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SECTION 7 OF THE CLAYTON ACT AS
APPLIED TO CONGLOMERATE
MERGERS: INCIPIENT ANTITRUST
DOCTRINE

LUTHER C. MCKINNEY*

The conglomerate merger\(^1\) movement\(^2\) has spawned much concern and
controversy that continues unabated. Critics of large, diversified corpora-
tions fear not only that conglomeration lessens competition in various
product lines, but also that it is responsible for the centralization of indus-

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1 A conglomerate merger is one that is neither horizontal (between actual competitors
in a relevant market) nor vertical (between firms in a supplier-customer relationship).
Conglomerate mergers can be further divided into the sub-categories of product extension,
geographic market extension and pure conglomerate. A product extension merger requires
that the acquired firm's product be closely related to one or more of the products of the
acquiring company. This relationship occurs when the products may be advertised, distrib-
uted or sold in the same fashion or through the same outlets or to the same customers.
Some writers have gone so far as to suggest every merger that permits any beneficial
integration of management, production and other facilities and marketing techniques is
of the product extension variety. See J. Narver, COGLOMERATE Mergers and Market
Competition 67-69 (1967). Thus, the acquisition by a soap manufacturer of a producer
of bleaches is a product extension merger. A market extension merger requires that the
acquiring firm deal in the same product, but in a different geographic area. A pure
conglomerate merger does not involve any relationship between the products involved,
and does not give rise to any integration of management, facilities or marketing of
products. This type rarely occurred until the rise of the modern conglomerate corporation.
On definitions generally, see Davidow, Conglomerate Concentration and Section Seven:

2 In recent years conglomerate mergers have accounted for the bulk of corporate
mergers and acquisitions. Federal Trade Commission statistics indicate that conglomerate
mergers in 1968 made up 89 percent of the total number of all acquisitions of manufac-
turing and mining firms with assets of $10 million or more. BUREAU OF ECONOMICS, FTC,
CURRENT TRENDS IN MERGER ACTIVITY (1969). This figure represents a sharp increase in
the incidence of conglomerate mergers over past years. For example, in the period 1951-
1954 conglomerates accounted for merely 51 percent of all mergers and in 1963-1966, for
only 71 percent of corporate mergers. Burck, The Merger Movement Rides High, FORTUNE,
Feb. 1969, at 79. Commission statistics also suggest that the incidence of mergers is generally significant
in terms of the assets acquired. In 1950, assets acquired in large mergers (acquired units
with assets of $10 million or more) amounted to only $173 million, and in 1968 the total
rose to $2,956 million. But in 1968, the assets acquired in large mergers totaled about
$12,800 million. BUREAU OF ECONOMICS, FTC, ECONOMIC REPORT ON CORPORATE Mergers
1-15 (1969) [hereinafter cited as FTC REPORT]. However, it should be noted that the pur-
chasing power of the dollar has declined substantially since 1950. In equivalent dollars,
the figures would be 1950-$208 million; 1963-$2,749 million; and 1968-$10,496 million.
The purchasing power of the dollar figures are from STATISTICAL ABSTRACT OF THE U.S.
1968, at 341.

The Commission's figures also indicate that the level of economic concentration has
increased. It reported that the share of manufacturing assets held by the hundred largest
corporations was larger in 1968 than the share of manufacturing assets held by the 200
largest corporations in 1950, the year Congress enacted the Celler-Kefauver amendment
to section 7. FTC REPORT at 3.
trial resources into fewer and fewer hands. Such a development, it is urged, could lead to fewer independent enterprises and decision-makers in the economy, thus posing substantial dangers to American economic, political, and social life. For example, the Attorney General of the United States has stressed the undesirable consequences that can occur in many areas of the country when businesses that were formerly locally-owned are acquired by a large corporation with headquarters thousands of miles away. Also, some critics have blamed unhealthy speculation in the securities markets on conglomerate firms. Conversely, others urge that conglomerate corporations promote competition and do not pose substantial dangers to the American society or its political life. Thus, Harold S. Geneen, Chairman of the Board of International Telephone and Telegraph (ITT), arguing that far from stifling competition, conglomerate corporations have increased competitive behavior in the industries they entered through acquisitions, recently warned that a policy denying access "to change, innovation and new industrial competition by the route of diversifications of meaningful size will result in a stagnant status quo of existing large companies within an industry regardless of efficiency or competitiveness."\footnote{Address by Att'y Gen. John Mitchell, Georgia Bar Association, Savannah, Georgia, June 6, 1969, in 5 TRADE REG. REP. ¶ 50,247 (June 16, 1969).}

