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1981

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Recommended Citation

C. Paul III Rogers, Perspectives on Corporate Mergers and the Antitrust Laws, 12 Loy. U. Chi. L.J. 301 (1981)

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FOREWARD

Perspectives on Corporate Mergers and the Antitrust Laws

C. Paul Rogers*

I.

Section 7 of the Clayton Act prohibits corporate acquisitions which "may . . . substantially lessen competition . . . or tend to create a monopoly."¹ This indefinite language was intended by Congress to enable courts to address incipient trends toward concentration resulting from acquisition or merger.² The statute deals in probabilities, not certainties. Although providing a malleable standard that can be used to curtail corporate expansion with anticompetitive overtones, the statute is inapplicable to increased concentration by means other than acquisition.³

Thus, it is at once necessary to recognize both the flexibility and limits of the statute. Recognizing the limitations of section 7 does not, however, reduce its importance in addressing collections of corporate power. Without question, corporate mergers, acquisitions, and take-overs are responsible, in large measure, for the continuing concentration of American free enterprise.⁴ The desirability of this trend is the subject of much debate.⁵ By necessity, the normative question concerning the role of section 7 in abating the trend is at the center of the debate.

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1. 15 U.S.C. § 18 (1976).

2. See *United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 586, 589-91 (1957), citing S. REP. No. 698, 63d Cong., 2d Sess. 13 (1914). See also *Brown Shoe v. United States*, 370 U.S. 294, 316 n. 29 (1962).

3. Section 2 of the Sherman Act, 15 U.S.C. § (1976), guards against corporate expansion by any means which rises to monopoly dimension.

4. See, e.g., Mueller, *Mergers Among Large Firms in Hearings on Economic Concentration Before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary, Part 2, Mergers and Other Factors Affecting Industry Concentration, Pursuant to S. Res. 40, 89th Cong., 1st Sess. 515-20 (1965)* [hereinafter cited as Mueller].

5. See text accompanying notes 66-87 *infra*.

It is interesting to speculate that the adaptability and pliancy of section 7 may indeed be a substantial weakness in its enforcement. The language of section 7 abdicates, to a significant extent, the legislative function to the judiciary.⁶ The courts are given great latitude in interpreting and applying the statute to myriad situations involving acquisitions of corporate wealth. The same point can be made about sections 1 and 2 of the Sherman Act and section 5 of the Federal Trade Commission Act. This may underscore the necessity for the transfer of the legislative function to the courts to enable them to deal effectively with the peculiarities of restraints of trade and monopolies. Given the state of academic understanding of these subjects at the time of the passage of the antitrust acts, Congress perceived, no doubt properly, that only a penumbra was needed.⁷ The courts seemed to be the appropriate forum to work out the details on a case by case basis. In this context, however, judicial attitudes toward big business and economic concentration necessarily shape the development of the law.

The resulting difficulty is that sixty-five years after passage of the Clayton Act and thirty years after its last amendment, it is still uncertain when the Act should apply. For example, the coming of the conglomerate merger has wreaked its own havoc. When the original version of section 7 was enacted in 1914, Congress was primarily concerned with the elimination of direct competition between competitors rather than with the uncertain competitive effects of geographic or product-extension acquisitions which were rare at that time.⁸ In fact, not until 1957 did it become firmly es-

6. The operative language of the statute concerns the substantial lessening of competition or tendency to create a monopoly. See 15 U.S.C. § 18 (1976). Neither term is defined in the Act.

7. *But see* Letwin, *Congress and the Sherman Antitrust Law: 1887-1890*, 23 U. CHI. L. REV. 221 (1956). It is certain that § 7 of the Clayton Act, particularly the 1950 Celler-Kefauver Amendment which extended coverage to include asset acquisitions, 64 Stat. 1125 (1950), was viewed by Congress as imposing a stricter standard of illegality than the Sherman Act. See *Brown Shoe Co. v. United States*, 370 U.S. 294, 318 n.33 (1962). See also G. HENDERSON, *THE FEDERAL TRADE COMMISSION: A STUDY IN ADMINISTRATIVE LAW AND PROCEDURE* 16-36 (1924); D. MARTIN, *MERGERS AND THE CLAYTON ACT* 20-56 (1959).

8. Section 7 originally made stock acquisitions illegal "where . . . the effect of such acquisition may be to substantially lessen competition *between the corporation whose stock is so acquired and the corporation making the acquisition.*" (emphasis added). Clayton Act, ch. 323, § 7, 38 Stat. 731-32 (1914). The 1950 amendment deleted the underlined language and eliminated any concern that § 7 might apply only to mergers involving directly competing firms. Celler - Kefauver Act of December 29, 1950, ch. 184, 64 Stat. 1125 (1950). See also *Brown Shoe Co. v. United States*, 370 U.S. 294, 317 & n.30 (1962).

tablished that section 7 applied even to vertical mergers.⁹ The 1950 Cellar-Kefauver Amendment was directed to closing a large loophole in the law in that section 7 previously had applied only to stock acquisitions. When Congress amended the Act to include asset acquisitions,¹⁰ however, it is unclear whether or not the conglomerate merger was of principal legislative focus. Conglomerate mergers simply did not predominate in 1950.¹¹ The diversification of American corporations in the last twenty years has changed that. According to one estimate, conglomerate mergers now account for eighty to ninety percent of all corporate acquisitions.¹²

II.

The uncertainty surrounding and trust merger law can be traced to more than a change in the nature of corporate expansion. The personnel change in the United States Supreme Court in the early 1970's coupled with the "new learning" about the pros and cons of industrial concentration also has contributed to the current quandary.¹³ For example, the Warren Court, in deciding a wave of merger cases during the 1960's, interpreted the latitude given to the courts by section 7 as a mandate to eliminate any increase in market concentration if fomented by corporate acquisitions.¹⁴ In reviewing horizontal mergers, the Court focused on the elimination of actual competition between competitors if the market was concentrated or if a perceptible trend towards concentration existed.¹⁵ When faced with a vertical or conglomerate merger, the Court rec-

9. See *United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 586 (1957).

10. The government's failure to successfully challenge an asset merger with horizontal and vertical aspects under the Sherman Act in *United States v. Columbia Steel Co.*, 334 U.S. 495 (1948) prompted Congress to action. See L. SULLIVAN, *HANDBOOK ON THE LAW OF ANTITRUST* § 198 (1977); Zlinkoff & Barnard, *Mergers and the Antitrust Laws: The Columbia Steel Case, The Supreme Court and a Competitive Economy, the 1947 Term*, 97 U.P.A. L. REV. 151 (1948).

