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THE SUPREME COURT AND THE "NEW ECONOMIC REALISM" OF SECTION 7 OF THE CLAYTON ACT

by

Miles W. Kirkpatrick*

and

Stephen Paul Mahinka**

SECTION 7 of the Clayton Act prohibits corporate acquisitions "where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly." The body of antitrust doctrine relating to mergers between competing or potentially competing firms which has developed in the interpretation and application of the Delphic language of this statute has hardly been a model of clarity. The initial judicial decisions in the area provided little in the way of either reasons or rules. The Supreme Court responded to the uncertainty and the criticism which these decisions engendered by developing a series of very clear rules. The announced rules, while providing a measure of predictability, failed to provide a clearly articulated or convincing rationale. Although it is currently unclear whether the shape of merger jurisprudence will be significantly altered by the Burger Court, three recent decisions have led many in the antitrust community to conclude that there has been a change in the Supreme Court's view of corporate mergers. That there has been some change cannot be doubted. The question is, what is the degree of shift in judicial attitudes represented by these opinions? Do they portend a significant change or merely a minor shift in emphasis? Further, if these new decisions do signal a shift toward a "new economic realism" by the Court, is the body of economic doctrine to be relied upon

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5. The phrase refers to the explicit utilization of and reliance upon economic data and concepts in antitrust decision-making. Cf. Fox, supra note 2, at 390 & n.4.

coherent and widely accepted? As the senior author of this Article has recently observed, "the economic content and theoretical underpinnings of antitrust cases have historically been more significant than in other fields of law." To the extent that economic doctrine in this area is in a state of flux, considerable difficulty may be expected from an explicit and intrusive economic analysis in anti-merger cases.

The three new judicial decisions at issue are United States v. General Dynamics Corp., United States v. Marine Bancorporation, Inc., and United States v. Connecticut National Bank. As these decisions are quite well known, the factual situations will be sketched only briefly. This Article will then address the possible implications of the "new economic realism," which some have seen as implicit in these decisions, on governmental and private enforcement activity under section 7.

In United States v. General Dynamics Corp. the Court upheld a horizontal merger of two coal producers, each of which enjoyed a substantial share of a concentrated market. The Government proved that a small number of leading companies dominated the coal producing industry, that there had been a trend toward increasing concentration, and that the merger significantly enhanced the acquiring company's market share. While the Court acknowledged that under prior horizontal merger decisions this statistical showing was sufficient to make out a case of illegality, the Court reached back to the decision in Brown Shoe Co. v. United States, decided twelve years earlier, for the proposition that while market-share percentages are "the primary index of market power . . . 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."

The Court held that while the Government's statistical showing might have been sufficient to support a finding of "undue concentration" in the absence of other considerations, the district court was justified in finding that other pertinent factors affecting the coal industry and the defendants' business mandated a conclusion that no substantial lessening of competition occurred or was threatened by the acquisition. The acquired company, United Electric, did not have sufficient coal reserves, a key factor in measuring a coal producer's market strength, to make it a significant competitive force. Therefore, in terms of probable future ability to compete, rather than in terms of past production on which the Government relied, the district court's

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10. 415 U.S. at 494-96.
11. Id. at 497-98.
13. Id. at 322 n.38, quoted in 415 U.S. at 498.
14. 415 U.S. at 498.
conclusion that the merger did not violate section 7 of the Act was warranted. 15

Thus, the relevant statistical inquiry was on "uncommitted reserves of recoverable coal," because those were the sources of future competitive potential. Under that standard the Government failed to show that the acquired company had sufficient reserves to compete effectively for long-term contracts or that the firm might obtain new reserves. The Court conceded that the Government had raised the possibility that United Electric might obtain deep-mine or other strip-mine reserves, but relied on the district court's finding that such reserves were not presently available. 16 Moreover, the Court concluded:

The mere possibility that United Electric, in common with all other companies with the inclination and the corporate treasury to do so, could some day expand into an essentially new line of business does not depreciate the validity of the conclusion that United Electric at the time of the trial did not have the power to compete on a significant scale for the procurement of future long-term contracts, nor does it vest in the production statistics relied on by the Government more significance than ascribed to them by the District Court. 17

Three months after the decision in General Dynamics the Supreme Court handed down decisions in two bank merger cases 18 involving the potential competition doctrine. 19 The Burger Court decided United States v. Marine Bancorporation, Inc. by affirming the judgment for defendants, but vacated and remanded the district court determination in United States v. Connecticut National Bank.