The debate concerning the applicability of section 7 of the Clayton Act\footnote{15 U.S.C. § 18 (1964).} to conglomerate acquisitions has occurred at the highest levels of antitrust enforcement. While the Antitrust Division previously was uncertain as to the application of section 7 to conglomerate mergers, the Division now views the situation quite differently. For instance, a spokesman for the Antitrust Division recently suggested that the legislative history of the amended section 7 of the Clayton Act and the spirit, if not the letter, of Supreme Court merger decisions in recent years indicate that this statute should be applied to stem the tide of aggregate concentration of assets. And from January 1969 to date, the Department of Justice brought five cases aimed, in whole or in part, at conglomerate acquisitions — including challenges to ITT's acquisitions of Canteen Corporation, Grinnell Corporation and the Hartford Fire Insurance Company;\footnote{United States v. International Tel. & Tel. Corp., 306 F. Supp. 766 (D. Conn. 1969).} to Northwest Industries' attempted takeover of B. F. Goodrich;\footnote{United States v. Northwest Indus., Inc., 301 F. Supp. 1066 (N.D. Ill. 1969) (preliminary injunction denied).} and to Ling-Temco-Vought's (LTV's) merger

\footnote{Address by Assistant Att'y Gen. McLaren, in Hearings on Tax Reform Before the House Comm. on Ways and Means, 91st Cong., 1st Sess. (1969).}
with Jones & Laughlin Steel Corporation. In response to this controversy, this article will examine the application of section 7 to conglomerate mergers.

**SECTION 7: LEGISLATIVE HISTORY**

Section 7, as amended, forbids any acquisition by a corporation of stock or corporate assets "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." The antimerger provision of the 1914 Act applied only to stock acquisitions and was so narrowly drafted that, literally interpreted, it appeared to apply only to the merger of direct competitors.

In 1950, Congress undoubtedly intended to close the loophole that exempted asset acquisitions from the coverage of the Act, and also, to demonstrate that Congress' concern was not limited to mergers between direct competitors. Although the legislative history is somewhat sparse in regard to conglomerate mergers, the House Report supporting the new section 7 stated: "[T]he bill applies to all types of mergers and acquisitions, vertical and conglomerate as well as horizontal which have the specified effects of substantially lessening competition . . . or tending to create a monopoly." Concern about conglomerates among proponents of the amendment was generally related to two issues. The first was the competitive superiority of diversified firms over single market firms. For example, Representative Hale Boggs, referring to conglomerate firms in the House debate, stated:

This is the type which carries the activities of giant corporations into all sorts of fields, often completely unrelated to their normal operations. In times such as these, when big corporations have such huge quantities of funds, they are constantly looking around for new kinds of businesses to enter. By this process they build up huge business enterprises which enable them to play one type of business against another in order to drive out competitors.

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14 Before its amendment in 1950, the Act read:

That no corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital of another corporation 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. . . .