11. Approximately 38 percent of mergers were conglomerate in nature in 1950. 125 CONG. REC. S.2418 (daily ed. March 8, 1979)(statement of Sen. Kennedy).

12. *Id.*

13. See, e.g., *INDUSTRIAL CONCENTRATION: THE NEW LEARNING* (H. Goldschmid, H. Mann, J. Weston, eds. 1974); U.S. DEP'T OF COMMERCE, *MERGERS AND ECONOMIC EFFICIENCY* (1980) [hereinafter *MERGERS AND ECONOMIC EFFICIENCY*]; P. STEINER, *MERGERS: MOTIVES, EFFECTS, POLICIES* (1975).

14. See *Brown Shoe Co. v. United States*, 370 U.S. 294, 317-18 (1962).

15. See *United States v. Pabst Brewing Co.*, 384 U.S. 546 (1966); *United States v. Von's Grocery Co.*, 384 U.S. 270 (1966); *United States v. Aluminum Co. of America*, 377 U.S. 271 (1964); *United States v. Continental Can Co.*, 378 U.S. 441 (1964); *United States v. Philadelphia National Bank*, 374 U.S. 321 (1963); *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962).

ognized the importance of potential competition for the support of its anticoncentration policy.¹⁶ The Court saw that, although a merger might not eliminate direct or actual competition, potential entrants into an oligopolistic market could exert significant competitive influence over the behavior of existing firms.¹⁷ Thus, if a merger eliminated potential competition, it was understood that the competitive equilibrium of the marketplace could be disturbed with a resulting likelihood of more oligopolistic behavior by existing competitors. The potential for deconcentration because of the merger's elimination of viable, new independent entrants also was regarded as significant.¹⁸

The Warren Court's approach was to create predictability in merger law by simplifying the legal analysis when possible.¹⁹ The Court was heavily influenced by statistical evidence of market concentration and foreclosure. The Burger Court, in contrast, has consistently looked to other market factors when reviewing mergers. In doing so, the Burger Court has found only one violation of section 7.²⁰ This change of merger philosophy by the Court signifies one of two things. It may mean that section 7 has lost much of its ability to deal with the anticompetitive effects of corporate expansion by acquisition; or it may simply indicate that mergers do not generally create, upon close inspection, substantial competitive disincentives. If that is true, then section 7 was both misapplied and overapplied by the Warren Court.

A brief comparison of two decisions is illustrative of this shift in approach. In 1966, the Warren Court decided *United States v. Von's Grocery Co.*,²¹ a case involving the purchase of Shopping Bag Food Stores, the sixth largest grocery store chain in the Los Angeles area, by Von's, the third largest chain in the area. Although the two firms together accounted for only seven and one half percent of the retail groceries sold in the Los Angeles market, the Supreme Court struck down the merger. Justice Black, writing for the majority, was concerned that the combination of two successful, aggressive competitors, resulting in the second largest

16. See *FTC v. Proctor & Gamble Co.*, 386 U.S. 568 (1967); *FTC v. Consolidated Foods Corp.*, 380 U.S. 592 (1965); *United States v. Penn-Olin Chemical Co.*, 378 U.S. 158 (1964).

17. See *FTC v. Proctor & Gamble Co.*, 386 U.S. 568, 578 (1967).

18. *Id.* at 579.

19. See *FTC v. Proctor & Gamble Co.*, 386 U.S. 568, 589-90 (1967)(Harlan, J., concurring); *United States v. Philadelphia National Bank*, 374 U.S. 321, 363 (1963).

20. *Ford Motor Co. v. United States*, 405 U.S. 562 (1972).

21. 384 U.S. 270 (1966).

chain in the area, would exacerbate the trend of absorption of small grocery companies by larger ones.²² He was particularly concerned with the decline in the number of single store operations.²³ Section 7 was unabashedly read as aimed at keeping a large number of small firms in business in order to prevent economic concentration.²⁴

Justice Stewart wrote a blistering dissent.²⁵ Stewart viewed the majority's concern about the declining number of single store operations as overly simplistic and reactionary.²⁶ He found no causal relationship between the decrease of single store groceries and acquisitions by chains because chains were not purchasing single outlets.²⁷ According to Justice Stewart, changes in society since World War II had effected the demise of the neighborhood specialty store.²⁸ He did not view section 7 as a cure for technological and economic changes of this sort, particularly given the lack of merger activity involving small or single store outlets.

Justice Stewart also took exception to the majority's finding of a trend towards concentration in the retail grocery market, particularly as affected by the acquisition in question. Only by gauging the level of concentration by the decrease in the total number of competitors could such a trend be discerned, Stewart argued, because the market shares of the two leading firms had declined in the decade before the merger.²⁹ Even though the market share of the top twenty firms had increased, a substantial turnover in the membership of the top twenty had occurred.³⁰ These factors, coupled with the "turbulent history of entry and exit of competing small chains," indicated to Justice Stewart an "obvious procreative vigor of competition in the market."³¹

22. *Id.* at 278.

23. The number of single store owners in the Los Angeles market had declined from 5,365 in 1950 to 3,590 by 1963. *Id.* at 273.

24. *Id.* at 275. See also *Brown Shoe Co. v. United States*, 370 U.S. 294, 315, 344 (1962).

25. Justice White concurred in the majority opinion. 384 U.S. at 280. Justice Harlan joined in Justice Stewart's dissenting opinion. *Id.* at 281.

26. *Id.* at 289.

27. *Id.* at 293. Justice Stewart further pointed out that the number of competing chains had increased even though some chains had been acquired by larger chains. *Id.*

28. *Id.* at 288-89.

29. Between 1948 and 1958 the market share of the leading entrant, Safeway, had declined from 14 percent to 8 percent. The combined shares of the top two chains had declined from 21 percent to 14 percent. *Id.* at 290.

