1966

Reciprocal Dealing in Conglomerate Mergers

Teddy M. Jones Jr.
breach with appropriate legislation. Until this dispute is resolved, there will remain the possibility of unjust results where "[state laws] which are designed to protect innocent persons dealing in faith on the revelations of title records are twisted to permit the great national sovereign to take property from one who is the acknowledged owner of it to apply on the tax debts of another . . . who has transferred the property."

John M. McMullen

Reciprocal Dealing in Conglomerate Mergers

I. TYPES OF MERGERS

For purposes of antitrust law there are three basic types of mergers: (1) vertical, (2) horizontal, and (3) conglomerate. Generally, mergers are effected by acquisition of either stock or assets. An economic arrangement between companies in a supplier-customer relationship is termed vertical. A vertical merger refers to an expansion directed toward control of raw material suppliers or toward acquisition of product outlets. Its primary vice results from tying a customer to a supplier, thus foreclosing competitors of either party from a previously open market segment.

A horizontal merger is aimed at absorption of a company in the same general product line. These combinations offer the greatest probability of anti-competitive effects. By combining business powers operating in the same or nearly indistinguishable product areas, horizontal mergers limit competition almost by definition and should be subject to much closer scrutiny than should either the vertical or the conglomerate.

A conglomerate merger is a hybrid, a unique combination often retaining some features of either horizontal or vertical arrangements. Because of this wide range of possible relationships, no exact definition of a conglomerate merger can be given. In a general sense, conglomerate mergers can best be defined as all mergers neither horizontal nor

---

2 Id. at 323-25.
3 Id. at 334.
4 Turner, Conglomerate Mergers and Section 7 of the Clayton Act, 78 Harv. L. Rev. 1313, 1322 (1965).
vertical. The conglomerate usually relates to the entry of a large, diversified firm into a new product line. The theory is that in the conglomerate each product line is but a single segment of a diversified corporate structure, and thus short-term losses can be incurred with impunity by balancing them against profits from alternate, well-established lines. The mere substitution of a large concern as the owner of a competing enterprise may lessen market vitality because of the large firm's retaliatory power. Fear of an extended price war may keep smaller firms in line with desired pricing policies, marketing techniques, or geographic market divisions. Also, a conglomerate company is often able to effect substantial increases in sales of either its products or the acquired firm's products through reciprocal dealing. Companies desiring to sell their products to the conglomerate structure may be forced to reciprocate in purchasing their requirements of other merchandise from it. A diversified product structure in a conglomerate firm lends itself to such reciprocal purchasing by and from other companies in related fields.

II. Section 7 of the Clayton Act

The original section 7 of the Clayton Act was directed only at combinations accomplished through stock acquisition. Any merger effected by a purchase of assets was beyond its scope. In addition, officials charged with enforcing the Clayton Act refused to direct its sanctions toward any mergers except those between directly com-

---

5 Id. at 1315. The two types of conglomerate mergers are: The "pure" conglomerate in which there is no discernible economic relationship between the acquiring and acquired firm and the "mixed" conglomerate (the type at which anti-trust actions are directed) which may involve horizontal or vertical relationships or both. Id. at 1315-16.
6 Id. at 1322-23.
8 The original § 7, 38 Stat. 731 (1914), read in relevant part as follows:
   No corporation engaged in commerce shall acquire, directly or indirectly the whole or any part of the stock or other share capital of another engaged also in commerce, 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, or to restrain such commerce in any section or community, or tend to create a monopoly in any line of commerce.
peting companies." Thus, vertical integration was thought to be beyond the scope of section 7 as originally enacted.

In 1950 Congress amended section 7 to include asset-acquisition mergers. The section now reads in relevant part:

No corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another corporation engaged also in commerce, where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.

Not only did Congress expand the scope of the act to include asset mergers, but also it apparently intended to proscribe vertical combinations which tended to create a monopoly or to lessen competition. Congress evidently wished to fashion an antitrust weapon which could be aimed at all mergers tending toward a substantial lessening of competition. Thus, the fusion of relatively unrelated businesses, the conglomerate merger, was brought within the effective range of the amended section.

