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CONGLOMERATE MERGERS — RECIPROCITY, REAL AND POTENTIAL, AS A BASIS FOR ATTACK

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I. THE CONGLOMERATE MERGER PROBLEM

In 1950, concern over economic concentration stimulated congressional revision of section 7 of the Clayton Act¹ in an attempt to tighten the legal definition of an actionable merger. Twelve years later, the Supreme Court in *United States v. Brown Shoe Co.*² noted:

It is apparent that a keystone in the erection of a barrier to what Congress saw was the rising tide of economic concentration, was its provision of authority for arresting mergers at a time when the trend to a lessening of competition in a line of commerce was still in its incipiency. [Moreover] Congress saw the process of concentration in American business as a dynamic force; it sought to assure the Federal Trade Commission and the courts the power to brake this force at its outset and before it gathered momentum.³

Nonetheless, as the Court recognized, the Clayton Act still applied only to those mergers involving a "probable anticompetitive effect"⁴ which had to be proven with respect to particular product markets.

Independent of these traditional antitrust considerations there may be philosophical questions as to the size which corporations should be permitted to attain, the number of industries in which a single corporation should be allowed to be a significant factor, and the concentration of power in several product markets in the hands of one company's management. These questions, however, do not necessarily involve an intent to preserve competition. In fact, there may be reasons to prevent such consolidations of economic power which are more or less unrelated to the prevention of monopoly.

There is some question as to whether the 1950 amendments to section 7 were ever truly effective in reducing the "rising tide of concentration." Indeed, regardless of any temporary slowdown, there seems to have been a recent upsurge in the number of large mergers, particularly in the field of conglomerate mergers. Numerous companies have expanded their size tenfold primarily through mergers, and in certain concentrated industries each and every company in the top 80 percent of the industry

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¹ 15 U.S.C. § 18 (1964), amending ch. 25, § 7, 38 Stat. 631 (1914).

² 370 U.S. 294 (1962).

³ *Id.* at 317-18.

⁴ *Id.* at 323.

has been absorbed.⁵ In short, there has been a new wave of concentration in which, "[m]erger activity has registered progressive increases since the early 1950's and has reached record levels in the 1960's."⁶

The accelerated trend toward concentration has not gone unnoticed by the enforcement agencies which have had to decide whether the more or less familiar tests of section 7 are applicable to inter-industry mergers of major companies in situations where it is difficult to demonstrate immediate competitive effects. The enforcement agencies seem to have accepted the challenge of attempting to utilize section 7 in its present form to combat this increasing concentration. Assistant Attorney General McLaren before the House Ways and Means Committee contended that conglomerate mergers may present different threats to competition, thus requiring a new type of analysis. In addition to analyzing and exposing the competitive implications of conglomerate mergers, it was the Department of Justice's duty to:

[F]ashion appropriate antitrust standards to meet all threats to competition which that study discloses. This effort may require us to ask the courts to adapt established theories to new circumstances, or to fashion new tests to meet new needs, in order to insure that the objectives of the Congress are achieved.⁷

He also identified some of the anticompetitive effects he attributes to conglomerate mergers, including (1) elimination of potential entrants; (2) increased barriers to entry in a concentrated market or entrenchment of a dominant firm's position; (3) creation of the opportunity to engage in reciprocal dealing; (4) dilution of inter-industry competitive zeal for fear of retaliation in different product areas by other inter-industry firms; (5) reduction in the number of independent firms conducting research and utilizing competitive innovation.

In a later speech, Mr. McLaren noted that current Department cases are aimed at those combinations which do have distinguishable anticompetitive effects, *viz.*, reductions in potential competition, reciprocity, and inter-industry relationships which reduce overall competitive levels. He stated that Department enforcement efforts:

[R]epresent no radical departure from established law; such factors as the elimination of potential competition, the creation of opportunities for reciprocal dealing, the entrenchment of a leading firm in a concentrated market, the triggering of additional mergers, all have been specifically

⁵ For example, in the car rental industry, Hertz, Avis and National were all acquired by conglomerate concerns; likewise in the fertilizer industry, many independent producers were bought by oil companies. BUREAU OF ECONOMICS, FTC, ECONOMIC REPORT ON CORPORATE MERGERS 307-08 (1969) [hereinafter cited as FTC REPORT].

⁶ *Id.* at 4.

⁷ *Hearings on Tax Reform Before the House Comm. on Ways and Means*, 91st Cong., 1st Sess. 2390 (1969) (remarks of Assistant Att'y Gen. McLaren).

recognized by the Supreme Court as grounds for enjoining mergers under Section 7⁸

Subsequently, Attorney General Mitchell, however, indicated that the Justice Department may very well oppose mergers among the top 200 manufacturing firms or firms of comparable size in other industries, and mergers by one of the top 200 manufacturing firms with any leading producer in any concentrated industry.⁹ He also stated that the Department would continue to attack mergers which reduce potential competition or develop a substantial potential for reciprocity.