30. The market share of the top 20 firms had increased from 44 percent to 57 percent between 1948 and 1958, but seven of the 1958 top twenty did not exist ten years before. *Id.*

31. *Id.* at 292.

Justice Stewart was also at odds with the majority's characterization of the effect of the acquisition by Von's Grocery on the market structure. He viewed the merger as primarily a market extension rather than a horizontal acquisition because more than one-half of the stores of the acquiring and acquired firms did not compete with each other for customers.³² The total market share foreclosed was, then, less than one percent of the total grocery sales in the Los Angeles area.³³

Finally, Justice Stewart looked beyond statistics to determine the impact of the merger. He asserted that Shopping Bag, the acquired firm, was on the decline and was something less than a powerful force in the market place.³⁴ Further, the advent of cooperative buying organizations formed by small chains enabled even single store operators to purchase goods at prices competitive with those paid by the large chains.³⁵ Moreover, no substantial barriers to entry existed.³⁶ Thus, by focusing both on the health of the acquired company and the economic realities of small competitors in the market, Justice Stewart concluded that the increase in the market share of the merged firm was not concomitant with any increase in its market power.³⁷

Eight years after *Von's Grocery*, the Supreme Court decided another horizontal merger case, *United States v. General Dynamics Corp.*³⁸ The make-up of the Court had changed dramatically in the interval, resulting in a pronounced effect on section 7 enforcement.³⁹ Justice Stewart wrote for the majority in a five to four decision which upheld the merger of two coal producers competing in

32. Further, the actual overlap in sales between the two firms represented only about 25 percent of their combined Los Angeles sales. *Id.* at 296.

33. *Id.* Interestingly, neither the majority nor the dissent considered the potential competition aspects of the merger. If the merger was in fact a market extension type, the influence that Von's, the acquiring firm, exerted over the acquired firm's market as an actual or perceived potential independent entrant would be relevant in determining the likely anticompetitive effects of the acquisition.

34. The district court found that Shopping Bag had suffered from a lack of qualified management and, although sales were increasing, declining earnings and profits. 348 U.S. at 298.

35. *Id.* at 298-99. See also *United States v. Topco Assoc., Inc.*, 405 U.S. 596 (1972).

36. 384 U.S. at 300.

37. *Id.* at 297.

38. 415 U.S. 486 (1974).

39. Warren Burger had replaced Earl Warren as Chief Justice. Justices Blackmun, Powell, and Rehnquist had been appointed by President Nixon to replace Justices Fortas, Black, and Harlan, respectively. Justice Marshall was a Johnson appointment subsequent to *Von's Grocery*, succeeding Justice Clark.

one of the four major coal distribution areas. All of the new appointees to the Court joined with the majority.⁴⁰ Justice Douglas wrote a dissent and was joined by Justices Brennan, White, and Marshall, all Warren Court holdovers.⁴¹ Thus, the four Burger Court appointees voted to allow the merger in *General Dynamics*, replacing three Warren Court votes to enjoin the acquisition in *Von's Grocery*.⁴²

Through a series of stock transactions, General Dynamics had become the country's fifth largest commercial coal producer. The government's case rested upon the proposition that a 1959 acquisition of United Electric Coal Companies' stock by Material Service Corporation, which was later acquired by General Dynamics, substantially lessened competition in the sale and production of coal in two geographic areas.⁴³ The government's approach was to show that a trend towards further concentration in an already concentrated coal market would be significantly advanced by the merger because the merger would materially enlarge the market share of the acquiring company.⁴⁴ The number of coal producing companies in Illinois had decreased from 144 to 39 between 1957 and 1967.⁴⁵ The acquisition had, using 1957 figures, increased the market share of the top two producers either by fourteen and one half percent or twenty two and four tenths percent, depending on the relevant geographic market.⁴⁶

The Court, in allowing the purchase, recognized that previous horizontal merger decisions had found "prima facie" violations of section 7 from statistical evidence such as that presented by the government.⁴⁷ The Court further stated that "in the absence of

40. Excluding Justice Marshall, who joined the dissent.

41. 415 U.S. 486, 511 (1974)(Douglas, J., dissenting). Justices Douglas and Brennan had been with the majority in *Von's Grocery*, and Justice White had concurred with the majority. Of course, Justice Stewart was a Warren Court holdover but he had dissented in *Von's Grocery*, 384 U.S. 270, 281 (1966)(Stewart, J., dissenting).

42. Justice Harlan, whose seat had been taken by Justice Rehnquist, had joined in Justice Stewart's *Von's Grocery* dissent.

43. 415 U.S. at 490.

44. *Id.* at 494.

45. *Id.* at 495.

46. *Id.* According to the government, the relevant geographic market was either Illinois or the Eastern Interior Coal Province which was one of four major coal producing areas in the country and was comprised of Illinois, Indiana, and parts of Kentucky, Tennessee, Iowa, Minnesota, Virginia, and Missouri. *Id.* at 490.

47. *Id.* at 496-97, citing *Brown Shoe Co. v. United States*, 370 U.S. 294, 315 (1962); *United States v. Philadelphia National Bank*, 374 U.S. 321, 363 (1963); *United States v. Continental Can Co.*, 378 U.S. 441, 458 (1964); *United States v. Von's Grocery Co.*, 384 U.S.

other considerations," the government's statistical offerings would support a finding of "undue concentration."⁴⁸ Evidence of the coal industry's "structure, history and probable future," however, was thought necessary to judge accurately the competitive effect of the merger.⁴⁹

In looking beyond percentage market foreclosure evidence, the Court went further than the analysis of Justice Black in *Von's Grocery* and closely mirrored the analytical approach of Justice Stewart's dissent in that case. For example, the Court regarded as significant the district court's finding that the percentage share of coal in relation to all energy consumed had fallen from seventy eight and four tenths percent in 1920 to twenty one and four tenths percent in 1968. The decline was attributed to changes in distribution and demand, as well as to the increased attractiveness of alternative fuels brought about by technological advances and increased environmental regulation of coal extraction.⁵⁰ The electric utility industry had become the primary consumer of coal within the preceding twenty years. Almost all coal sold to utilities was by long-term requirements contracts. As a result, limited amounts of coal were available on the open market for "spot" purchases.⁵¹

The Court held that the basic changes in the demand for and sales method of coal justified the district court's conclusion that the government's statistical evidence was not, when viewed in context, sufficient to prove an anticompetitive effect.⁵² Proof of past and present market shares was misleading, according to the Court, because it did not reflect current competition for the procurement of new long-term supply contracts.⁵³ Past and present coal production was typically already committed under previously negotiated supply agreements.⁵⁴ The most significant factor in determining the competitive impact of a merger of coal producers was thought to be the acquired company's uncommitted coal reserves.⁵⁵

270, 277 (1966); *United States v. Pabst Brewing Co.*, 384 U.S. 546, 550-52 (1966).