In Marine Bancorporation the Government challenged the acquisition of a state-chartered bank, the third largest bank in the concentrated Spokane, Washington, market, by a large nationally-chartered bank whose principal office was located in Seattle, Washington. The Government charged that the merger (1) eliminated the likelihood that the acquiring bank would have

15. Id. at 501-04.
16. Id. at 509.
17. Id. at 509-10.
entered the Spokane market de novo or by toehold acquisition; (2) ended the acquiring bank's present pro-competitive effect on the edge of the Spokane commercial banking market; and (3) ended the probability that the acquired bank would have developed independently or by smaller acquisitions into a regional and ultimately statewide actual competitor of the acquiring bank as well as other large banks. 20 In an opinion by Justice Powell the Court held that in applying the potential competition doctrine to commercial banking "courts must take into account the extensive federal and state regulation of banks, particularly the legal restraints on entry unique to this line of commerce." 21 The legal barriers to entry into the banking market in Washington, notably a state law prohibition against de novo branching, against branching from a branch office, and against multi-bank holding companies, compelled the Court to conclude that the challenged merger was not in violation of section 7 of the Clayton Act. 22

As to the question of geographic markets, the Court ruled that only the Spokane metropolitan area was relevant, and rejected the Government's contrary contention that the entire state was the relevant market. The Court noted that in prior section 7 cases "section of the country" had been consistently equated with "relevant geographic market," a term which has traditionally been defined as the area in which the goods or services are marketed by the acquired firm. 23 Thus, while there may be several relevant geographic markets, each must be shown to be an "area in which the acquired firm is an actual, direct competitor." 24 The Court also concluded that the Government's state-wide approach was "simply too speculative on this record," 25 particularly since section 7 deals in "'probabilities' not 'ephemeral possibilities.' " 26 Although the market concentration ratios in Marine Bancorporation were high, thereby justifying a presumption that the market was not vigorously competitive, the Court stated clearly that the defendant banks nevertheless were entitled to attempt to prove that "the concentration ratios . . . did not accurately depict the [market's] economic characteristics . . . ." 27 In this connection Justice Powell cited General Dynamics for the proposition that such statistics "can be unreliable indicators of actual market behavior." 28 Finally, in light of the legal barriers preventing entry into the Washington banking market, the Court held that the Government failed to sustain the burden of proof that the challenged merger violated section 7 since neither of the proposed alternative methods of entry, de novo or a foothold acquisition of a small state bank in the Spokane area, was feasible or offered a

20. 418 U.S. at 632-41. The first theory of illegality had been expressly left open the year before in United States v. Falstaff Brewing Corp., 410 U.S. 526, 537 (1973). The Court again declined to reach the question. 418 U.S. at 639.
21. 418 U.S. at 606.
22. Id.
24. 418 U.S. at 622.
25. Id.
27. 418 U.S. at 631.
28. Id.
substantial likelihood of ultimately producing deconcentration in the Spokane market or other significant pro-competitive effects.29

In Connecticut National Bank the Government challenged a proposed consolidation of the fourth and the eighth largest commercial banks operating in adjoining regions of Connecticut. The Court vacated and remanded the decision of the district court and relied on Marine Bancorporation, decided the same day, to hold that the relevant geographic market was not the state as a whole.30 The Court noted that the Government had the burden to produce evidence defining localized banking markets.31

The interesting question concerning these decisions is not the impact of these cases on coal markets or on mergers in the banking field or on other fields in which entry is regulated. Rather, the question is whether these cases demonstrate a change in the outlook of the new Supreme Court majority toward section 7 of the Clayton Act. Do these decisions indicate a change in the nature of the questions asked concerning the legality of corporate mergers? Are the standards of illegality to be applied in merger cases to be significantly changed? In short, is there, as Justice White, dissenting in Marine Bancorporation, feared, a “new antitrust majority” with a significantly different outlook and approach to section 7 of the Clayton Act?32

These cases need not be read as having far-reaching consequences. General Dynamics, for example, is hardly a run-of-the-mill horizontal merger case. The limited supply situation and the requirements contract method of marketing, standard in the coal industry, are not typical. In addition, United Electric was in an unusual competitive position, having committed virtually all its coal reserves by long-term contracts.33 Therefore, the case can be read narrowly as a unique application of section 7 with little precedential significance. Support for this view “can be inferred from the absence of any express disagreement on the majority’s part with any of the Court’s earlier section 7 decisions.”34 Similarly, the analysis set forth in the bank merger cases could easily be viewed as limited to commercial banking or to other industries with regulated growth potential.35 A strong argument may be made, however, that in the past two or three years, with the Warren Court majority becoming the Burger Court minority, the judicial attitude toward interpretation of section 7 of the Clayton Act has shifted toward a “new economic realism.”36 In the view of several distinguished commentators in the antitrust area these cases may herald a new approach to section 7, and a new and higher threshold of illegality.37

