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ANTITRUST POLICY AND THE CONGLOMERATE FIRM: "A ROSE IS A ROSE IS A ROSE"

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Only a year ago, the mere mention of the word "conglomerate" was likely to cause the blood of investors and securities analysts to race wildly while visions of quick profits and high price/earnings ratios danced in their heads. More recently, however, the appellation appears to be less frequently employed. Executives seem to prefer the term "multi-market" to describe a business enterprise engaged in a range of disparate activities.[1] Although there may be no real difference in meaning between the two terms,[2] the fact is indisputable that the conglomerate form of business organization has rather recently come under close judicial and governmental scrutiny in the light cast by the antitrust laws.[3]

The guiding principle behind antitrust policy in the United States is that competition is the key to a successful economic system and the antitrust laws are the tools by which competition is to be kept viable and effective.[4] It is based on the belief that freely acting competitive forces will afford us the lowest prices, the highest quality, and the greatest economic progress.[5] A corollary proposition is that the lack of competition, such as occurs in a monopoly, is dangerous. The framers of the antitrust laws appear to have been in agreement with the Actonian monition: "Power tends to corrupt and absolute power corrupts absolutely."[6]

One of the most effective ways in which a business enterprise can increase its economic power is by the direct acquisition of another company. Although section 1 of the Sherman Act,[7] which forbids all contracts in restraint of trade, can undoubtedly reach contracts to merge,[8] the primary weapon in the antitrust arsenal directed against anticompetitive mergers and acquisitions is section 7 of the Clayton Act.[9]

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1 *See, e.g.*, Wall Street Journal, April 10, 1969, at 1, col. 4.

2 "That which we call a rose by any other name would smell as sweet." W. SHAKESPEARE, ROMEO & JULIET, act II, scene ii, line 42.

3 The name "trust" was early ascribed to all giant business enterprises and stuck even after they had abandoned the trust device whereby stockholders surrendered voting power to managing "trustees." 1 S. WHITNEY, ANTITRUST POLICIES 4 (1958).

4 Northern Pacific Ry. v. United States, 356 U.S. 1, 4-5 (1958).

5 *Id.* at 4.

6 Letter from John Emerich Edward Dalberg-Acton, Lord Acton, to Bishop Mandell Creighton, April 5, 1887, in J. BARTLETT, FAMILIAR QUOTATIONS 750 (14th ed. 1968).

7 15 U.S.C. § 1 (1964), *formerly* 26 Stat. 209 (1890).

8 *See, e.g.*, United States v. First Nat'l Bank & Trust Co., 376 U.S. 665 (1964); Northern Sec. Co. v. United States, 193 U.S. 197 (1904).

9 15 U.S.C. § 18 (1964), *formerly* 38 Stat. 731 (1914), *as amended*, 64 Stat. 1125 (1950).

Section 7 provides, in essence, that it is unlawful for one corporation to acquire stock or assets of another "where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or tend to create a monopoly."[10] Since its enactment it has been clear that section 7 is applicable to horizontal mergers, that is, the acquisition of one competitor by another.[11] A hypothetical example of a horizontal merger would be the acquisition of Ford by General Motors. Further, one need not possess a graduate degree in economics to be able to conclude that such a transaction, if consummated, might substantially lessen competition in the American automobile industry.

It is now equally well settled that section 7, particularly as amended in 1950,[12] reaches vertical mergers, *i.e.*, the acquisition of a supplier by his customer, or vice versa.[13] By way of illustration, if a television manufacturer acquired the only company producing a rare earth phosphor needed in color television tubes, his competitors might well be foreclosed from an essential source of supply and go out of business.[14]

Having roughly defined horizontal and vertical mergers, a definition for conglomerate mergers can readily be devised: they are something else.[15] In other words, mergers which are neither horizontal nor vertical may loosely be referred to as "conglomerate."