In actions under section 7, the courts have recognized that the provision is primarily, though not absolutely, concerned with the probability rather than the certainty that competition will be retarded. This primary concern makes possible the arrest of any combination in restraint of trade in its incipiency. But the emphasis on probabil-

---

13 See cases and authorities cited note 10 supra.
14 In 1957, however, the Supreme Court in United States v. E. I. du Pont de Nemours & Co., 353 U.S. 186 (1957), Note, 12 Sw. L.J. 128 (1958), held the original section to apply to vertical integrations. Further expanding the original provisions, the Court held that companies did not have to compete directly to be subject to the sanctions of § 7. According to the decision, the merger was within the scope of § 7 if the effect of the merger was to restrain commerce or to create a monopoly. Congressional amendment in 1950, 64 Stat. 1125, eliminated the requirement that "competition between the corporation whose stock is ... acquired and the corporation making the acquisition" must be lessened.
15 "The purpose of the proposed legislation is to prevent corporations from acquiring another corporation by means of the acquisition of its assets, whereunder [sic] the present law it is prohibited from acquiring the stock of said corporation." S. Rep. No. 1175, 81st Cong., 2d Sess. 2 (1950).
20 See, e.g., United States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963). A merger was invalidated under § 7 because it would have resulted in one bank's controlling at least 30% of the commercial bank business in the four-county Philadelphia area.
ity does not preclude an action under section 7 after such restraint has become a reality. The justification for action after a merger has become a fait accompli is usually couched in terms referring to a threat which only recently has become apparent. Preoccupation with "probabilities" does not open the door to prohibitions based upon mere "possibility" that restraint of trade would actually take place. "Reasonable probability" is the criterion most often employed by the courts.

In applying the section to specific cases, the areas of effective com-


To accomplish the congressional aim, the Government may proceed at any time that an acquisition may be said with reasonable probability to contain a threat that it may lead to a restraint of commerce or tend to create a monopoly of a line of commerce. Even when the purchase is solely for investment, the plain language of § 7 contemplates an action at any time the stock is used to bring about... the substantial lessening of competition.

Id. at 597-98.

32 "Prior cases under § 7 were brought at or near the time of acquisition. None of these cases holds, or even suggests, that the Government is foreclosed from bringing the action at any time when a threat of the prohibited effects is evident." Id. at 598.

33 But cf. United States v. Penn-Olin Chem. Co., 378 U.S. 158 (1964), on remand 246 F. Supp. 917 (1965). Pennsalt Chemical Company and Olin Mathieson Chemical Company formed a joint venture to form a third corporation, Penn-Olin Chemical Company. The purpose of this new entity was to manufacture and sell sodium chlorate in the southeastern part of the United States. The United States District Court for the district of Delaware originally dismissed the government's complaint, and an appeal was taken by the government to the Supreme Court. A divided Court remanded the case for a determination of whether potential competition had been eliminated by the joint venture. Mr. Justice Clark, speaking for the majority, said:

Certainly the sole test would not be the probability that both companies would have entered the market. Nor would the consideration be limited to the probability that one entered alone. There still remained for consideration the fact that Penn-Olin eliminated the potential competition of the corporation that might have remained at the edge of the market, continually threatening to enter. Just as a merger eliminates actual competition, this joint venture may well foreclose any prospect of competition between Olin and Pennsalt in the relevant sodium chlorate market.

378 U.S. at 173.

Even though the court speaks in terms of "probability," such a contingent lessening of potential competition approaches the realm of "possibility." The district court on remand again dismissed the government's action on the ground that the burden of proof had not been met. The court stated that the government would have to show a reasonable probability, absent the joint venture, that one of the corporations would have constructed a sodium chlorate plant in the same general location. A showing of reasonable probability was not made, and the court refused to invalidate the formation of the joint venture corporation on the grounds of mere possibility. "It is, of course, possible that if there had been no joint venture Pennsalt alone would have constructed a facility in the Southwest for the manufacture of chlorate... Anything is possible. But, if the record is to be the criterion, it is unlikely that this would have occurred." 246 F. Supp. at 934.

34 The final Senate Report contained explicit language relating to this question:

The use of these words ['may be'] means that the bill, if enacted, would not apply to the mere possibility but only to the reasonable probability of the prescribed [sic] effect... The words 'may be' have been in section 7 of the Clayton Act since 1914. The concept of reasonable probability conveyed by these words is a necessary element in any statute which seeks to arrest restraints of trade in their incipiency... S. Rep. No. 1771, 81st Cong., 2d Sess. 6 (1910).
petition (frequently termed the relevant market) is determined by reference to product and geographic markets (lines of commerce and sections of the country). In construing lines of commerce in horizontal or vertical mergers, courts are assisted by the nature of these combinations. Product relationships are relatively easy to trace between companies producing the same type goods (horizontal combinations) and between companies in a supplier-customer relationship (vertical mergers). In a conglomerate merger situation the task of defining areas of effective competition and tracing probable effects of a merger are more complex.