The Justice Department has not been alone in its response to this accelerated trend in concentration. In announcing a proposed complaint against White Consolidated Industries Inc., the Federal Trade Commission (FTC) warned:

There is a vital connecting link between growing aggregate concentration and the market power conferred by concentration in individual markets. The resulting accumulation of oligopoly power in numerous markets may result in the mutual entrenchment of unhealthy market situations and the enhancement of the new combination's power to pursue anticompetitive practices in any of its markets by selectively applying oligopoly power against less powerful firms.¹⁰

Accordingly, although the antitrust agencies have expressed a willingness to test the boundaries of the present section 7, these tests to date seem to have been conceived primarily in terms of reciprocity or potential competition. Professor Donald F. Turner, former Chief of the Antitrust Division, has expressed reservations as to whether section 7, in its present form, proscribes mergers which demonstrably increase overall industrial concentration but do not immediately affect competition within any given industry. The problem, as the Department once viewed it, is the difficulty of establishing in satisfaction of the Act a reasonable likelihood of a substantial lessening of competition, without reference to particular anticompetitive consequences. The Turner Administration indicated that if Congress is concerned about increased concentration even absent proof of anticompetitive effect (a concern which the Department shared) the proper remedy would be to amend the statute to prevent such mergers.¹¹

With this difference of opinion as to the scope of section 7, it

⁸ Address by Assistant Att'y Gen. McLaren, Town Hall, Los Angeles, California, May 27, 1969, in 5 TRADE REG. REP. ¶ 50,244, at 55,500 (1969). He also stated that "foothold" acquisitions by conglomerates in concentrated industries would be welcomed—a point to be considered during the discussion of "reciprocity effect."

⁹ Address by Att'y Gen. Mitchell, Georgia Bar Association, Savannah, Georgia, June 6, 1969, in 5 TRADE REG. REP. ¶ 50,247 (1969).

¹⁰ 3 TRADE REG. REP. ¶ 18,688, at 21,059 (Mar. 6, 1969).

¹¹ See 1968 WHITE HOUSE TASK FORCE REPORT ON ANTITRUST, 115 CONG. REC. 5642 (daily ed. May 27, 1969) [hereinafter cited as NEAL TASK FORCE REPORT]; 1969 WHITE HOUSE TASK FORCE REPORT ON PRODUCTIVITY AND COMPETITION, 115 CONG. REC. 6350 (daily ed. June 16, 1969).

will be useful to analyze the major cases brought during the last year to test the boundaries of the Clayton Act. These cases include: *United States v. Ling-Temco-Vought*,¹² *United States v. Northwest Industries, Inc.*¹³ and three cases involving *ITT — Hartford Insurance*,¹⁴ *Grinnell*,¹⁵ and *Canteen*.¹⁶ In addition, the proposed FTC complaint against the White Consolidated Industries-Allis Chalmers merger should be examined together with the private action filed by Allis Chalmers in opposition to White's takeover attempt.¹⁷

Significantly, each of these cases contains a charge that the merged concerns will engage in reciprocal buying and selling programs to the detriment of competition. Elimination of potential competition was cited in the *LTV* case, in the *Allis-Chalmers* case, in *Hartford* and *Northwest Industries*. An increase in aggregate concentration and the creation of higher entry barriers to new competitors was cited in *Northwest Industries*, in *LTV*, in *Grinnell*, and in the proposed FTC *Allis-Chalmers* complaint. Certain of the more conventional theories involving horizontal or vertical considerations were involved in *Hartford*, *Northwest Industries*, and *Allis-Chalmers*.

The more conventional offenses charged, if proven, should constitute an easy method of disposition in favor of Government. Even though the product markets or geographic markets involved in these allegations are minor when compared to the overall scope of the companies' activities, the merger may be prohibited. Of course, to the extent that horizontal and vertical problems are present in these large-scale mergers, they probably can be eliminated by spin-offs or sales of assets; and the acquisition of horizontal or vertical assets seems unlikely to have been a prime motivating factor of the acquiring company in these cases. For purposes of this discussion, therefore, it may be assumed that neither horizontal nor vertical considerations constitute the primary basis of the government's attack on the mergers and that the Government would consider these mergers objectionable even absent these allegations.

II. RECIPROCITY AS A BASIS FOR ATTACKING CONGLOMERATE MERGERS

Despite indications from the Attorney General that big companies' moves into concentrated industries may be actionable in and of themselves under section 7, the Justice Department thus far has chosen to battle principally on grounds of reciprocity and reciprocity effect. Attacking mergers on grounds of reciprocity raises three interesting questions. The first con-

¹² 5 TRADE REG. REP. ¶ 45,069 (W.D. Pa. April 14, 1969).

¹³ Complaint, 301 F. Supp. 1066 (N.D. Ill. 1969).

¹⁴ *United States v. International Tel. & Tel. Corp.*, 306 F. Supp. 766 (D. Conn. 1969).