29. Id. at 638-39.
30. 418 U.S. at 666.
31. Id. at 669-70.
32. 418 U.S. at 642 (White, J., dissenting).
34. For this view see Comment, supra note 19, at 979.
35. See note 5 supra. There is no reason to suspect that the appointment of Justice Stevens will reverse this apparent trend.
36. See, e.g., Fox, supra note 2, at 390, 413; Posner, supra note 2, at 310-11; Robinson, supra
At a minimum, these decisions indicate that the Warren Court's strict enforcement approach has been diluted. The stark fact is that *General Dynamics* and *Marine Bancorporation* are decisions squarely against the Government.\(^{38}\) If the "new antitrust majority" proceeds in the manner foreshadowed by these decisions, then the desirability of corporate mergers may be evaluated much more favorably, and, as a consequence, a private or governmental plaintiff may be required to prove with greater certainty that the merger probably will cause measurable or objectively probable anti-competitive effects.\(^{39}\)

This apparent shift in point of view has several significant implications. The most important are that the shift diminishes the predictability of the legality of a particular merger and escalates the plaintiffs' burdens as fewer presumptions may be made in the plaintiffs' favor. Should economic inquiry become more far-reaching, anti-merger activity will be more time-consuming, more costly, and more difficult. Should this new economic emphasis become the direction of future merger analysis, an increase in types and complexity of the economic data that must be produced by either governmental or private plaintiffs will result, and the ultimate effect will be to place defendants in a more favorable position.

Some indication of the potential consequences of a shift in outlook may be gleaned by a comparison of the analysis used in these new decisions with the traditional antitrust analysis of mergers by the Warren Court. The first opinion handed down by the Supreme Court under the amended section 7 was *Brown Shoe Co. v. United States*,\(^{40}\) in which the Court unanimously held that Brown Shoe Company's merger with G.R. Kinney Company violated section 7. Rather than attempting to formulate a definite standard of illegality, the Court enumerated a disparate set of relevant factors,\(^{41}\) including congressional concern with the "rising tide of economic concentration."\(^{42}\) The Court also stressed that Congress wanted to prevent only those mergers "having demonstrable anticompetitive effects," noting that the statute's concern was "with the protection of competition, not competitors . . . ."\(^{43}\) The Court concluded that Congress had rejected any simple rule of illegality, but noted that congressional deliberations reflected the "conscious avoidance of exclusively mathematical tests."\(^{44}\) As one distinguished commentator, Professor Posner, observed, "in *Brown Shoe* . . . one has no sense that the Court has any notion of how a nonmonopolistic merger might affect competition."\(^{45}\)

\(^{38}\) Justice Stewart, reviewing the unbroken series of government victories in the Supreme Court under the amended §7, was moved to comment that the "sole consistency... in litigation under §7 [is that] the Government always wins." United States v. Von's Grocery Co., 384 U.S. 270, 301 (1966) (Stewart, J., dissenting).

\(^{39}\) See Fox, supra note 2, at 423.

\(^{40}\) 370 U.S. 294 (1962).

\(^{41}\) Id. at 316-23.

\(^{42}\) Id. at 317.

\(^{43}\) Id. at 319-20 (emphasis in original).

\(^{44}\) Id. at 321 n.36.

\(^{45}\) Posner, supra note 2, at 304. Professor Kauper, formerly Chief of the Antitrust Division of the Department of Justice, has referred to *Brown Shoe* as "perhaps . . . the most radical of the
Although it followed Brown Shoe by only a year, the Court's opinion in United States v. Philadelphia National Bank rested on a much different concept of section 7. While the Court in Brown Shoe rejected any simple quantitative test of illegality, the Court in Philadelphia National Bank cited several factors motivating the adoption of a structural market test of illegality, including the desire "to avoid the difficulties of dealing with the complex and elusive pertinent economic data, to provide the predictability needed for business planning, and to avoid overly broad economic investigations that might subvert the congressional intent that antitrust questions be resolved expeditiously." Therefore, the Court declared that a merger which (1) created a firm having thirty percent of the market, and (2) thereby increased concentration among the leading firms by at least one-third, was presumptively unlawful. Only three years later, the Court ignored the test espoused in Philadelphia National Bank and held in United States v. Von's Grocery Co. that the acquisition of a retail grocery supermarket chain was a violation of section 7, even though the market was competitive and fragmented. There had been a marked decline in the number of independent small firms, a fact which the Court emphasized by stating that "the basic purpose of the [Clayton Act] was to prevent concentration in the American economy by keeping a large number of small competitors in business."  