III. FTC v. Consolidated Foods Corp.

Consolidated Foods Corp., a company owning food processing plants and networks of wholesale and retail food outlets, acquired Gentry, Inc., a manufacturer of dehydrated onion and garlic. FTC v. Consolidated Foods Corp. represents the effort of the Federal Trade Commission to have the merger invalidated on the ground that a violation of section 7 of the Clayton Act resulted from the combination. The Commission contended that both potential and actual lessening of competition resulted from the merger. This allegation was supported primarily by Consolidated's potential to institute reciprocal dealing arrangements with other companies.

Consolidated purchased in substantial amounts the products of other food processors in connection with its wholesale and retail selling endeavors. These food processing companies (Consolidated's suppliers), in turn, purchased dehydrated onion and garlic (Gentry's two main products) for use in their operations. A reciprocal buying arrangement based upon mutual opportunity for supply purchase would prohibit competitors of Consolidated and the firms purchasing from it from entering the supply markets. A possibility, at least, of

---

29 See, e.g., United States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963); United States v. E. I. du Pont de Nemours & Co., 353 U.S. 586 (1957), Note, 12 Sw. L.J. 128 (1958). The Philadelphia Nat'l Bank merger's probable effect of concentrating a large proportion of the commercial banking business in one institution was readily apparent. See text accompanying note 20 supra. The du Pont-General Motors standing as supplier-customer led to a foreclosure of outside companies which also was easily traced.
30 Turner, Conglomerate Mergers and Section 7 of the Clayton Act, 78 Harv. L. Rev. 1313, 1315 (1965). "The rules developed for determining the validity of horizontal and vertical mergers clearly will not do for conglomerate acquisitions generally." Id. at 1315.
32 Ibid.
reciprocity was thus presented in the facts of the case. Food processors selling to Consolidated might find advantage in giving preference to Gentry products for reciprocity purposes. Imperfect competitive conditions in Gentry's market, moreover, increased the probability of reciprocal dealing. Gentry and its main competitor, Basic Vegetable Products, Inc., accounted for approximately ninety per-cent of the dehydrated onion and garlic market both before and after the acquisition. Prior to the merger in 1951, Gentry's share of total sales was thirty-two percent; in 1958 its portion was thirty-five per-cent of a doubled industry output. Despite Gentry's absolute increase in sales over the seven year period, the firm's product revenue allocation was subject to a marked realignment. Though its portion of the dehydrated onion market increased seven per-cent, Gentry's share of dehydrated garlic sales actually dropped twelve per-cent during the same period. Whatever advantage the merger may have given Gentry, it apparently did not prevent a significant decline in its share of the garlic market.

When faced with the Commission's ruling, the Court of Appeals for the Seventh Circuit reversed the decision, holding that probability of a substantial lessening of competition was not shown. The court considered the oligopolistic nature of the industry and gave heavy weight to post-acquisition evidence. Relying particularly upon the drop in dehydrated garlic sales and the failure of Gentry substantially to increase sales of onion, the court held that neither actual nor potential restraint was present.

The Supreme Court sustained the conclusion of the Commission, placing emphasis upon the probability of reciprocal buying between the two companies and the resultant discouraging effect upon entry into the market by new firms.

**Notes**

---

28 380 U.S. at 596-97. Officials of Consolidated made overt attempts to encourage reciprocity and to assist Gentry in its selling. A letter sent to Consolidated's distributing divisions shows at least an attempt to find product areas in which reciprocity could be brought to bear:

> Oftentimes, it is a great advantage to know when you are calling on a prospect, whether or not that prospect is a supplier of someone within your own organization. Everyone believes in reciprocity providing all things are equal.

> Attached is a list of prospects for our Gentry products. We would like to have you indicate on the list whether or not you are purchasing any of your supplies from them. If so, indicate whether your purchases are relatively large, small, or insignificant. . . .

> . . . If you have any special suggestions, as to how you could be helpful in properly presenting Gentry to any of those listed, it will be appreciated.

Id. at 196. (Emphasis added.)