¹⁵ *Id.*

¹⁶ *United States v. International Tel. & Tel. Corp.*, 5 TRADE REG. REP. ¶ 45,069 (N.D. Ill. April 28, 1969).

¹⁷ *Allis-Chalmers Mfg. Co. v. White Consol. Indus., Inc.*, 414 F.2d 506 (3d Cir.), *rev'g* 294 F. Supp. 1263 (D. Del. 1969).

cerns the validity of utilizing any increase in reciprocity potential as a ground for finding the probability of a substantial lessening of competition. The second is whether reciprocity effect¹⁸ is or should be actionable, particularly as products become more fungible.¹⁹ The question is whether some irrelevant or irrational factor must necessarily be applied to purchase orders of fungible, uniformly priced commodities. If some factor other than price or quality must be utilized to select a supplier, then is the practice of favoring customers with orders a logical method of selection? The third question is whether the propensity for reciprocal trading is influenced by the nature of the products, specifically whether product fungibility is an important factor.

A. Reciprocity as an Antitrust Violation — Section 1 and Section 7.

There is one major problem in the suggestion that the creation of an opportunity for reciprocal dealing practices alone would violate section 7; that is the fact that reciprocal dealing affecting interstate commerce constitutes an independent basis for attack under the antitrust laws. Thus, if the practice of reciprocity is illegal, then enlargement of the opportunity to engage in it should be of little consequence since, presumably, companies will restrict themselves to lawful conduct.

By analogy, a merger between two companies, one of which substantially controls a scarce product, might allow the merged company to tie the products of the other company to the product in which it enjoyed market dominance. To do so, however, would violate section 3 of the Clayton Act and section 1 of the Sherman Act. So long as these companies refrained from what may be assumed to be illegal tying practices, however, there might be no reduction in competition associated with the merger. The mere possibility that the companies would wish to engage in an independently illegal act would not constitute grounds for attacking the merger under section 7.²⁰ Similarly, a greater potential for engaging in illegal reciprocity practices should not constitute grounds for finding a section 7 violation.

It is true that unlike section 1 of the Sherman Act, section 7 of the Clayton Act is designed to reach anticompetitive situations in their incipency. To satisfy section 7 it is not necessary to wait until the violation is full blown — conduct may be enjoined as soon as the probability of a lessening of competition can be shown. But allegations that a new potential

¹⁸ Reciprocity effect differs from actual reciprocity which encompasses the knowing utilization of purchase orders to promote sales. Reciprocity effect has been defined as "the tendency of a firm desiring to sell to another company to channel its purchases to that company." *United States v. Ling-Temco-Vought, Inc.*, Civil No. 69-488 (W.D. Pa., April 14, 1969) (complaint filed).

¹⁹ Fungible produces are those which are essentially interchangeable regardless of supplying source, being of nearly uniform physical characteristics, e.g., salt.

²⁰ Likewise, a combination of buying power might give a merged company additional leverage to induce price discriminating discounts from sellers in violation of section 5 of the FTC Act. The presence of additional buying power and its use to induce discounts are not however the same.

for reciprocity exists seem more in the category of possibilities than probabilities. Something more than a greater number of products under one corporate roof than were present prior to a merger is required to show a probability. Recent complaints and decisions illustrate (and generally support) this proposition.

In several complaints, the Government has taken the position that engaging in reciprocal trading practices violates the Sherman Act. In theory, almost every large company has the capacity to direct some business to its friends, but having the capacity and having an active program to solicit sales on a reciprocal basis are not the same. Sherman Act complaints have alleged *active* programs as in *United States v. United States Steel Corp.*,²¹ filed in June 1969, and settled by consent judgment in August 1969. Pointing out that U. S. Steel's overall size gave it sufficient power to induce would-be suppliers to purchase their steel requirements from defendant, the Government charged that U. S. Steel violated section 1 by entering into combinations involving reciprocal purchasing agreements and violated section 2 by attempting through use of its purchasing power to monopolize trade and commerce of potential supplier-customers for steel, cement, and chemicals. According to the complaint, U. S. Steel compiled and coordinated purchase and sales data and used this information to determine which suppliers to favor and the extent to which they should be favored. Company personnel discussed sales and purchase positions with actual and potential suppliers and made purchase contracts contingent on reciprocal buying contracts.

The Department of Justice also has outstanding a complaint against General Tire and Rubber Company²² and its subsidiaries, charging Sherman Act violations similar in nature to those attacked in the *U. S. Steel* complaint. General, it is charged, maintained a trade relations department and tabulated purchases and sales so that an effective reciprocity program could function. According to the complaint, the parent company and subsidiaries' purchases of supplies amount to approximately \$500 million.

The FTC has taken a position parallel to that of the Department of Justice. For example, American Standard, a major plumbing fixtures firm, and GAF (formerly General Aniline and Film), a large chemical company, each recently consented with the FTC to abandon reciprocal trading plans similar to the plan employed by U. S. Steel.