16 95 CONG. REC. 11,496 (1949).
Thus, Congress clearly intended conglomerates to be included within the scope of the amended section 7. And, as commentators have pointed out, the appropriate congressional committees did not even demand rigorous analysis of the economic effects a conglomerate can produce in the marketplace.\(^{17}\)

Secondly, as the Supreme Court has pointed out, Congress expressed concern over economic concentration itself. In its *Brown Shoe Co. v. United States*\(^{18}\) opinion the Court stated that "[t]he dominant theme pervading Congressional consideration of the 1950 amendment was a fear of what was considered to be a rising tide of economic concentration in the American economy."\(^{19}\) Proponents of the amendment spoke at length about the dangers such concentration posed to the country. For example, Congressman Celler asked the following question:

> How far should government, the people, allow that kind of concentration . . . we call conglomerate concentration to proceed? . . . [I]f no brakes are placed on it, we are going to have, are we not, a few dominating companies like General Motors, which in effect is a holding company, purely an investment holding company . . . ? You get to the point where it is so large that it affects the lives and happiness of so many people, that as a matter of fact, you could not let it fail.\(^{20}\)

The Senate Report on the bill stated:

> [N]ot only must we consider the probable effects of the merger upon the economics of the particular markets affected but also we must consider its probable effects upon the economic way of life sought to be preserved by Congress. Congress was desirous of preventing the formation of further oligopolies with their attendant adverse effects upon local control of industry and upon small business. Where an industry was composed of numerous independent units, Congress appeared anxious to preserve this structure.\(^{21}\)

Nonetheless, the legislative history does not clearly indicate that Congress intended to proscribe mergers that would result solely in increasing economic concentration. As Donald Turner has pointed out, the House and Senate committee reports, which contained explicit exceptions for acquisitions of failing companies, and for small company mergers that will lead to greater competition with large firms, generally indicate that the amended statute was directed only at mergers that would lead to a reasonable probability of anticompetitive effects.\(^{22}\) It should also be noted that the statute which Congress finally enacted appears to apply only to mergers

\(^{17}\) See, e.g., J. NARVER, *supra* note 1, at 47-48.

\(^{18}\) 370 U.S. 294 (1962).

\(^{19}\) Id. at 315.


\(^{21}\) *S. REP. No. 1775, 81st Cong., 2d Sess. 4 (1950).*

\(^{22}\) Turner, *Conglomerate Mergers and Section 7 of the Clayton Act, 78 HARV. L. REV. 1313, 1316 (1965).* See also *S. REP. No. 1775, 81st Cong., 2d Sess. 4, 6, 7 (1950); H.R. REP. No. 1191, 81st Cong., 1st Sess. (1949).*
that have demonstrable anticompetitive effects in a specific relevant market, and the courts have consistently construed section 7 in this fashion.

SECTION 7: THE CASES

Government agencies have adopted four basic approaches in challenging conglomerate acquisitions under section 7.23 The first three theories, which have been accepted by the courts in the proper circumstances, include: (1) a lessening of potential competition; (2) the "deep pocket" or subsidization theory; and (3) increased opportunity for reciprocity or reciprocity effect. All three involve the traditional determination in merger cases that it must be probable that competition will be lessened in a relevant market. In the fourth approach, which has not yet been embraced by any court, the Government argues that the mere aggregate concentration of assets leads to a probable lessening of competition, thereby falling within the ambit of section 7.

Potential Competition

The doctrine that a merger may violate section 7 by eliminating potential rather than actual competition between the merging companies has played an important role in the law relating to conglomerate mergers, and is particularly effective when employed against a product or market extension merger. Thus, when two firms deal in similar products, or in the same products in different, possibly contiguous, market areas, the theory has much force which can be demonstrated in court. However, the doctrine does have severe limitations, and it is doubtful, for reasons discussed below, that it can (or should) have much application to a pure conglomerate acquisition.