Such analyses, while inconsistent and lacking a coherent economic rationale, do have the common aspect of favoring the imposition of liability under section 7. This series of decisions, providing plaintiffs with a virtual presumption of illegality regarding challenged mergers, was apparently impaired by the decisions in General Dynamics and Marine Bancorporation. If the single outstanding characteristic of section 7 law prior to the advent of a "new antitrust majority" was "the extent to which the courts were willing to draw inferences of anti-competitive effect from the evidence which the government presented," then the most striking feature of the new antitrust decisions is the shift in the burden of proof regarding the probability of anticompetitive effects of the merger and the requirement of an examination of the particular market instead of reliance upon market-share percentages.

47. Comment, supra note 19, at 984; see 374 U.S. at 362.
48. 374 U.S. at 363-65. This sort of structural test forms the basis of the Department of Justice Merger Guidelines, which define a "highly concentrated" market as one in which the shares of the four largest firms amount to approximately 75% or more, and which set percentage shares for acquired and acquiring firms above which the Department "will ordinarily challenge mergers . . . ." Merger Guidelines of Department of Justice, 1 Trade Reg. Rep. ¶ 4510, at 6884 (1975).
50. Id. at 275.
51. See note 37 supra.
52. Williams, supra note 34, at 968.
54. An exhaustive recent opinion in United States v. Black & Decker Mfg. Co., 1976-2 Trade Cas. ¶ 61,033 (D. Md. 1976), relied on Marine Bancorporation to uphold the acquisition of a leading manufacturer of gasoline-powered chain saws by the leading manufacturer of portable electric tools. The court stated that a "trend away from exclusive reliance on concentration ratios and structural analysis [was] discernible . . . ." Id. at 69,574 n.27. See United States v. International
Certainly the Burger Court has departed from precedents established by the Warren Court in holding that sole reliance on concentration ratios to demonstrate the lack of competition would be inadequate when the defendant introduces evidence of competitive market conduct. Both General Dynamics and Marine Bancorporation sanctioned the introduction of evidence by the defendants showing that, given the particular characteristics of the markets involved, the Government's market-share statistics did not represent actual market power. The ability to use this evidence thereby undercuts the determination in Philadelphia National Bank that a structural test of concentration was sufficient to establish market power. One commentator has concluded that Marine Bancorporation "graphically illustrates the present Court's unwillingness to accept, without evidentiary support, economic theory and mere possibilities of anticompetitive impact as dispositive of a section 7 case." This apparent shift in the magnitude and burden of proof required to establish a violation of section 7 should result in making more difficult the successful pursuit of either governmental or private anti-merger suits. The resulting escalation in the burden of proving that a merger "may substantially lessen competition" within the meaning of section 7 was recognized and criticized by the dissenters in Marine Bancorporation.

As to governmental enforcement activity, consideration of the possible impact of the analysis presented by these new judicial decisions on the type of situation dealt with in the two recent FTC decisions of In re The Budd Co. and In re British Oxygen Co. may be useful. In Budd the Commission reversed an administrative law judge's initial decision that the acquisition of the Gindy Manufacturing Corporation by The Budd Company violated section 7 of the Clayton Act. The Commission held that the acquisition by Budd was a pro-competitive toehold acquisition in an industry dominated by


54. See Comment, supra note 19, at 983.
55. Cf. the statement in General Dynamics that the "structure, history, and probable future" of an industry was a more relevant concern than market shares. 415 U.S. at 498.
56. Robinson, supra note 34, at 254.
60. [1973-1976 Transfer Binder] TRADE REG. REP. at 20,857. The administrative law judge found that Budd was one of the most likely potential entrants into the manufacture and sale of van trailers, closed-top dry freight van trailers, open-top van trailers, and containers and container chassis, and that, by acquiring Gindy, Budd eliminated itself as a substantial potential competitor in these markets.

national companies. The Commission established a general rule in potential competition cases that "firms possessing no more than ten percent in a target market . . . should ordinarily be presumed to be toehold or foothold firms." The presumption is not conclusive, and the inference of lack of anti-competitive effects flowing from acquisition of such a firm can be rebutted in particular cases.