An example of a pure conglomerate merger would be the acquisition of a baby food packer by a locomotive manufacturer. The lack of any discernible relationship between the two organizations makes it apparent that traditional antitrust concepts are of little value in weighing the effects of conglomerate acquisitions. This is not surprising because "traditional" connotes "old" and the conglomerate merger trend is a comparatively recent phenomenon. Perhaps as a result of heightened enforcement activity directed against horizontal and vertical acquisitions, conglomerate mergers increased from 38.1 percent of all mergers from 1948 to 1951, to 91 percent of all mergers in 1968.[16]

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[10] *Id.*

[11] *See* United States v. E. I. du Pont de Nemours & Co., 353 U.S. 586, 617 (1957) (dissenting opinion).

[12] 64 Stat. 1125 (1950). The 1950 amendment took asset acquisitions, as well as stock acquisitions, into the coverage of section 7 and eliminated the requirement that adverse effects were to be measured only against the competition between the acquiring and acquired firms. ATT'Y GEN. NAT'L COMM. ANTITRUST REP. 117 (1955).

[13] Brown Shoe Co. v. United States, 370 U.S. 294 (1962); United States v. E. I. du Pont de Nemours & Co., 353 U.S. 586 (1957).

[14] "The primary vice of a vertical merger . . . is that, by foreclosing the competitors of either party from a segment of the market otherwise open to them, the arrangement may act as a 'clog on competition'. . . ." Brown Shoe Co. v. United States, 370 U.S. 294, 323-24 (1962).

[15] This is not to be considered a lapse into current idiom. It is generally agreed that "[a] 'conglomerate merger' is most simply defined as one that is not horizontal or vertical. . . ." ABA SECTION OF ANTITRUST LAW, ANTITRUST DEVELOPMENTS 1955-1968, at 83 (1968).

[16] Address by Att'y Gen. Mitchell to Georgia Bar Ass'n, June 6, 1969, in 5 TRADE REG. REP. ¶ 50,247 (1969).

Of course, taxonomists are as active in the field of conglomerate mergers as they are elsewhere, and so sub-classes have been discerned. In addition to the pure conglomerate merger there is the "product extension" merger, the acquisition of a firm selling different but related or complementary products; and the "market extension" merger, which involves the acquisition of a firm selling the same product but in a different geographical area.[17]

Although traditional antitrust criteria are not ordinarily applicable to conglomerates, new approaches have been devised to test whether or not a conglomerate acquisition threatens competition. Such factors as potential reciprocity,[18] increased economic concentration[19] and effect on potential competition,[20] alone or in combination, have been considered by the courts and agencies in arriving at the conclusion that a given conglomerate acquisition might substantially lessen competition.

Reciprocity is the practice by which a firm purchases from a company to which it also sells products of its own. The vice of reciprocity is that it injects "an irrelevant and alien factor"[21] into the choice of supplier. When a company which previously did not sell to one of its suppliers acquires a firm which manufactures goods needed by that supplier, the potential for reciprocity is created; "I'll continue to buy from you only if you buy from me."

A trend toward economic concentration exists when fewer, bigger firms emerge to control production in an industry. Economic concentration can be hardened through the acquisition of an already dominant firm by an even larger company engaged in different but related activities whose greater resources can supply competitive advantages.[22]

Potential competition is the threat posed by firms not yet in the market to enter if conditions become sufficiently attractive. If firms already in a given market are enjoying extremely high profit margins, they may soon have company. Knowing this, it is theorized, the existing competitors will be willing to pass on greater savings to their customers because their greed is tempered by prudence. If a potential competitor enters the market through the conglomerate acquisition of a company already there, the number of competing firms in the market is not increased (the acquiring firm is simply substituted for the acquired firm) and the regulating pressure of the acquiring firm's potential competition is removed. This was one of the results decried in *FTC v. Procter & Gamble Co.*[23]

Cases using the foregoing tools for analysis of conglomerate mergers are increasing in frequency as the Justice Department aggressively files new

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17 ABA SECTION OF ANTITRUST LAW, ANTITRUST DEVELOPMENTS 1955-1968, at 83 (1968).
18 FTC v. Consolidated Foods Corp., 380 U.S. 592 (1965).
19 FTC v. Procter & Gamble Co., 386 U.S. 568 (1967).
20 *Id.*; United States v. Standard Oil Co., 253 F. Supp. 196 (D.N.J. 1966).
21 FTC v. Consolidated Foods Corp., 380 U.S. 592, 594 (1965).
22 FTC v. Procter & Gamble Co., 386 U.S. 568 (1967).
23 *Id.* at 575.

