protection clause] is only such action as may fairly be said to be that of the States. That amendment erects no shield against merely private conduct, however discriminatory or wrongful.” Thus a violation of the fourteenth amendment necessitates a finding of two factors. First, it requires a finding of state action. Secondly, there must be a finding of a substantive denial of equal protection, a denial that must

54. Contra, Neal, supra note 27.

3. Id.