In British Oxygen the Commission held that the acquisition by British Oxygen Company of thirty-five percent of the stock of a United States Company, Airco, Inc., violated section 7 by eliminating the acquiring manufacturer as a potential entrant in the United States industrial gases market. The Commission stated that the acquisition also removed the British firm's presence on the fringe of the market, which might have had some disciplining effect on United States market prices in the future even though there was no evidence of any such disciplining effect prior to the acquisition. The Supreme Court expressly reserved decision on whether an acquisition having no immediate market effects except the elimination of a future entrant could violate section 7.

The approach of these two cases to the problems of dealing with the entrance into a market of a firm which may be considered, at least in hindsight, to have been a potential entrant is essentially one of minimizing difficulties of proof. To the extent that the burden of proof is shifted to the Government in such cases, serious difficulties will be encountered. As Professor Posner has noted, "if the government is required to prove that in fact the elimination of a given potential competitor altered the structure of competition in the market it will always fail" since we do not know how to measure the entry costs of different firms or to establish reliably the perceptions of the firms in the market.

The alternative to requiring proof on these costs and perceptions is to adopt presumptions. Thus far, the Government has been able to devise only the presumption that the acquisition of a firm shows that the acquirer was perceived, at the least, as more likely than other firms to enter the market by internal expansion or toehold acquisition. Posner concluded that this presumption "is, if anything, contrary to the probabilities" and that a "more sensible presumption would be that the acquiring firm was less inclined than at least some other firms to enter the market by internal expansion." Should this contrary presumption be accepted, the chances of the Government's

63. Id. at 20,857.
64. Id. The Commission did not, however, specify what rebuttability would entail. See 89 HARV. L. REV. 800, 807 (1976). As to burdens of proof see Fox, supra note 61, at 583-84; 89 HARV. L. REV. at 805 & n.37.
67. Id. at 20,916-18; see note 20 supra.
68. Posner, supra note 2, at 324.
69. Id. (emphasis in original).
prevailing in a potential competition suit would be virtually nil given the difficulties of providing adequate proof.

Thus far, this Article has attempted to demonstrate the potential impact of a "new economic realism" in certain areas of merger jurisprudence. A "new economic realism" may have additional effects, however, which have not been commonly realized. For example, an increase in the use of and reliance upon economic data and concepts in decisions under section 7 may reveal that the economic concepts and categories through which lawyers will try and judges will decide merger cases are not widely accepted but rather are subjects of serious dispute.

That the phrase "new economic realism" refers to the utilization of economic data in antitrust decision-making in accordance with accepted economic doctrine and concepts appears to be a common assumption. In recent years, however, whatever developing scholarly consensus regarding antitrust concepts that had existed has now given way to disputes in several key areas. The effect of the existence of such disputes among economists concerning a wide range of important concepts has thus far apparently escaped general notice. Nevertheless, in light of the decisions in General Dynamics and Marine Bancorporation the presence of discordant views is of great importance to the extent that the judiciary is consciously concerned with realistically evaluating the economic effects of a corporate merger as a means of testing the merger's legality under section 7 of the Clayton Act. While these controversies ultimately may have affected the judicial approach of the Warren Court, they will have an impact much sooner than they otherwise would have had and sooner than many may now suspect as a result of the nature of the inquiry and apparent focus of concern of the "new antitrust majority."

The basic theories underlying antitrust enforcement in recent years have been derived from the structure-conduct-performance model developed by industrial organization economists. This model holds that the structure, conduct, and performance aspects of an industry are closely linked to each


71. To the extent that the courts and the enforcement agencies fail to deal with these discordant views in antitrust decision-making, the system fails to meet a basic test of economic rationality. See Williamson, Economies as an Antitrust Defense: The Welfare Tradeoffs, 58 Am. Econ. Rev. 18, 34 (1968).


Structure refers to those relatively stable and permanent characteristics of the industry, such as number and makeup of industry members, industry concentration, and the nature and extent of entry barriers. Conduct refers to the competitive business practices undertaken by the members of a particular industry. Finally, performance refers to the economic results produced by an industry with desirable economic performance generally being identified with the maximum output of goods, at the lowest prices, with technological progressiveness and efficiency, and a full rate of employment. See Mueller, The New Antitrust: A "Structural" Approach, 12 Vill. L. Rev. 764, 766 n.7 (1967).
other; the model focuses on market structure "because the structure determines the behavior [conduct] of firms in the industry, and that behavior [conduct] in turn determines the quality of the industry's performance."73 The conclusion based on this model has been that "an industry which does not have a competitive structure will not have competitive behavior."74 Arguably, this model has provided the theoretical basis for such recent structural antitrust cases as the actions by the Federal Trade Commission against the four major cereal companies75 and the eight leading petroleum companies,76 and the complaint brought by the Department of Justice against American Telephone and Telegraph.77 Increasingly, however, the structural model has been perceived to be less than a satisfactory explanation of industrial organization and behavior.78