actions probing the outer limits of section 7. The Department has recently challenged the acquisition of Jones & Laughlin Steel Corporation by a well-known conglomerate, Ling-Temco-Vought, Inc.;[24] sought the divestiture of Canteen Corporation, a food and vending service company, by International Telephone and Telegraph Corporation (ITT);[25] attacked the proposed take-over of B. F. Goodrich Company by another conglomerate, Northwest Industries, Inc.;[26] and, unsuccessfully, sought to preliminarily enjoin the unlikely-seeming merger of ITT and Hartford Fire Insurance Company.[27]

Of course, since no merger is per se unlawful,[28] the mere presence of concentration, potential reciprocity, or loss of potential competition is not, per se, equivalent to a finding that a conglomerate acquisition is to be condemned. It must first be determined that these or other factors, in the particular circumstances involved, may substantially lessen competition within the meaning of section 7. It is at this point that economic analysis becomes important. After all, entrance into a market by merger as well as by internal expansion can bestow benefits upon the economy. It may shake up a lethargic, oligopolistic industry and inject the element of brisk competition. The management know-how of a conglomerate company may provide its newly acquired subsidiary with just the efficiency it needs to become a viable competitor. Economies of scale in research and selling and the action of synergism, by which the whole becomes greater than the sum of its parts, may aid both the acquired and acquiring companies. The loss of a potential competitor may be more than compensated for by the new strength of a previously marginal operator.

In short, the mere incantation of "reciprocity," "concentration" and "potential competition" is not sufficient to prove an anticompetitive result. As stated by President Nixon's Task Force on Productivity and Competition:

> If one interprets "elimination of potential competition," "reciprocity," and "foreclosure" as threats to competition, one can always bring and usually win a case against the merger of two large companies, however diverse their activities may be.[29]

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[24] United States v. Ling-Temco-Vought, Inc., Civil No. 69-438, 5 TRADE REG. REP. ¶ 45,069, at 52,712 (W.D. Pa., April 14, 1969).

[25] United States v. International Tel. & Tel. Corp., Civil No. 69 C 924 (N.D.Ill., April 28, 1969).

[26] United States v. Northwest Indus., Inc., 301 F. Supp. 1066 (N.D. Ill. 1969).

[27] United States v. International Tel. & Tel. Corp., 306 F. Supp. 766 (D. Conn. 1969).

[28] *See* Brown Shoe Co. v. United States, 370 U.S. 294 (1962). "Statistics reflecting the shares of the market controlled by the industry leaders and the parties to the merger are, of course, the primary index of market power; but only a further examination of the particular market — its structure, history and probable future — can provide the appropriate setting for judging the probable anticompetitive effects of the merger." *Id.* at 322 n.38.

[29] 1969 PRESIDENTIAL TASK FORCE REPORT ON PRODUCTIVITY AND COMPETITION, 115 CONG. REC. 6472, 6476 (daily ed. June 16, 1969) [STIGLER TASK FORCE REPORT].

If the issues before the deciding courts are economic as well as legal, then the courts should receive the expert testimony of qualified economists. However, it is at least possible that such testimony will be conflicting. If one group of economists can assert that increasing national debt is essential for a sound economy while another group believes debt to be as dangerous for governments as it is for individuals, it is not surprising that differences of opinion may exist as to the anticompetitive effect of conglomerate acquisitions.[30]

It is the purpose of this section to examine the antitrust laws as they speak with regard to the conglomerate phenomenon in the hope that, at least, the battle lines will become more clearly drawn.

30 "We are in the midst of a great debate on conglomerate mergers. While some have warned that the current merger movement poses grave dangers to the structure and vitality of competitive markets, others have defended conglomerate activity as a method of increasing the efficiency and dynamism of corporate enterprise, thereby adding to competitive vigor." Address by FTC Commissioner Elman, American Bar Ass'n National Institute, October 23, 1969.