According to the FTC, American Standard is a company large enough to affect other companies' buying choices by use of economic force unrelated to product superiority. Its 1968 sales were \$1.075 billion, and within its highly concentrated industry (top four manufacturers accounted for more than 75 percent of total value output) American was one of the leaders. American established a commercial relations department which utilized a

²¹ 5 TRADE REG. REP. ¶ 45,069, at 52,720 (W.D. Pa. June 13, 1969).

²² *United States v. General Tire & Rubber Co.*, 5 TRADE REG. REP. ¶ 45,067, at 52, 643 (N.D. Ohio Mar. 2, 1967).

choice of designated bank depositories for withholding taxes as a method of influencing banks to specify American Standard fixtures and to encourage bank customers to do the same.²³

GAF had 1968 sales of \$570 million and it, too, had an active program designed to press reciprocal trading on its suppliers. Trading partners were assigned percentage allocations for specific materials, and in some cases minimum dollar volumes were designated to be protected against a decline in requirements. Sometimes GAF held "symposiums" with other companies, discussing reciprocal possibilities, and, on other occasions, "review" sessions were held.²⁴

These cases make abundantly clear the Government's contention that the foreclosure of a market to competitors through the use of reciprocity constitutes a violation of the Sherman Act. By contrast, *United States v. General Dynamics Corp.*,²⁵ *FTC v. Consolidated Foods Corp.*,²⁶ and *United States v. Ingersoll-Rand Co.*²⁷ were brought under section 7, and in each the court found that the companies had deliberately arranged to benefit from the merger under a planned program of reciprocal buying. In *General Dynamics* a new Special Sales Program was instituted within months after the acquisition. This program was further refined to categorize some 350 companies, each selling \$250,000 of goods or services to General Dynamics, into a "National Accounts System." Moreover, this group consisted of accounts where final purchasing authority was concentrated at a central headquarters location.

Whether an increased opportunity for reciprocity is actionable under section 7 was presented but not resolved in *Consolidated Foods*. The Supreme Court relied upon post-acquisition evidence that reciprocity had been practiced (although there was debate as to how successful the attempts at reciprocal trading had proven). This finding left it unclear whether a charge that there was a probable anticompetitive effect merely by the merger of the two companies would have been sustained. The Court stated at one point, "We hold 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,"²⁸ but the use of the word reciprocity might be taken to include the reciprocal practices which appeared in the post-acquisition evidence. On the other hand, there were references to the "power to foreclose competition from a substantial share of the markets,"²⁹ and notice was taken of the FTC's finding that "merely as a result of its connection with Consolidated, and without any action of the latter's part, Gentry would have an unfair advantage over competitors enabling it to

²³ FTC REPORT 354 *passim*.

²⁴ *Id.* at 373 *passim*.

²⁵ 258 F. Supp. 36 (S.D.N.Y. 1966).

²⁶ 380 U.S. 592 (1965).

²⁷ 320 F.2d 509 (3d Cir.), *aff'g* 218 F. Supp. 530 (W.D. Pa. 1963).

²⁸ 380 U.S. at 594.

²⁹ *Id.* at 593.

make sales that otherwise might not have been made."³⁰ This suggests that an increased ability to practice reciprocity might be actionable.

Mr. Justice Stewart, concurring, concluded, however, that "[c]learly the opportunity for reciprocity is not alone enough to invalidate a merger under Section 7" and "[i]t obviously requires more than this kind of bare potential for reciprocal buying to bring a merger within the ban of Section 7."³¹ The Stewart view supports the conclusion that there must be some overt act indicating that reciprocity is a distinct threat or real possibility.

The *Ingersoll-Rand* case terminated after the Government was successful in its application for a preliminary injunction. Among the grounds pressed in support of the motion was an opportunity to make reciprocal sales. One of the difficulties of *Ingersoll-Rand* is that there was no evidence that reciprocity had been practiced or that there was an intent to do so. Of course, the court was required to find only a reasonable probability of success on the part of the Government. Also, the court's ruling was not couched solely in terms of the reciprocity issue. Accordingly, whether an increased opportunity to practice reciprocity alone would have violated section 7 was never finally resolved.³²

The new attack on conglomerate mergers, however, adds the dimension of reciprocity effect which, as we have seen, was not basic to the prior decisions.³³ In the *LTV-J & L Steel* complaint³⁴ the Department stated that competition would be lessened in the following ways: (a) potential competition would be reduced in the steel industry and in other markets; (b) the power of LTV and J & L Steel, and of their suppliers, to employ and to benefit from reciprocity and reciprocity effects in the sale of their products will be substantially enhanced; (c) concentration of control of manufacturing assets will be substantially increased and the trend to further concentration by merger will be encouraged.³⁵ Most pertinent to this discussion is the allegation that J & L Steel has actively engaged in reciprocity for many years. If this allegation can be proven, then it is difficult to understand why J & L should not have been the subject of a complaint similar in scope and nature to the one filed against U. S. Steel.

³⁰ *Id.* at 597.

³¹ *Id.* at 603.