30 Consolidated Foods Corp. v. FTC, 329 F.2d 623 (7th Cir. 1964).

31 Ibid.

32 380 U.S. at 600-01.
Mr. Justice Douglas, speaking for seven members of the Court, held "at the outset that the 'reciprocity' made possible by such an acquisition is one of the congeries of anticompetitive practices at which the antitrust laws are aimed. The practice results in 'an irrelevant and alien factor' . . . intruding into the choice among competing products, creating at the least 'a priority' on the business at equal prices." Pointing out that "section 7 of the Clayton Act is concerned with 'probabilities, not certainties . . .'" the Court concluded that "reciprocity in trading as a result of an acquisition violates §7, if the probability of a lessening of competition is shown." The Court found that the possibility of reciprocal dealing became a probability in light of the degree of competition present in the dehydrated onion and garlic industry.

Though not condemning absolutely the Court of Appeals' use of post-acquisition evidence, the majority in Consolidated Foods concluded that "it gave too much weight to it." Emphasizing again the probability test of section 7, the Court stated that "if the post-acquisition evidence were given conclusive weight or was allowed to override all probabilities, then acquisitions would go forward willy-nilly, the parties biding their time until reciprocity was allowed fully to bloom." In addition to finding that a probability of restraint was present, the majority found that the post-acquisition evidence tended to confirm the anti-competitive aspects of the merger. Gentry's increase in onion sales and loss of only twelve per-cent of its garlic business sustained the probability of reciprocity, for these shifts took place at a time when its main competitor had a product quality advantage.

The court found probable and actual reciprocity coming about as a direct result of the merger. This reciprocity, in turn, strengthened the already-present oligopolistic characteristics of the industry, thus leading to a section 7 violation of the Clayton Act. Mr. Justice Stewart concurred in the result reached by the court but differed with the majority as to the proper weight to be given post-acquisition evidence.

---

36 Id. at 594.
37 Id. at 595.
38 Id. at 598.
39 Ibid.
40 Ibid.
41 Ibid. at 599-600.
42 See United States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963); Reynolds Metals Co., 56 F.T.C. 743 (1960), aff'd, 309 F.2d 223 (D.C. Cir. 1962). The Philadelphia Nat'l Bank case invalidated an oligopoly-strengthening horizontal merger. See text accompanying note 20 supra. The Reynolds merger, though also strengthening oligopoly, would have survived as a vertical acquisition but was struck down as a conglomerate.
evidence. His separate opinion emphasizes that the Commission should rely upon the best information available in determining probability of restraint, "whether it is an examination of the market structure before the merger has taken place, or . . . after the merger has been consummated." Mr. Justice Harlan, concurring separately, stated agreement with the views as expressed by Stewart except as to post-acquisition evidence. His opinion indicates that only evidence upon which the Federal Trade Commission has acted should be considered by the Court.

IV. CONCLUSION

However correct the Consolidated Foods decision may be on its particular facts, it does little in the way of setting firm guidelines for merger activity. In prior cases, the Court has recognized the need to protect competition rather than to insulate competitors. Nevertheless, underlying the philosophy and application of the antitrust laws is a concern for the small business firm. When the court applied section 7 in the 1962 Brown Shoe decision, the majority felt that it "[could not] fail to recognize Congress' desire to promote competition through the protection of small, locally owned businesses." The Federal Trade Commission has been even more active in implementing this Congressional concern. No matter how wise or unwise this policy may be and irrespective of the fact that economic diffusion may have been the motivating factor behind Congressional action,

---

43 380 U.S. at 602-08.
44 Id. at 606.
45 380 U.S. at 601-02.
46 Id. at 601.
48 Ibid.
49 Ibid. At times the courts seem carried away by the romance of anti-trust endeavors; often they paint an ominous picture calling to mind an impending upheaval or class struggle. The following language is taken from United States v. Trans-Missouri Freight Ass'n, 166 U.S. 290, 323 (1914):

Trade or commerce under those circumstances may nevertheless be badly and unfortunately restrained by driving out of business the small dealers and worthy men whose lives have been spent therein, and who might be unable to readjust themselves to their altered surroundings. Mere reduction in the price of the commodity dealt in might be dearly paid for by the ruin of such a class, and the absorption of control over one commodity by an all-powerful combination of capital.