Adverse effects on competition by the acquisition of a potential competitor may come about in several different ways. For example, the merger may diminish potential competition by raising barriers to entry, or it may remove as an independent competitive force a firm that, although not selling in the market of the acquired firm, has had an impact on the behavior of companies in that market because it was recognized as a likely entrant. And finally, the merger may involve a firm that would have entered the acquired firm's market by internal expansion or by acquiring a smaller company (foothold acquisition) if the merger had not occurred.24

The first of the modern potential competition cases was United States v. El Paso Natural Gas Co.25 El Paso, the only out-of-state supplier of natural gas to California (with over 50 percent of sales), acquired Pacific Northwest, which was operating in a contiguous market and had on previous occasions attempted to enter El Paso's California market. The Supreme Court, holding

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23 Mergers which are primarily conglomerate in nature may have horizontal or vertical aspects which are themselves sufficient to bring the acquisition within section 7. See, e.g., United States v. Northwest Indus., Inc., 301 F. Supp. 1066 (N.D. Ill. 1969).
24 Turner, supra note 22, at 1362.
that the merger was violative of section 7, stressed the salutary effect that
Pacific had on competition by remaining, capable of entry, on the edge of
the California market. In fact, evidence in the record demonstrated that
El Paso did provide better service and lower prices to an account after
Pacific had made overtures for the business.26

But proof that the acquired company has attempted to enter or will
enter the relevant market is not essential to invoke the doctrine of potential
competition. The courts will look to objective factors indicating that a
particular firm is a potential entrant, even if "subjective" evidence that the
company intends to enter does not exist. United States v. Penn-Olin Chem-
ical Co.27 clearly sets forth this principle. Olin Mathieson and Pennsalt
formed a joint venture to build and operate a sodium chlorate producing
plant in the southeastern United States. The market structure was highly
oligopolistic, with two corporations holding a virtual monopoly share (90
percent) of the market; and no company had entered the market for ten
years prior to the entry of the defendant companies. Eschewing the fact that
no evidence existed that either company intended to enter individually, the
Supreme Court remanded for a determination that one of the corporations
would have entered alone, while the other remained a potential competitor.
The Court looked to several objective factors. The market itself was an
oligopoly, yet the industry was expanding rapidly. Both parent corporations
possessed the inclination, resources and know-how to enter the market, while
few other corporations possessed the same. Also, each company had im-
portant reasons for entering the southeast market.28 In view of these circum-
stances, the Court concluded that there was a prima facie probability that
one of the firms would enter alone, and explicitly stated that subjective
evidence was not required.

FTC v. Procter & Gamble Co.,29 the third recent Supreme Court deci-
sion on potential competition, adds little to the rules set forth in El Paso
and Penn-Olin, although it does suggest that the Court remains receptive
to "objective" rather than "subjective" tests of likely potential entrants.
Procter, the nation's largest seller and advertiser of household cleansing
products, acquired Clorox, a firm accounting for almost 50 percent of sales
in the extremely concentrated household liquid bleach market. The FTC

26 Id. at 659. El Paso can also be analyzed as a case where actual horizontal competition
was present, since Pacific Northwest did compete for contracts with El Paso, although it
did not obtain any. Nevertheless, the case was analyzed in terms of potential competition,
generally is characterized as such, and is the seminal case for an analysis of this doctrine.
28 Id. at 173. On remand, the district court dismissed for the second time. It found
that neither Pennsalt nor Olin-Mathieson probably would have entered independently
since neither company's board of directors had shown much interest in entering alone, and
since projected profitability did not meet managements' standards for diversification.
Government again appealed, the dismissal was affirmed by an equally-divided Court.
389 U.S. 308 (1967).
29 386 U.S. 568 (1967).
found that Procter was the most likely potential entrant into the liquid bleach industry because of its marketing strength, the close relationship of its household products to the bleach sold by Clorox, and its previous history of strong independent entry into related product areas. The Supreme Court affirmed this view over the court of appeals' reversal of the Commission, stating:

Procter was engaged in a vigorous program of diversifying into product lines closely related to its basic products. Liquid bleach was a natural avenue of diversification since it is complementary to Procter's products, is sold to the same customers through the same channels, and is advertised and merchandised in the same manner.\(^{30}\)