³² Note that Justice Stewart's concurrence in *Consolidated Foods* was written after the *Ingersoll-Rand* decision.

³³ *Cf.* *United States v. Ingersoll-Rand Co.*, 320 F.2d 509 (3d Cir. 1963).

³⁴ *United States v. Ling-Temco-Vought, Inc.*, Civil No. 69-438 (W.D. Pa., April 14, 1969) (complaint filed).

³⁵ The effects of (c) are further alleged to be: (1) a reduction in the number of firms capable of entering concentrated markets, (2) a reduction in the number of firms with the capability and incentive for competitive invasion, (3) an increased barrier to entry in concentrated markets, (4) diminishing of the vigor of competition by increasing actual and potential customer-supplier relationships among leading firms in concentrated markets. It is beyond the scope of this paper to examine these interesting contentions. As noted earlier, the Government seems to be relying principally on reciprocity theories in its new conglomerate cases, notwithstanding the allegations relating to concentration of control. *Id.*

The *LTV* case emphasizes a possibly significant shift in emphasis between the unilateral reciprocity program cases and the *LTV*, *ITT*, and *Northwest Industries* series of complaints — the ones charging a violation of section 7. In the former cases charging a violation of section 1 of the Sherman Act, it was reciprocity itself that was attacked. In the merger cases reciprocity is attacked, and in addition, power to employ "reciprocity effect" is attacked. Reciprocity and reciprocity effect were defined in all of the section 7 complaints in language identical to that of the *LTV* complaint.³⁶

The *Northwest Industries* complaint, however, identified specific markets in which opportunities for reciprocity existed and in which reciprocity effect was likely to occur. For example, it was alleged that reciprocity is a factor significantly influencing routing decisions of large shippers by rail and that Northwest might benefit by reason of Goodrich's purchasing power. Also, Goodrich's sales of tires may benefit by reason of Northwest's substantial purchases of railroad equipment and petroleum products from companies which buy tires.

Denying the government's request for a preliminary injunction, the court balanced actual evidence of a history of reciprocity against a statement by Northwest's chief executive that the company has a policy against reciprocal dealing, considers such a practice uneconomic, and has no machinery for effectuating that practice. In its findings of fact the court concluded that the potential for the practice of reciprocity would be increased but that the extent to which actual reciprocity would be practiced and "therefore, the probable actual anti-competitive effect thereof is, on the basis of the present record, difficult if not impossible to forecast."³⁷

One very interesting aspect of *Northwest Industries* was the court's receipt of evidence indicating that many customers and suppliers, including several leading companies in highly concentrated industries, of both Goodrich and Northwest practice reciprocity, thus highlighting the difference between actual reciprocity and the potential reciprocity challenged in the complaint.³⁸

In the *ITT* complaints,³⁹ the power to employ reciprocity or benefit from reciprocity effect has played a prominent role. In the *Canteen* case, it also was alleged that the acquisition would reduce actual and potential competition for vending business at industrial locations, raise entry barriers, and tend to trigger other mergers by competitors of Canteen seeking to

³⁶ For the definition of "reciprocity effect," see note 18 *supra*.

³⁷ 301 F. Supp. at 1095.

³⁸ One sidelight to this evidence was the fact that certain large companies which allegedly practice reciprocity may not insist upon reciprocal trading unless the amounts involved reach certain minimum figures. This suggests that unless large sums are involved, reciprocity is uneconomic. If such is the case, the Government's burden of showing the actual anticompetitive effect of "reciprocity effect" should be maintained. See Part II-B *infra*.

³⁹ See notes 14-16 *supra*.

protect themselves from the impact of the acquisition. In *Hartford* and *Grinnell*, the Government emphasized reciprocity, not only in the complaint, but also in its arguments for a preliminary injunction. The motion was denied, and an important factor in the court's decision was its finding that ITT correctly represented that it did not have a trade relations department, that it did not solicit business on a reciprocal basis, and that its method of management encompassed a series of separate profit centers, each striving to maximize the unit's individual profit without particular regard to the effect on other company units.

Not only would the profit center approach militate against reciprocity, but there was testimony that the compensation and promotion of the individuals who manage each profit center is determined by the performance of their own profit center, not the performance of ITT as a whole. Insofar as management would thus be working against its own personal interest, it would appear that this may well be the strongest single factor underlying the rejection of a reciprocal trading posture. A second strong piece of evidence was the fact that ITT did not collect the purchasing and sales data incidental to reciprocal purchasing opportunities.⁴⁰ The court also favored ITT's argument that suppliers who purchased ITT products in the hopes of being rewarded with additional supply contracts would soon abandon that practice when they found that ITT was not equipped to render such favors.⁴¹

An issue which may receive further exploration at the trial stage of the *ITT* proceedings is the extent to which top management is prepared to override unit managers, the profit center approach notwithstanding, in order to increase overall company profits. There may be times when a management-coordinating committee might want to insist that a particular unit favor another even though the purchasing unit's income statement may appear to be reduced.