Ibid. (Emphasis added), (opinion by Mr. Justice Black).
50 See, e.g., Foremost Dairies, Inc., 50 F.T.C. 944 (1962). "[N]ecessary proof of violation of the statute consists of types of evidence showing that the acquiring firm possesses significant power in some markets or that its overall organization gives it a decisive advantage in efficiency over its smaller rivals." Id. at 1084. (Emphasis added.)
51 "Throughout the history of these statutes it has been constantly assumed that one of their purposes was to perpetuate and preserve, for its own sake and in spite of possible cost,
small businesses should not be protected at all costs within existing monopolistic or oligopolistic markets. Given an imperfectly competitive market, assailing mergers with the purpose of protecting and maintaining competition may actually result in a lessening of competition within the market. In a highly developed market, moreover, a decrease in price competition may be more than offset by an increase in more effective non-price competition. In the Consolidated Foods situation, for example, competition and product innovation might have been increased by strengthening Gentry at the expense of Basic Vegetable Products, Inc. "Indeed, the evidence seems to show that, after the acquisition, the industry reflected the salutary qualities normally associated with free competition. Overall, both Basic and Gentry were furnishing a better product at the end of this period than at the beginning." Gentry's industry competition did not present a small, relatively weak firm to be protected; yet the Court is

[Oligopolistic competition is found in] market situations in which there are a few enough sellers of a particular product for the activities of one to be of importance to the others. . . . A single seller occupies a position of sufficient importance in the product market for changes in his market activities to have repercussions on the others. Other sellers react to the market activities of the one and their reactions in turn have repercussions on him.

United States v. Aluminum Co. of America, 148 F.2d 416, 429 (2d Cir. 1945) (Judge Learned Hand).

Adelman, Integration and Antitrust Policy, 63 Harv. L. Rev. 27, 47 (1949): Horizontal and vertical integration will often serve to limit monopoly or destroy it. For example, vertical integration may be the response to a supplier's monopoly: by making instead of buying, one by-passes the toll gate. A similar tactic may end a buying monopoly. Diversification may serve a similar purpose: if there are monopoly profits being earned in a product which a firm can easily add to its line, it will probably enter the field in order to share them. The possibility that integration or diversification may be the response of one's business neighbors is one of the most potent of all forces maintaining competition in our economy.

As a sector of the economy becomes more highly developed and as imperfect competition sets in, price competition often gives way to non-price competition. This trend is aided by the significant role advertising and brand identification play in the present-day economy. In some cases, however, actual innovations may take place; and some of the undesirable effects of imperfect competition can be offset. "Hence, a decision whether the vigor of competition as a whole has been significantly reduced depends on a weighing process in which the result is determined by our value judgments as to which forms of rivalry are most beneficial." Bok, supra note 10, at 244. See generally id. at 238-49.

forced to apply measures designed for the protection of such businesses to all merger cases coming before it. If the purpose of section 7 is to encourage a higher degree of competition, the Court might well consider separate sets of criteria when dealing with market models as they approach or diverge from idealized competitive standards. In fact, when surveying imperfectly competitive industries and when viewing unpredictable conglomerate mergers, the Court perhaps should give strong weight to available post-acquisition evidence.

The Court of Appeals concluded that "probability can best be gauged by what the past has taught." The majority of the Supreme Court countered this view by stating that "no group acquiring a company with reciprocal buying opportunities is entitled to a 'free trial' period." Though the Court's reasoning is based upon section 7 terms of probabilities, its effect may be to give the Government a "free trial period" separate and distinct entirely from any consideration of probabilities.

The merger in this case was achieved in 1951, yet the Commission did not issue a cease-and-desist order until six years later. We may be sure that the Commission relied on post-acquisition factors in issuing its order; there is no reason why we should rely on those factors less in assessing the propriety of the Commission's action. Indeed, if anyone had a 'free trial' period to check the anti-competitive potential of the merger, it was not the respondent but the Commission.

The nature of section 7 cases makes it imperative that the courts delve rather deeply into the facts as presented. On the other hand, "vague rules and the prospect of cumbersome proceedings threaten to dissuade many a businessman from undertaking what might actually be a lawful and even beneficial merger. In this way, the effort to give thorough consideration to the particularities of each case is carried out at the cost of preventing other acquisitions from taking place at all." A greater emphasis on post-acquisition evidence

57 Adelman, supra note 54; Bok, supra note 10; Turner, supra note 27.

59 329 F.2d at 627.
60 380 U.S. at 598.
61 Id. at 606 (Stewart, J., concurring).
62 Bok, supra note 10, at 272.