The structural approach holds that when concentration reaches a certain level, the effects on competition will be adverse.79 In order to determine what the competitive effect of any acquisition might be in section 7 cases, numerical measures of concentration have increasingly come to be relied upon by courts, the Federal Trade Commission, and the Department of Justice. The measure of economic concentration most frequently used by lawyers and economists in horizontal merger cases is the four-firm concentration ratio.80

73. R. CAVES, supra note 72, at 17.
79. See P. AREEDA, ANTITRUST ANALYSIS 669-82 (2d ed. 1974).
80. See Merger Guidelines of Department of Justice, 1 TRADE REG. REP. ¶ 4510, at 6884 (1975).
This is a percentage figure representing the aggregate market share of a given number of leading firms in an industry, generally the percentage of the market accounted for by the top four firms. One commentary has observed that:

the structure of this ratio is so simple and intuitively appealing that there has never been a satisfactory analysis of its utility for resolving antitrust issues. This omission has become increasingly important as the Court has come to rely more heavily on economic statistics interpreted through concentration ratios.\(^8\)

Should a “new economic realism” become a major influence in decisions in merger cases, the difficulties in measuring competitive effects through the use of the four-firm concentration ratio or, indeed, through other possible measures, become even more significant as avoiding detailed consideration of which of the several alternative measures is appropriate in a particular case will be difficult.

There are several disadvantages to the four-firm concentration ratio as the measure of concentration. The ratio does not reflect changes in the market shares of the four leading firms when their aggregate market share remains unchanged, or changes involving the market share of the remaining firms in the industry when their aggregate share remains unchanged. Yet, these changes can be of considerable economic importance.\(^8\) For example, two industries may show the same ratio, even though in the first industry the top four firms are of equal size, while one or two large firms may dominate in the second industry. Similarly, the remaining market may be divided among few or many firms. The competitive behavior of firms in such markets will differ considerably even though in all cases the first four firms may have the same aggregate percentage share. The use of the four-firm concentration ratio to measure a single change in firm sizes resulting from an acquisition presents other difficulties, as the ratio reflects only an arbitrarily chosen number of firms.\(^\)\(^8\) The four-firm concentration ratio thus has “fundamental defects when used to measure either economic trends or the effects of a single horizontal merger.”\(^8\)

Other suggested measures of concentration,\(^8\) including, for example, the Herfindahl index,\(^8\) are superior because they reflect both relative and

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\(^8\) Id. at 680.

\(^8\) Id.

\(^8\) Id. at 682-83. *See also* B. *Bock, Concentration, Oligopoly and Profit: Concepts vs. Data* 15-16 (1972).

\(^8\) Various alternative measures of concentration include: the Lorenz curve, which takes into account the total number of firms in an industry and shows the percentage of total industry sales (or some other variable) accounted for by any given fraction of the total company production; the Gini coefficient, which measures the departure between the Lorenz curve actually observed and the curve which would appear if all firms had equal market shares or sales; and the relative mean deviation intercept, which measures the extent to which the assets of each member firm differ from the assets of the average-sized firm in the industry or the mean value of the total industry assets. These alternative measures are discussed and evaluated in P. *Asch, Economic Theory and the Antitrust Dilemma* 150-58 (1970); D. *Needham, Economic Analysis and Industrial Structure* 83-96 (1969); F. *Scherrer*, *supra* note 72, at 50-57; E. *Singer, Antitrust Economics* 136-56 (1968); Marfels, *A Bird's Eye View of Measures of Concentration*, 20 *Antitrust Bull.* 485 (1975).

\(^8\) The Herfindahl index is a concentration measure that takes into account both the number of firms and the size inequality among the firms. It is defined as:
absolute concentration and are not dramatically affected by the entry or exit from the market of a firm of negligible size. Several theorists have suggested that the degree of market power and the probability of anti-competitive behavior will be influenced by the degree of size disparity among oligopolistic firms. They conclude that:

size inequality among large firms in an industry is an important structural element because it can affect the degree of oligopolistic interdependence and discipline. Significant disparity in size among the large firms influences the degree of dominance which the largest firm or firms exercise over the price and output decisions of the other firms. In other words, size disparity can be expected to affect the nature of competitive forces in the industry.

A measure of concentration which does take into account the size inequality among the leading firms in an industry has been considered to be “a more discriminating index of concentration.”