48. 415 U.S. at 497-98.

49. *Id.* at 498.

50. *Id.* at 499.

51. *Id.* at 499-500.

52. *Id.* at 501.

53. *Id.* at 501-02.

54. Thus, statistical evidence of coal production was not of great significance in measuring the current competitive power of a firm. *Id.* at 501.

55. *Id.* at 502.

United, the acquired company, had very limited uncommitted reserves and was not in a position to acquire additional reserves.⁵⁶ United was thus unable to compete vigorously for new supply contracts and was, the Court concluded, a far less significant factor in the coal market than the government's statistics suggested.⁵⁷

General Dynamics demonstrates that Justice Stewart gained several adherents to his merger philosophy in the Warren Court-Burger Court transition. By looking beyond statistical evidence to market structure and demand behavior, merger analysis became at once more complicated and, hopefully, more reflective of the true competitive impact of acquisitions.⁵⁸ Cynics could argue, however, that the Burger Court is using this increased sophistication to defeat the intent of Congress to prohibit mergers which have an incipient anticompetitive effect. Indeed, the dissent in *General Dynamics* took grave exception to the majority's structural analysis, stating that the analysis fell far short of considering all relevant market factors and reflected "a deep-seated judicial bias against section 7 of the Clayton Act."⁵⁹ It is troublesome that the Supreme Court spectrum has swung so dramatically; the government cannot win in an area where fifteen years previously it could not lose.

Part of the difficulty with the Burger Court approach to section 7 does lie in the complexity of the analysis and the uncertainty that results. In contrast, the Warren Court's penchant for statistics and trends produced a more bright-line standard and thus provided a substantial degree of predictability for business.⁶⁰ Of

56. United, the acquired company, ranked fifth among Illinois coal producers in annual production but tenth in reserve holdings, controlling less than one percent of reserve holdings held by coal producers in Illinois, Indiana, and Western Kentucky. United's reserves were so depleted that it had already closed several mines. *Id.*

57. *Id.* at 503.

58. Although *General Dynamics* produced substantial ammunition for defendants in horizontal merger cases, the decision also led to uncertainty and inconsistency in the lower courts. See generally Note, *Horizontal Mergers After United States v. General Dynamics Corp.*, 92 HARV. L. REV. 491 (1978).

59. 415 U.S. at 527. See also Kirkpatrick & Mahinka, *The Supreme Court and the "New Economic Realism" of Section 7 of the Clayton Act*, 30 SW. L.J. 821 (1976); Lurie, *Mergers Under the Burger Court: An Anti-Antitrust Bias and Its Implications*, 23 VILL. L. REV. 213 (1978).

60. Arguably the Warren Court came close to adopting a *per se* rule for mergers resulting in a large market share foreclosure. In *United States v. Philadelphia National Bank*, the Court stated:

intense congressional concern with the trend toward concentration warrants dispensing, in certain cases, with elaborate proof of market structure, market behavior, or probable anti-competitive effects. Specifically, we think that a merger which produces a firm controlling an undue percentage share of the relevant mar-

course, predictability in the law is a valued commodity. It enhances informed business planning and deters obvious anticompetitive conduct.⁶¹ However, *Von's Grocery* suggests the possibility that a simplified analysis may result in a finding of illegality in a "trend" market when the increased concentration may not be attributable to merger activity and the merger in question may have little anticompetitive effect. In other words, statistical appearances may be deceiving.

The Burger Court's emphasis on the operation of the market in question may, however, have the overall effect of lessening the reach of section 7, even with regard to mergers in which the apparent market foreclosure is substantial. For example, the *General Dynamics* case creates the opportunity for a broad number of defenses relating to the business and economic realities of the market.⁶² A strong statistical case is considered only prima facie evidence of an anticompetitive effect.⁶³ Evidence to rebut the presumption is ultimately within the province of the trier of fact. A reviewing court can reverse only for errors of law, which of course leaves considerable discretion to the trier of fact when evaluating defendant's evidence of market structure and behavior. The defendant, in effect, has nothing to lose by proffering rebuttal evidence. If the trier of fact is convinced by the defendant's proof, the effect is to limit section 7, at least as that section was interpreted by the Warren Court.

This limitation possibility is amplified by the Burger Court's reluctance to set forth broad guidelines for merger decision-making. Again, using *General Dynamics* for illustration, that decision gives little guidance except to mandate more flexibility in considering

ket, 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.

374 U.S. 321, 363 (1963). If *Philadelphia National Bank* buried the need for a broad factual inquiry in horizontal merger cases, *General Dynamics* probably resurrected it.

61. In another context, the Court has noted the risk of "overdeterrence" and over-regulation of free enterprise with regard to business behavior proscribed by the antitrust laws which is "difficult to distinguish from the gray zone of socially acceptable and economically justifiable business conduct." *United States v. United States Gypsum Co.*, 438 U.S. 422, 441 (1978). Thus, where the legal standards are uncertain, obvious anticompetitive conduct may not be so obvious and procompetitive conduct may be unwittingly deterred.

62. See Ponsoldt, *The Expansion of Horizontal Merger Defenses After General Dynamics: A Suggested Reconsideration of Sherman Act Principles*, 12 *LOY. CHI. L.J.* 361 (1981) [hereinafter cited as Ponsoldt].

63. *United States v. General Dynamics Corp.*, 415 U.S. 486, 496 (1974).

mergers. The decision is unclear about the weight to be accorded justification evidence or the limitations, if any, upon such proof.⁶⁴ Other Burger Court decisions can arguably be confined to their "unique" facts as well.⁶⁵ Thus, the Burger Court approach can be viewed as at once sophisticated and openended. In evaluating this approach, the benefit of increased sophistication in pinpointing only acquisitions with real anticompetitive consequences must be balanced against the possible contraction of the application of section 7 to questionable mergers because of the expanded flexibility and latitude given to the trier of fact.