It is plain that the Department of Justice is making good its promise to test the boundaries of section 7, at least in terms of reciprocity. The issues

⁴⁰ A third piece of evidence upon which the court relied was ITT's written policy against reciprocity which had been disseminated to purchasing and sales personnel. The weight to be given this evidence obviously is related to the sincerity with which the policy was drafted and disseminated. Evidence of this type is particularly susceptible to self-serving purposes. The denial of access to purchasing and sales data, however, deprives would-be reciprocal traders from the essential tools necessary for their task.

⁴¹ Without reference to the full trial transcript certain other points cited or relied upon by the court as evidence that no reciprocity program was contemplated by ITT seemed weak. For example, the court noted that defendants adduced considerable evidence that ITT's major suppliers have non-reciprocity policies and in fact do not practice reciprocity (in purchasing insurance). Once again, proof that a supplier has a non-reciprocity policy seems subject to self-serving manufacturing of evidence. This is especially true if the contention that reciprocity practiced independently of a merger is itself illegal is accepted. Moreover, the fact that a defendant requests its major suppliers to make such statements might reduce the statements' value since supply contractors would be subject to reallocation as much out of disfavor should the supplier not testify as requested by reciprocal trading considerations.

of potential for reciprocity and reciprocity effect were perhaps just around the corner in *Consolidated Foods* and *Ingersoll-Rand*. The new complaints show that their importance has been enlarged — but the Department may find that unless it has some evidence of an intent to use the new potential, it will not be able to foreclose conglomerate mergers on this ground.

B. *Should Reciprocity Effect be Actionable?*

In attacking reciprocity effect the Government seems concerned with the proposition that certain mergers will lead to certain trading patterns. At the same time, the Antitrust Division seems aware that there are differences between systematic trade relations programs and nonstructural reciprocal dealing arrangements.⁴²

The problem is one of finding that mutual trading by preference, rather than agreement, violates the antitrust laws. In recent Department cases, such as *United States Steel*, there have been allegations that trading partners have been pressured into making choices they might not otherwise have made. In order for this persuasion to work, however, some sort of policing system must be in effect. Either tabulations must be kept so that a company wishing to practice reciprocity can establish quotas and keep score, or an active trade relations department must be maintained in which executives from one company continually remind purchasing agents from the other company that each company can guarantee sales for a mutual trading program. In most instances, the Government has been able to show the existence of both a trade relations department and a tabulation program.

If there is no active program to encourage reciprocal trading, however, but the same reciprocal trading patterns emerge, is there a section 1 violation? Does it require some affirmative act to violate section 1? And with respect to section 2, except in the most extreme cases of market concentration, how is the Government to show that the trading pattern is not the result of quality or service preferences? Suppose, for example, U.S. Steel's trading patterns are not appreciably altered by the abandonment of its trade relations program.

Another problem in assessing the impact of reciprocity effect on competition is the lack of economic information on the subject. In strict empirical terms there is no way of measuring the success of a trade relations program. One might see its pernicious effect more clearly in cases such as *General Dynamics* and in the evidence cited in the *FTC Staff Report* with respect to *American Standard*. In those cases, clearly external factors shifted business away from competitors although they might have had product

⁴² After all of the smoke has cleared, it becomes rather clear to me that the overriding issue today is really not whether coercive reciprocity or mutual patronage agreements violate the Sherman Act, but whether and to what extent there is in practice a difference between a systematic trade relations program, on the one hand, and reciprocal dealing arrangements, on the other hand. Address by Director Rashid, Antitrust Division Operations, Sept. 4, 1969, in 5 TRADE REG. REP. ¶ 50,256, at 55,537 (1969).

superiority, better price, or better service. In *Hartford* and *Grinnell*, however, ITT maintained that reciprocity effect would be lost when suppliers realized that ITT would not play the reciprocity game.

Another unanswered question is whether non-coercive reciprocity is anticompetitive. When dealing with fungibles, some external factor is necessary in determining which source is to receive a purchase order. The argument against reciprocity has sometimes been stated in terms that reciprocity induces an irrational or alien factor into the selection process for goods which would not be present if perfect competition existed.⁴³ The difficulty is that in a perfectly competitive situation — a situation which does not exist but which within our economy is more closely approached in terms of fungible basic products — some such irrational factor must be present in the selective process. If we eliminate reciprocity, a selection could be made using factors such as whose father-in-law worked for which company, the political stance of company executives, *etc.*; but some competitively irrational factor would have to come into play.

Two factors suggesting that companies will tend to select their own customers as suppliers, where economically possible, are desire to protect against labor problems and shortages. In times when products are in short supply, either because of strikes or shortages, companies will seek inducements to foster favorable delivery schedules. A history of reciprocal trading can be influential in establishing delivery preferences.