Hence, the decisions of the Supreme Court clearly demonstrate that when an oligopolistic market structure exists, and the acquiring firm is the most likely entrant, as evidenced by ability, product affinity and past history, the potential competition theory can be utilized to block the acquisition of a significant factor in the market. Stated thusly, the limitations of the doctrine are easily discerned. The market involved must be an oligopoly. If vigorous competition actually exists among a significant number of firms in the relevant market, it can be argued that a potential competitor would have little additional impact on the quality of competition and, indeed, is not needed. Also, there must be some degree of product affinity between the merging firms. If not, there is no objective reason for deciding that one particular large company is any more of a potential entrant than another; thus the theory would have little application to a pure conglomerate acquisition. An additional limitation is that the objective factors discussed above must show that the acquiring firm would have been a likely entrant by internal expansion. And finally, the acquired firm must be a significant factor in its market. Indeed, if a large firm purchased a very small competitor, this "foothold acquisition" might well stimulate rather than stifle competition.

One district court, however, on a hearing for a preliminary injunction, has taken the potential competition doctrine one step further in *United States v. Wilson Sporting Goods Co.*\(^ {31}\) Wilson, the largest seller of sporting goods and a subsidiary of LTV acquired Nissen, the country's leading producer of gymnastic equipment. Although it found that the objective factors set forth in the *El Paso* case did not indicate that Wilson would enter by internal expansion, the court held that the elimination by this merger of one of the most likely potential entrants might lessen competition since "it could easily be the trigger to a round of mergers that would transform the nature of the industry."\(^ {32}\) Even though other large firms would remain on the fringe as potential entrants, it would be less likely that any

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\(^{30}\) Id. at 580.


\(^{32}\) Id. at 562.
of them would consider entering by internal expansion because entry barriers would be raised, and the remaining competitors themselves would encourage mergers with the large firms. The court continued, stating:

Loss through merger of one of a recognized small group of significant potential entrants, lessens the likelihood of future deconcentration for it removes a company which could have been expected to furnish significant competition to the leading firms in the industry had it entered.\textsuperscript{33}

The district court did say that it would not preliminarily enjoin the merger solely for this reason; rather, it would consider this anticompetitive effect along with the others involved.

Essentially, the Wilson court extended the doctrine in two particulars. First, it broadened the class of potential competitors to include any one of several companies capable of entry into a market without a showing that the firm was the most likely entrant. It thus extended the decisions in El Paso and Procter & Gamble, where, in each instance, the Supreme Court found that the acquiring firm was the most likely entrant, as well as the Penn-Olin decision, where the Court found that one firm conceivably could enter alone while the other remained a potential competitor. Secondly, the view that potential competition would be lessened because other firms will be more reluctant to enter internally and would be likely to merge with other leaders in the acquired firm's industry represents a broader approach. Instead of regarding only the acquiring company as the potential competition eliminated by the merger, the court looked to other potential entrants whose future behavior probably would be affected by the combination.

The recent decision of the Third Circuit in Allis-Chalmers Manufacturing Co. v. White Consolidated Industries, Inc.,\textsuperscript{34} which resulted from White's tender offer for Allis-Chalmers stock, appears to adopt the view that a merger with any one of a number of eligible entrants lessens potential competition. As one of its reasons for reversing the district court's denial of a preliminary injunction, the court found that Allis-Chalmers was "a potential entrant" into the steel rolling mill industry in which White's Blaw-Knox subsidiary was a leading manufacturer, and that its elimination was sufficient to invoke section 7.\textsuperscript{35} The adoption of this approach, of course, expands the reach of section 7 considerably.

Transferral of Market Power: The Deep Pocket Theory

The "deep pocket" or rich parent theory strikes directly at the substance of what critics of the conglomerate merger movement find most troublesome: the fear that competition will be impaired by large, diversified firms capable of dominating various product lines. The House Report which accompanied the Celler-Kefauver Act suggested that mergers might hinder competition

\textsuperscript{33} Id.
\textsuperscript{34} 414 F.2d 506 (3d Cir. 1969), cert. denied, — U.S. — (1970).
\textsuperscript{35} Id. at 533-54.
not only by eliminating a direct competitor or foreclosing a market, but also
by creating an "increase in the relative size of the enterprise making the
acquisition to such a point that its advantage over its competitors threatens
to be decisive." 36 Similarly, Robert A. Bicks, former Assistant Attorney
General in charge of antitrust, has written that, "if we gauge the legality of
'conglomerates' under Section 7 . . . most in point is the 'advantage that
threatens to be decisive' test."37