III.

Accentuating the judicial uncertainty surrounding antitrust merger law is the academic and legislative debate and doubt about the actual competitive effect of economic growth by acquisition. The contention centers around two broad, overlapping issues. The first concerns the role of economic efficiency in merger adjudication. The second focuses upon the economic consequences of conglomerate acquisitions.

The efficiency question has arisen primarily in the vertical and conglomerate context and has been a source of controversy since the 1962 Supreme Court decision in *Brown Shoe Co. v. United States*.⁶⁶ In *Brown Shoe*, the government argued that the purchase of a large independent retail chain of shoe stores by a large shoe manufacturer would be anticompetitive because the resulting integrated company would, through increased efficiencies, be able to undercut local, unintegrated competitors. Counsel for the defendant apparently had felt forced to argue that the merger produced no consumer benefits or economic advantages.⁶⁷ The Supreme Court agreed with the government and held that the increased efficiencies supported the conclusion that the merger was unlawful, irrespective of consumer benefit.⁶⁸ The decision quickly produced

64. See Ponsoldt, *supra* note 62, at 375-76.

65. See, e.g., *United States v. Citizens & Southern National Bank*, 422 U.S. 86 (1975); *United States v. Marine Bancorporation, Inc.*, 418 U.S. 602 (1974); *United States v. The Connecticut National Bank*, 418 U.S. 656 (1974); *United States v. Falstaff Brewing Corp.*, 410 U.S. 526 (1973).

66. 370 U.S. 294 (1962). See Williamson, *Economics as an Antitrust Defense Revisited*, 125 U. PA. L. REV. 699 (1977).

67. See Blake & Jones, *Toward a Three-Dimensional Antitrust Policy*, 65 COLUM. L. REV. 422, 456-57 (1965) [hereinafter cited as Blake and Jones].

68. 370 U.S. at 344.

a plethora of criticism.⁶⁹ Subsequently, the 1968 Department of Justice Merger Guidelines stated an enforcement policy of not accepting, absent exceptional circumstances, increased economic efficiency as a justification for a merger.⁷⁰ The position of the Department of Justice was arguably a retreat from the *Brown Shoe* position that improved efficiency was a factor supporting illegality.

Questions concerning economic efficiency are also pivotal to the debate over conglomerate mergers. Efficiencies resulting from a product or geographic extension acquisition may have additional appeal as a justification for the merger, at least superficially, because the anticompetitive effects of such a merger appear more problematic. In fact, two focal points can be discerned in the conglomerate merger debate. In addition to the efficiency dialogue, the validity of the potential competition theories is being extensively questioned.⁷¹

The efficiency enigma is itself severable. One question involves the legal standards to be accorded demonstrable gains in efficiency. The courts thus far have had little to say about efficiency considerations in conglomerate cases. Justice Harlan, concurring in *FTC v. Proctor & Gamble Co.*,⁷² argued that economic efficiencies are procompetitive because competitive benefits gained thereby "may stimulate matching innovation by others, the very essence of com-

69. See, e.g., Kauper, *The "Warren Court" and the Antitrust Law: Of Economics, Populism, and Cynicism*, 67 MICH. L. REV. 325 (1968); Bork & Bowman, *The Crisis in Antitrust*, 65 COLUM. L. REV. 363 (1965). See also M. HANDLER, R. BLAKE, R. PITOPFSKY, & H. GOLDSCHMID, *TRADE REGULATION, CASES AND MATERIALS* 918-22 (1975) [hereinafter cited as *TRADE REGULATION*].

70. U.S. Dep't of Justice Merger Guidelines, ¶ 14 (May 30, 1968).

71. See, e.g., Bauer, *Challenging Conglomerate Mergers Under Section 7 of the Clayton Act: Today's Law and Tomorrow's Legislation*, 58 B.U. L. REV. 199 (1978); Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 HARV. L. REV. 226 (1960); Brodley, *Potential Competition Mergers: A Structural Synthesis*, 87 YALE L.J. 1 (1977); Dunfee & Stern, *Potential Competition Theory as an Anti-Merger Tool Under Section 7 of the Clayton Act: A Decisional Model*, 69 NW. U. L. REV. 821 (1975); Markovits, *Potential Competition, Limit Price Theory, and the Legality of Horizontal and Conglomerate Mergers Under the American Antitrust Law*, 1975 WIS. L. REV. 658. The so-called actual potential entry theory, which seeks to measure the competitive impact of a merger by looking to alternative means of toehold or *de novo* entry by the acquiring firm, is drawing substantial attention. See, e.g., Brodley, *supra*; Carter, *Actual Potential Entry Under Section 7 of the Clayton Act*, 66 VA. L. REV. 1485 (1980). The Supreme Court has twice declined to consider the validity of the doctrine in recent years. See *United States v. Marine Bancorporation*, 418 U.S. 602, 623-41 (1974); *United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 537-38 (1973). See also *BOC Int'l Ltd. v. FTC*, 557 F.2d 24 (2d Cir. 1977).

72. 386 U.S. 568 (1967).

petition."⁷³ He urged that reviewing bodies weigh possible efficiencies against likely anticompetitive effects when applying section 7.⁷⁴ This proposed balancing approach, however, appears to have obtained little favor.⁷⁵

The disinclination of the courts to give much weight to efficiency arguments as affirmative defenses probably stems in part from the constraints of *stare decisis*⁷⁶ and in part from judicial uncertainty about what constitutes a gain in efficiency.⁷⁷ This judicial uncertainty is not misplaced, given that both the academic and legislative communities are in almost total disagreement about whether conglomerate mergers produce substantial efficiencies. Proponents of the efficiency rationale argue that conglomerate acquisitions must be dictated by efficiency considerations because the purchase does not add to the acquiring firm's existing market share. The acquisition is thus attractive to the acquiring firm only if efficiencies which will provide a competitive return on investment can be brought to the acquired firm.⁷⁸ In other words, substantial econo-

73. *Id.* at 598 (Harlan, J., concurring).