If the necessity of "irrational factors" is conceded in determining supplier selection, and if the reasonability of reference to mutual trading patterns is admitted, then it would seem that non-coercive reciprocity or reciprocity not by agreement sometimes plays a useful role. If the Government were to quarrel with these assumptions, then in the case of extremely large and economically powerful companies, such as U.S. Steel, the Government would be in the position of outlawing mutual trading without regard to the existence of a conscious program based upon reciprocity. Stated differently, the Government's concern with reciprocity effect should apply to all concentrated industries if reciprocity effect has some pernicious effect upon competition. If the Government is not willing to go this far, however, then a merger which arguably would increase the possibility of reciprocity effect perhaps, should not be judged by different standards.⁴⁴ Unfortunately, if the Government attacks reciprocity effect based on industry position then selling to one's supplier becomes suspect under the antitrust laws. Yet the law should not produce a result where a company consciously avoids selling to its supplier. Such a result is plainly anticompetitive.

⁴³ FTC REPORT 328.

⁴⁴ Of course, the issue of whether it is fair to attack lesser concentrations of market power within an industry caused by mergers when established companies with a greater degree of market power are permitted to maintain their position, has been a source of comment for many years. See NEAL TASK FORCE REPORT.

C. *Is Product Fungibility a Factor in Assessing Probability of Reciprocity?*

An issue related to both reciprocity and reciprocity effect is whether either is limited in its practice by the confines of the market structure. The subject was touched upon in *ITT* where the court noted that an essential prerequisite to reciprocal dealing is an oligopolistic or concentrated market with dull price competition.⁴⁵ The government's economist, Dr. Mueller (who also was the chief architect of the FTC *Economic Report On Corporate Mergers*), testified that the product must be reasonably interchangeable with competitive products, *i.e.*, "more or less homogeneous — or when it is differentiated, then these differences can be translated into price and cost differences."⁴⁶ This suggests a rule of comparative fungibility. The more fungible the product which is being supplied, the more likely its price will be uniform throughout the market and the more probable it is that buying decisions will turn on some factor other than price. In these instances a company willing to utilize reciprocity might find the opportunities enhanced. Conversely, the more unique the product or the more it is designed especially for some purpose, the less likely it is that reciprocity can be applied. For example, in *ITT-Hartford*, part of the argument turned upon whether insurance and insurance coverage are essentially interchangeable so that any number of insurers can provide acceptable service or whether coverage varies with respect to cost and service.

An interesting commentary on this point is found in the FTC merger study section dealing with the *General Tire* complaint.⁴⁷ Apparently, General Tire was willing to "purchase" reciprocal orders by increasing the business it gave to J & L Steel. Some of the exhibits noted that a special type of giant tire used for mining equipment was unacceptable to J & L because General's tires had no durability. As a matter of fact, there were specific complaints of the substandard performance of General's tires. Despite these complaints General was able to secure an order for six tires at a value of \$13,000 after the trade relations director became active. The record is silent as to the profit margin on this sale, but considering the amount of correspondence which apparently went into the sale, the personal involvement of the trade relations director of General Tire, the involvement of other executives, and the small size of the order, one might question whether such a reciprocal trading program would not prove more costly to General in the long run. Notwithstanding this example — or taking it into account — it would seem that reciprocity either is wasted because it is too costly or it is ineffective as a means of increasing sales of non-fungible items.

The FTC *Report* describes this as the "all other things being equal argument"; and the economic staff took the position that all other things seldom, if ever, are equal.⁴⁸ The *Report's* examples supporting this point

⁴⁵ *United States v. International Tel. & Tel. Corp.*, 306 F. Supp. 766, 787 (D. Conn. 1969).

⁴⁶ *Id.* at 781-82.

⁴⁷ FTC REPORT 393.

⁴⁸ *Id.* at 387.

seem isolated, however, and as noted above, indicate that the company made a poor choice in insisting upon reciprocal buying of non-fungible items. It would appear that there may be a large degree of equality in dealing with easily identifiable fungible items, such as, bushels of wheat, steel or aluminum ingots, basic chemicals, or petroleum products.

By contrast, in the *Allis-Chalmers* complaint and in the private action injunction suit, much was made of the enhanced opportunity for reciprocity which would arise when White, a substantial purchaser of steel, acquired a company owning Blaw Knox, one of the few producers of steel rolling mill machinery. Here the rule of comparative fungibility would seem to operate against the reciprocal buying argument. A steel company making a sizeable capital investment in a machine to be depreciated over a period of years and one which would have a substantial effect upon overall plant efficiency should not be affected by reciprocal trading pressure. The cost of securing White Industries' steel orders should prove too high, provided a Blaw Knox competitor had a machine with better performance. This assumes that steel rolling mill machines are not identical, that they vary in cost, in performance specifications, in economy, in durability, and in maintenance-free operation.

The *American Standard* situation illustrates the importance of fungibility to successful reciprocity as well as any of the situations thus far considered. American utilized for its reciprocity program a choice of approved depository banks for withholding tax deposits, a decision ostensibly non-competitive in nature. The banks, however, due to the very nature of this choice exercised by American, were peculiarly susceptible to reciprocity pressures. They were "buying" immediate assets and since these assets could only be profitable — there was no downside risk in making the "purchases" — they were easy targets for an active trade relation department.