An illustration of how the use of a different measure of concentration may affect the legality of corporate mergers may be useful. A merger by an already dominant firm automatically increases concentration in the market and leads to a change in the size inequality among those dominant firms. If a substantial reduction in size inequality results, a court, arguably, should approve the merger on the grounds that less asymmetry produces greater rivalry, with the increased rivalry acting as a trade-off against the increase in concentration.

Such an approach is particularly useful when a market is dominated by one or two large firms and when even the next largest firms are forced to consolidate in order to maintain their competitiveness. For the courts to make this judgment, however, requires the application of a measure of concentration which is sensitive to such considerations.

The question of the appropriate measure of concentration was addressed directly in only one case prior to General Dynamics and Marine Bancorporation. In that case, In re Litton Industries, Inc., the Federal Trade Commiss-

\[ H = \sum (x_i/X)^2 \]

\( x_i \) is the size of firm \( i \) (in terms of value of shipments, assets, or any other market base) and \( X \) is the total size of the industry, the market base held by all firms. As Asch states: “In other words, the Herfindahl index is the sum of the squares of the size of each firm in an industry, where firm size is expressed as a percentage of the industry; that is, the sum of the squares of the market share of each firm.” P. ASCH, supra note 85, at 155 (emphasis in original); see F. SCHERER, supra note 72, at 51-52; E. SINGER, supra note 85, at 152-54.


90. See Hexter & Snow, supra note 87, at 419.

91. See id. It should be noted that the Herfindahl index is extremely insensitive to the market effect of small firms. See P. ASCH, supra note 85, at 156; Finkelstein & Friedberg, supra note 81, at 706-07.

92. 82 F.T.C. 793 (1973). Subsequent to the Court’s decisions in General Dynamics and Marine Bancorporation the defendants in United States v. Black & Decker Mfg. Co., 1976-2 Trade Cas. ¶ 61,033 (D. Md. 1976), advocated use of the Herfindahl index in lieu of four-firm concentration ratios. The Herfindahl index showed a trend to decline in concentration in the relevant market. The court declined to use the Herfindahl index stating:

The critical problem with the Herfindahl index, aside from its non-recognition by courts which have uniformly used concentration ratios and its concomitant lack
sion ordered a large conglomerate corporation to divest itself of an acquired competing manufacturer of typewriters. The hearing examiner had dismissed the complaint, stating that under the Herfindahl measure of concentration the effect of the merger on market concentration was insignificant. The traditional two- and four-firm concentration ratios were rejected as a "fallacy" which leads to "misleading and erroneous conclusions" since there were firms with extremely high market percentages in both of the relevant lines of commerce. Reversing the decision of the hearing examiner, the Commission concluded that no compelling reason existed to ignore the traditional four-firm concentration ratio analysis which was "well suited for the purpose of merger law enforcement." The decision in Litton Industries was later modified, with the result that the acquired manufacturer did not have to be divested.

No specific comment was made upon whether the Commission's view on the proper measure of concentration had changed. The Commission stated, however, that "no significant increase in concentration" resulting from the retention of the acquired manufacturer was then seen, and observed that the relevant markets would remain dominated by a single firm.

Once the degree of market concentration has been assessed, consideration must be given to the implications arising from that market concentration. At one time, a generally accepted proposition was that if one seller had at least twenty to twenty-five percent of the sales in his market, a serious danger existed that the market price would be above the competitive level. The of comparability to data from earlier authority, is that one or two firms could have sizable market shares but if enough small, insignificant firms existed, the market could appear relatively deconcentrated. The competitive effect of these small firms might well be marginal, but the Herfindahl index by reflecting them, could significantly distort by underestimation the market power of the leading firms. 

Id. at 69,577 n.38. Given that the Herfindahl index is extremely insensitive to the market effect of small firms, the court's analysis and conclusions appear highly questionable. See note 91 supra.

93. 82 F.T.C. at 1014-15.
94. Id. at 969-70.
95. Id. at 904-07.
96. Id. at 1010.
98. Id. at 20,718.

Rhoades notes, however:
There is widespread agreement, among students of industrial organization, that industry concentration is an important determinant of industry profit performance. Unfortunately, neither economic theory nor existing empirical evidence is clear as to the nature of the concentration-profitability relationship.