74. *Id.* See also *In re General Foods Corp.*, 69 FTC 380, 449 (1966)(Elman, Commissioner, dissenting).

75. See, e.g., *R.S.R. Corp. v. FTC*, 602 F.2d 1317 (9th Cir. 1979); *IT&T Corp. v. GT&E Corp.*, 351 F. Supp. 1153 (D. Haw. 1972), *rev'd in part*, 518 F.2d 913 (9th Cir. 1975). See also *United States v. Yellow Cab Co.*, 332 U.S. 218 (1947). *Cf.* *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320, 328-29, 334 (1961)(efficiencies must be weighed in favor of the vertical integration by a requirements contract at issue); *United States v. International Harvester Co.*, 564 F.2d 769, 780 (7th Cir. 1977); *In re The Pillsbury Co.*, 93 F.T.C. 966 (1979).

76. See, e.g., *Brown Shoe Co. v. United States*, 370 U.S. 294, 344 (1962).

77. A difference exists between "real" economic efficiencies which produce economies inhering to the betterment of the marketplace and perhaps to consumers, and efficiencies which only result in money savings for the firm. See Blake & Jones, *supra* note 67, at 459. For example, the gains of advertising efficiency occasioned by an acquisition may not provide consumers with proportionately more information upon which to make an informed purchasing decision, but may only give greater opportunity for product exposure for the resulting firm. See *FTC v. Proctor & Gamble Co.*, 386 U.S. 568, 580 (1967). Further, the advertising efficiencies may heighten entry barriers by adding to artificial consumer preferences going beyond the relative advantages of the product. See Address by Donald F. Turner on Advertising and Competition, delivered before the Briefing Conference on Federal Controls of Advertising and Promotion, Washington, D.C. (June 2, 1966), *reprinted in TRADE REGULATION*, *supra* note 69 at 1036-39.

78. See, e.g., Turner, *Conglomerate Mergers and Section 7 of the Clayton Act*, 78 HARV. L. REV. 1313, 1354 (1965); White House Task Force on Antitrust Policy, Report on Antitrust Policy (1968)(statement of Robert H. Bork). But this rationale assumes that the acquired firm market is not already a high return market and thus is not attractive for the reason alone. More recent arguments for the efficiency of conglomerate mergers include Weston, *Industrial Concentration, Mergers, and Growth: A Summary*, in *MERGERS AND ECONOMIC EFFICIENCY*, *supra* note 13, at 38-44 [hereinafter cited as Weston]; Brozen, *A Comment on Weston's Industrial Concentration, Mergers and Growth*, in *MERGERS AND ECONOMIC EFFI-*

mies must be perceived before a conglomerate acquisition is likely to occur.

Opponents point to empirical evidence which seems to demonstrate that conglomerate mergers do not yield substantial efficiencies.⁷⁹ This data may indicate that corporate managers often miscalculate the economic potential of an acquisition, or it may imply that mergers are pursued for reasons not directly related to economic welfare maximization.⁸⁰ Further, the same evidence may mean that small business protectionism is not the antithesis of welfare maximization.⁸¹ Because conglomerate mergers are not particularly efficient they may not unduly harm the ability of small enterprises to compete.⁸² That is, conglomerate mergers may contribute little to firm efficiency or to market concentration.⁸³

The question of corporate control has bearing on the efficiency dilemma. Berle and Means believed that the increasing diffusion of stock ownership means that corporate management becomes less and less subject to the effective control of shareholders, who are interested only in profit maximization.⁸⁴ Concomitantly, managers gain more freedom to manage the corporation in furtherance of

CIENCY, *supra* note 13, at 65-69.

79. See S. REID, *MERGERS AND THE ECONOMY* (1968); Boyle, *Pre-Merger Growth and the Profit Characteristics of Large Conglomerate Mergers in the United States*, 44 ST. JOHN'S L. REV. 152 (1970); Mueller, *The Effects of Conglomerate Mergers*, 1 J. OF BANKING AND FINANCE 315, 344 [hereinafter cited as Mueller, *Effects*]. Cf. Weston, *supra* note 78, at 40-42; Weston & Mansinghka, *Tests of the Efficiency Performance of Conglomerate Firms*, 29 J. FIN. 919 (1971). The debate has been fueled by recent legislative proposals which would make large conglomerate acquisitions presumptively illegal. S. 600, 96th Cong., 1st Sess. (1979). See also Mueller, *Do We Want a New, Tough Anti-Merger Law?*, 24 ANTITRUST BULL. 807 (1979).

80. See Mueller, *Effects*, *supra* note 79, at 339.

81. Some sentiment exists to scrap § 7 entirely because it is believed incompatible with achieving a more efficient economy. See R. POSNER, *ANTITRUST LAW: AN ECONOMIC PERSPECTIVE* 97 (1976) [hereinafter cited as R. POSNER].

82. On the other hand, conglomerate mergers may stifle competition because of the increased opportunity for predatory practices which a deep pocket acquiring firm brings to the acquired firm's market. See *Reynolds Metals Co. v. FTC*, 309 F.2d 223, 229-30 (D.C. Cir. 1962). See also *Ford Motor Co. v. United States*, 405 U.S. 562 (1972); *FTC v. Proctor & Gamble Co.*, 386 U.S. 568 (1967); Edwards, *Conglomerate Bigness as a Source of Power in BUSINESS CONCENTRATION AND PRICE POLICY* 331 (1955).

83. See Scherer, *Book Review, The Posnerian Harvest: Separating Wheat from Chaff*, 86 YALE L.J. 974, 987-88 (1977).

84. See A. BERLE & G. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932). The Berle-Means separation of ownership and control thesis has not been satisfactorily proved empirically. See, e.g., De Alessi, *Private Property and Dispersion of Ownership in Large Corporations*, 28 J. FIN. 839 (1973); Kamin and Ronen, *The Effects of Corporate Control on Apparent Profit Performance*, 45 S. ECON. J. 181 (1978); Stano, *Executive Ownership Interests and Corporate Performance*, 42 S. ECON. J. 272 (1975).

their own, as opposed to the shareholders', self-interest. If managerial goals differ from profit maximization, the increased discretion afforded management by diffused ownership may hinder efficient firm operation.⁸⁵

In a merger context, a diffusion of control and ownership may have several ramifications. If managers benefit by an increase in the size of their firm without a concomitant increase in profitability, conglomerate mergers may not generally increase efficiencies.⁸⁶ Thus, profits or rates of return on common stock may decrease after a corporate acquisition if managerial autonomy and diversity of goals do exist.