Another factor rendering certain products non-fungible would be the ownership of patents which would cause various products (especially machinery) to differ. To the extent that a supplier offers a patented product, chances increase that the purchasing company will not be able to insist upon reciprocal purchases. A case illustrating this point, but one in which the court seemed to be proceeding toward an erroneous conclusion or at least an unprovable conclusion, was *Ingersoll-Rand*. As noted, the case terminated at the preliminary injunction stage, and the court's findings with respect to reciprocity or potential reciprocity were tentative in nature. The potential reciprocity which was of concern to the court, involved coal mining machinery and equipment, particularly a machine known as a continuous miner.⁴⁹ The court theorized that Ingersoll, a large machinery manufacturer, also purchased substantial quantities of steel. Steel companies were large customers of the coal industry, and continuous miners and other

⁴⁹ The decision that the Government had showed a substantial probability of success also was based on the court's finding that the "deep pocket" theory applied and that Ingersoll's resources would give the three companies to be acquired competitive advantages over their smaller unintegrated rivals.

coal machinery were manufactured by the companies Ingersoll wished to acquire. Coal companies wishing to sell to steel companies which in turn wished to sell steel to Ingersoll were to favor Ingersoll in purchasing mine equipment, including continuous miners.⁵⁰

In view of some of the court's findings, it just does not seem probable that reciprocity would have played a part in purchase orders for continuous miners. There was evidence that the price of continuous miners varied between \$85,000 and \$250,000 and that the machines varied by weight, by size, and by the size of the coal seam they were capable of mining. Only six companies manufactured these machines, and Lee-Norse, one of the companies Ingersoll wished to acquire, held the number one position. Its machine had extensive patent coverage. This machine had enabled Lee-Norse and Goodman (another acquisition partner) to increase its market share from 42.5 percent in 1958 to 60.1 percent in 1961. Industry shipments of continuous coal miners reached a dollar value of only \$10 million. It seems apparent, therefore, that a coal mining company would be concerned with factors other than reciprocity in the selection of a continuous mining machine. The court's suggestion that the judicious use of steel purchasing power could measurably increase the acquired companies' sales of machinery and equipment implies that the coal companies, because of the reciprocity factor, would make poor economic decisions with respect to the operation of their plant.

Moreover, the reciprocity which the court feared would occur was second-line reciprocity — that is, Ingersoll could not directly affect the machinery buying choices of the coal companies. It would have to pressure a steel company to pressure one of its suppliers. The court stressed that the steel industry would have to rely upon coal for several years to come, but this infers that coal may have been in short supply. The record is not complete on this point — the coal industry apparently had reversed some decline in demand — but if it is assumed that supply and demand of coal for steel industry purposes are approximately in balance or that coal is in short supply, then the steel companies would be unable to exercise any leverage against their coal company suppliers even if they were of a mind to do so. To facilitate such a reciprocity program Ingersoll would have to implement an actual program to correlate potential customers for coal mining machinery with coal companies selling steel to potential Ingersoll suppliers. Finally, a buyers' market for steel is assumed, a factual area not covered by the court's opinion.

It appears that the cases thus far decided have not focused sufficiently on the role of product fungibility on a successful reciprocal trading scheme.

⁵⁰ Mention was made of steel companies with "captive" mines, but no findings of fact were made as to the importance of such mines.

CONCLUSIONS

In view of the pressure on management, especially management of conglomerate companies, to increase profits, it seems likely that the Government frequently will be able to find evidence of intent to benefit from reciprocity. As long as some conscious use of reciprocity is contemplated, a merger is vulnerable to section 7 attack. However, allowing government prohibition of a merger solely on a showing that the merged companies will have a greater arsenal of products to sell to actual or potential suppliers appears beyond the bounds of section 7. To hold that an increased potential for reciprocity alone violates section 7 would have the practical effect of relieving the Government of the burden of showing the probability of a substantial lessening of competition with respect to particular product markets. Certainly, economic evidence thus far available does not warrant such a result.

The presumption that merger partners will wish to engage in reciprocity should be closely examined where products are non-fungible, since prospective leverage over such products may be difficult to establish. Again, the burden of proof should be on the Government to demonstrate why trading partners would make uneconomic choices in the selection of differentiable products.

As products grow more fungible, the temptation to engage in reciprocity will increase, and in these instances a company's disavowal of the intent to utilize reciprocity may warrant even closer examination. At the same time, as fungibility increases, reliance upon some external factor, such as mutual trading relationships, becomes more necessary. This problem is related to already existing patterns of mutual trading in concentrated industries even where no active reciprocity program exists. If we are concerned with whether section 7 should be amended in order to address itself directly to increased concentration without immediately demonstrable anticompetitive effects, then perhaps the question of mutual trading patterns in concentrated industries should be considered in depth at the same time.