Rhoades, The Concentration-Profitability Relationship: Policy Implications and Some Empirical Evidence, 18 ANTITRUST BULL. 333, 354 (1973). For additional commentary see Winn & Leabo, Rates of Return, Concentration and Growth—Question of Disequilibrium, 17 J.L. & ECON. 97 (1974). A considerable number of recent studies have cast doubt on the significance of the relationship between profits and concentration or prices and concentration. See H. Demsetz, THE MARKET CONCENTRATION DOCTRINE (1973); Peltzman, Profit Data and Public Policy, in PUBLIC POLICY TOWARD MERGERS 128 (J. Weston & S. Peltzman eds. 1969); Demsetz, supra note 78; Handler, supra note 77, at 223-29. Professor Brozen has concluded that there "is no
premise that "competition is likely to be greatest when there are many sellers, none of which has any significant market share," which formed the basis of the statistical shortcut approved by Philadelphia National Bank, was found by Justice Brennan to be "common ground among most economists." As Professor Posner has noted, "this scholarly consensus has collapsed." While much economic literature may be found in support of the proposition that a concentrated market will invariably result in anticompetitive behavior, many recent examinations by economists have cast doubt on the validity of this proposition, and, at the very least, the proposition "is open to legitimate debate." It remains to be seen whether the Supreme Court will now permit the defendant in a horizontal merger case to show that the relevant market, though concentrated, behaves not anti-competitively as dictated by economic theory, but in a highly competitive fashion, "and whether such proof is sufficient to rebut the Philadelphia National Bank presumption that an increase in concentration tends to substantially lessen competition." Nevertheless, Justice Powell's citation in Marine Bancorporation of General Dynamics for the principle that the degree of concentration does not always reflect the way the market as a whole actually behaves may allow for the introduction of such evidence.


100. 374 U.S. at 363.
102. See note 72 supra.
103. See note 99 supra. See also J. McGee, In Defense of Industrial Concentration (1971).
104. Robinson, supra note 34, at 252.
105. Id.
potential competition, for example, has come under severe attack by many as providing neither a theoretical nor an empirical basis "for believing that the elimination of a specific potential competitor has ever affected the price level of a market."¹⁰⁸ No particular resolution of these various economic controversies is urged; rather, an attempt has been made to point out these disputes in an effort to illustrate that conflict exists concerning very fundamental concepts which are relied upon in the antitrust analysis of merger cases.

A "new economic realism" by courts in anti-merger cases will both stimulate the use of economic data concerning market characteristics by defendants in antitrust litigation and demonstrate the current limitations of economic analysis for the antitrust area.¹⁰⁹ A proper response by antitrust specialists to the challenges posed by a "new economic realism" is the exercise of greater creativity than has been characteristic of the antitrust bar heretofore. Professor Posner has commented:

Whereas the lawyers for the Justice Department have been ingenious in proposing new theories of liability, the defense bar has been on the whole timid and unimaginative in proposing alternative theories of business behavior and standards of liability. The typical defense posture in a case is to accept the theoretical basis of the Government's position but try to show that the defendant did not in fact commit the act complained of. As a result, the Government's constant pressure to expand the grounds of antitrust liability has met little resistance from the defense bar.¹¹⁰

hand, Professor Spence agrees with Markovits' conclusions that "the nature of competitive interaction in an industry is determined by a rich collection of structural features of markets, and that "competition is multidimensional, occurring in many dimensions other than price . . . ." Spence, Markovits on Imperfect Competition, 28 STAN. L. REV. 915, 918 (1976); see Markovits, A Response to Professor Posner, 28 STAN. L. REV. 919 (1976); cf. Asch, Collusive Oligopoly: An Antitrust Quandary, 2 ANTITRUST L. & ECON. REV. 53 (1969).


To the extent that a determination of illegality under section 7 is made following an examination of particular market characteristics which may indicate the presence of competition, as in *General Dynamics*, defense counsel has the opportunity to present to the Court economic evidence and concepts not yet a part of merger jurisprudence. For example, there is some evidence which suggests that there are significant pro-competitive consequences of entry into a market through mergers. Similarly, scholarly thinking on the costs of preventing mergers is also in a state of flux. Measures of concentration other than the traditional four-firm ratio may be suggested as more appropriate in particular contexts.

Whether the Supreme Court's decisions in *General Dynamics* and *Marine Bancorporation* in fact represent a significantly different approach to section 7 of the Clayton Act is by no means clear. To the extent that they do represent a changed outlook, however, several significant consequences are apparent. An attempt has been made herein to outline the nature and impact of some of these possible consequences, and to suggest that an emphasis on economic realism may inevitably hasten the reconsideration of several fundamental economic concepts which traditionally have provided the categories for antitrust analysis.

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113. See text accompanying notes 82-91 *supra*. 