On the other hand, viewing a prospective acquisition from the perspective of the about-to-be-acquired firm, it can be seen that the acquisition may be efficient for that firm even though management has a conflict of interest with its shareholders. Inefficient management will typically be replaced by the acquiring firm.⁸⁷ When this occurs, the acquired firm will presumably be operated in a more efficient manner with a resulting increase in profit levels. Of course, the existing acquired firm managers, fearing the loss of their jobs, will likely attempt to block the takeover, even though to do so is against the best interests of the shareholders.⁸⁸ To the ex-

85. Substantial theoretical and empirical attention has been given to the question of managerial discretion. That is, assuming management autonomy from firm ownership, focus is placed on: (1) what managers will seek to maximize, *see note 84 infra*; and (2) whether or not management self-interest will result in firm operation that does not seek profit maximization as the primary goal, *see, e.g., Williamson, Managerial Discretion and Business Behavior*, 53 AM. ECON. REV. 1032 (1963); Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288 (1980).

86. It has been suggested that the pecuniary and non-pecuniary rewards which managers receive, such as salaries, bonuses, stock options, and promotions, are more closely tied to the growth rate of the firm than to its profits. In addition, the prestige and power that managers seek may be more directly related to size or increases in size than in profit levels. *See generally* R. REID, *MERGERS, MANAGERS, AND THE ECONOMY* (1968); Mueller, *A Theory of Conglomerate Mergers*, 83 Q. J. ECON. 643, 644 (1969). *Cf.* R. POSNER, & K. SCOTT, *ECONOMICS OF CORPORATION LAW AND SECURITIES REGULATION*, 195-231 (1980); Kummer and Hoffmeister, *Valuation Consequences of Cash Tender Offers*, 33 J. FIN. 505 (1978); Mandelker, *Risk and Return: The Case of Merging Firms*, 1 J. FIN. ECON. 303 (1974).

87. *See* Holl, *Control Type and the Market for Corporate Control in Large U.S. Corporations*, 25 J. IND. ECON. 259 (1977). *Cf.* Scott, *On The Theory of Conglomerate Mergers*, 32 J. FIN. 1235 (1977).

88. It may be, however, that the target managers act in the shareholders' interest in opposing an outstanding tender offer. To the extent that the target managers have information that would induce a higher bid or a higher stock valuation, a formal opposition by existing management to the offer may be an effective and efficient way of communicating the information to the shareholders. *See* Bradley, *Interfirm Tender Offers and the Market for Corporate Control*, 53 J. BUS. 354, 356 (1980). This point assumes that the current target

tent they are unsuccessful, efficiency is likely to be advanced.

Similarly, the existing poor management of the acquired firm may be what makes the acquisition attractive to the acquiring firm. Thus, the prospect of takeover may limit the autonomy of management from ownership as well as limit management's discretion to focus on goals other than profit maximization. Acquisitions may effect efficiency, then, either through the threat or actuality of takeover.

Of course, the efficiency criterion in antitrust analysis focuses on the performance of the merged firm, not on the corporate decision-making process prior to the acquisition. Efficiency measurements should presumably compare the pre-merger profits of the acquired firm with post-merger profit levels. The corporate control question and insight into the reasons for acquisitions, however, may bear heavily upon post-merger performances. A measure of predictability regarding efficiency levels may be gleaned, particularly where no post-acquisition data is available such as when a merger is challenged prior to culmination.

It is doubtful, given the conflicting theoretical and empirical evidence, that the conglomerate merger efficiency question can be conclusively decided. Assuming the efficiency dilemma is not unanswerable, the outcome should influence section 7 enforcement and adjudication. That is, the substantive evidence of the effect of conglomerate mergers on gains in efficiency generally should guide the legal standard to be applied to demonstrable efficiency advantages in a given situation. If conglomerate acquisitions do not generally produce substantial efficiencies, the standard of analysis implemented should presumably still focus on the probability of anticompetitive effects resulting from the merger. Then the difficulty, in the conglomerate context, would center around the likelihood that the potential competition and market structure approach currently in use is competent to adduce anticompetitive mergers accurately.⁸⁹

management has something of importance to communicate to its shareholders. If inept current management is a primary reason for the attractiveness of the merger, management opposition to the merger would still seem to conflict with the target shareholders' best interests. Current management is not likely to communicate information regarding its own poor performance.

89. See, e.g., note 71 *supra*. See also MacLeod, *The Relevant Product Market After Brown Shoe*, 12 LOY. CHI. L.J. 321 (1981). On the transposing of economic theory to legal policy, see Brodley, *Oligopoly Power Under the Sherman, and Clayton Acts - From Economic Theory to Legal Policy*, 19 STAN. L. REV. 285 (1967); Stigler, *Mergers and Preventive*

If conglomerate mergers do tend to enhance economic welfare, the problem lies in determining the weight to be accorded gains in efficiency. If welfare maximization is to be the sole aim of antitrust enforcement, demonstrable gains in efficiency should constitute an absolute defense. The protection of small enterprise or the preservation of deconcentration opportunities would not be worth the loss of efficiency. The other alternative, an "efficiency rule of reason," is more palatable to those who do not view efficiency and small business as mutually exclusive.⁹⁰ Presumably the gains in efficiency would be balanced against the increase in concentration resulting from the merger.⁹¹ Particular attention would hopefully be given to the possibility of alternative methods of expansion which would be less objectionable to competition while achieving the efficiency increase of the acquisition.⁹²

IV.

The role of economic welfare maximization in the conglomerate acquisition context is of course a crucial part of the larger philosophical warfare over the primary aims of the antitrust laws.⁹³ For those scholars who believe that efficiency is always procompetitive, if the effect on individual competitors is discounted, the efficiency criterion is the paramount goal for antitrust law to attain.⁹⁴ Others view competition in a different light. Instead of looking at competition as purely a process of rivalry where only the strong — i.e. efficient — survive, competition, as defined by the antitrust laws, is seen as protecting the opportunity to compete. Under this view,

Antitrust Policy, 104 U. PA. L. REV. 176 (1955); Rogers, *Book Review*, 32 VAND. L. REV. 1239, 1240-53 (1979).

90. See notes 81-83 *supra* and accompanying text.

91. See notes 72-74 *supra* and accompanying text. A balancing approach is arguably even more appealing given the current uncertainty about the efficiencies of conglomerate mergers.

92. Market entry by internal expansion or by toehold acquisition has traditionally been favored because an additional entrant is added or a weak entrant is replaced with one more able to compete significantly. See Note, *Budd Co., The Toehold Defense to a Section 7 Attack*, 71 NW. U.L. REV. 264 (1976); Note, *Toehold Acquisitions and the Potential Competition Doctrine*, 40 U. CHI. L. REV. 156 (1972).

93. See Bork, Bowman, Blake, & Jones, *The Goals of Antitrust: A Dialogue on Policy*, 65 COLUM. L. REV. 363 (1965); Brodley, *Massive Industrial Size, Classical Economics, and the Search for Humanistic Value*, 24 STAN. L. REV. 1155 (1972); Dewey, *The Economic Theory of Antitrust: Science or Religion?*, 50 VA. L. REV. 413 (1964); Elzinga, *The Goals of Antitrust: Other Than Competition and Efficiency, What Else Counts?*, 125 U. PA. L. REV. 1191 (1977).

94. See, e.g., R. BORK, *THE ANTITRUST PARADOX* 90-133 (1978); R. POSNER, *supra* note 81, at 18-22; Posner, *The Chicago School of Antitrust Analysis*, 127 U. PA. L. REV. 925 (1979).

the maximization of efficiency must sometimes give way to non-economic, political, or social goals such as the protection of the competitive viability of small business.⁹⁵ This "political" approach derives from a belief that the Sherman Act and Clayton Act Congresses, which were influenced by Populist politics, were not solely, or even primarily, concerned with welfare maximization.⁹⁶ The fundamental American value of freedom of opportunity coupled with the traditional dislike of concentrations of power can be cited as underscoring the congressional desire to retain local control and ownership of business.⁹⁷

Section 7 is at the core of this philosophical debate. Antitrust merger law has been more stringently interpreted as a protective device for the small, locally-owned competitive entity than any other provision of the antitrust statutes,⁹⁸ with the possible exception of the Robinson-Patman Price Discrimination Act.⁹⁹ The Burger Court has sharply curtailed this protectionism approach and has seriously questioned the previous methods of ascertaining the the anticompetitive effects of mergers. Further, our new president has selected a noted conservative on antitrust enforcement to direct the Antitrust Division of the Department of Justice.¹⁰⁰ The new Assistant Attorney General is on record as favoring a welfare maximization approach to antitrust enforcement.¹⁰¹ If the efficiencies of a merger become an important barometer in the enforcement decision, the courts may be spared the hard efficiency questions for the near future.¹⁰² An efficiency consciousness in the

95. See, e.g., Pitofsky, *The Political Content of Antitrust*, 127 U. PA. L. REV. 1051 (1979); Schwartz, *"Justice" and Other Non-Economic Goals of Antitrust*, 127 U. PA. L. REV. 1076 (1979); Sullivan, *Economics and More Humanistic Disciplines: What Are the Sources of Wisdom for Antitrust?*, 125 U. PA. L. REV. 1214 (1977).

96. Cf. R. POSNER, *supra* note 81, at 20-23; Bork, *Legislative Intent and the Policy of the Sherman Act*, 9 J.L. & ECON. 7 (1966). The legislative debates probably are inconclusive, since both economic and non-economic objectives were frequently considered. See generally H. THORELLI, *THE FEDERAL ANTITRUST POLICY* 164-232 (1954).

97. See *Brown Shoe Co. v. United States*, 370 U.S. 294, 315-16 (1962). See also Blake & Jones, *In Defense of Antitrust*, 65 COLUM. L. REV. 377, 381-84 (1965).

98. See *Brown Shoe Co. v. United States*, 370 U.S. 294, 344 (1962).

99. 15 U.S.C. § 13-13a (1976). See U.S. DEP'T OF JUSTICE, *REPORT ON THE ROBINSON-PATMAN ACT* (1977).

100. The new head of the Antitrust Division of the Department of Justice is William F. Baxter, Professor of Law at Stanford University.

101. See Silk, *Antitrust Issues Facing Reagan*, N.Y. Times, Feb. 13, 1981, at 28, col. 1.

102. See Singer, *Big Is Back in Favor - But Only If It Promotes Economic Efficiency*, Nat. Journal, April 4, 1981, at 573; Taylor, *Antitrust Nominee Says He Plans to Limit Agency's Role, Prosecute Price Fixers*, Wall St. Journal, Mar. 20, 1981, at 4, col. 3. If Professor Baxter does challenge mergers more selectively, a striking parallel with the Warren

Antitrust Division, coupled with the more restrictive approach of the current Supreme Court, can only mean further retrenchment of section 7.¹⁰³ Only time will tell whether the usefulness of anti-trust merger law in arresting industrial concentration will be severely undermined, or whether the combination of selective enforcement and strict construction will focus section 7 only on those acquisitions which are truly harmful to a competitive economy.

Court years may occur. If only the most obvious anticompetitive acquisitions are challenged, where no substantial efficiencies are likely, the Antitrust Division's decision to initiate an enforcement action will become paramount, just as in the Warren Court years when the government always won.

103. Some interesting parallels can be drawn between the beginning of the 1980's and the 1920's. A conservative government and a resulting freedom and respect for business produced virtually no § 7 enforcement in the 1920's, even in the face of a wave of merger activity. See TRADE REGULATION, *supra* note 69, at 429-31. The Supreme Court's approach to industrial concentration during this time can only be characterized as indulgent. See *United States v. Int'l Harvester Co.*, 274 U.S. 693 (1927); *United States v. United States Steel Corp.*, 251 U.S. 417 (1920). Of course the parallel ends when one remembers that the 1920's were a post-war boom economy. But it is interesting to speculate that similar political and judicial approaches may produce results comparable to the 1920's.