Several courts, including the Supreme Court of the United States, have
considered this theory and have used it to invalidate conglomerate mergers
in certain market situations. Although these cases involved disparate circum-
stances, each contained certain common factors. Generally, a large and
powerful company acquired a leading firm in an oligopolistic market and
the court found that the stronger company could transfer its financial power
either directly or indirectly to its new line, thereby augmenting or en-
trenching the market position of the acquired company. In the invalidated
mergers, the courts found that the financial power could be used either to
help the smaller firm gain marketing or promotional advantages or to en-
gage in predatory pricing.

In the extremely important case of FTC v. Procter & Gamble Co.,38
this leading soap manufacturer, with assets of over $500 million and sales
of $1.1 billion, acquired Clorox, the largest producer of liquid bleach with
sales of $40 million. The Supreme Court found that the liquid bleach
market consisted of a number of small producers in a tight-knit oligopoly.
The Court also noted that Procter relied heavily on advertising to promote
its products, that it advertised heavily enough to receive quantity discounts,
and that advertising was extremely important in the sale of bleach, since
all liquid bleaches were chemically identical. The Court found that the
combination of huge resources with these quantity discounts could "sub-
stantially reduce the competitive structure of the industry by raising entry
barriers and by dissuading the smaller firms from aggressively competing." 39

37 Bicks, Corporate Mergers and the Antitrust Laws: Clayton Act, Section 7, in THE
38 386 U.S. 568 (1967).
39 Id. at 578. In General Foods Corp. v. FTC, 386 F.2d 936 (3d Cir. 1967), cert. denied,
391 U.S. 919 (1968), a case extremely similar to Procter, the court of appeals applied the
subsidization doctrine. General Foods, a large manufacturer of household name brands,
acquired SOS, one of the two largest makers of steel wool pads. (The two largest, SOS and
Brillo, had a combined market share of 90 percent.) After the merger SOS launched a
promotional campaign that increased its market share from about 45 percent to 60 percent.
In addition to subsidization of advertising, the FTC found that General Foods aided
SOS by offering discounts on pooled purchases of SOS and other General Foods products
and by securing favorable shelf space arrangements. This case previews United States
v. Wilson Sporting Goods Co., 288 F. Supp. 543 (N.D. Ill. 1968), which will be discussed
below. Cf. Butler Aviation v. CAB, 389 F.2d 517 (2d Cir. 1968), where the Second Circuit
rejected the argument that the acquisition of Remmert-Werner by Eastern Airlines came
within the rationale of Procter. The court found that advertising was not a substantial
factor in the marketing of executive business jets. Also, the court pointed out that the
Thus, Procter would assume the role of price leader and the oligopoly would become more rigid.

A second type of resource shifting that has invalidated a merger is subsidization of predatory pricing. In *Reynolds Metals Co. v. FTC*, in an opinion written by Chief Justice Burger while he was a member of the District of Columbia Circuit, the court of appeals sustained the Commission’s decision that Reynolds, the world’s largest maker of aluminum, violated section 7 by its product extension acquisition of Arrow. The acquired company was a leading firm (33 percent of the market) in an industry comprised of companies that were dwarfed by Reynolds. Since the amount of foreclosure was insignificant, the court disregarded any possible vertical overtones of the merger, and focused instead on the conglomerate issue, stating:

> The power of the “deep pocket” or “rich parent” for one of the florist foil suppliers in a competitive group where previously no company was very large and all were relatively small opened the possibility and power to sell at prices approximating cost or below and thus to undercut and ravage the less affluent competition.

The court did not demand that the Commission prove that such conduct had actually taken place; rather it need only establish that the acquisition had the capacity or potentiality to lessen competition. In *Reynolds*, however, an anticompetitive effect was shown, since Arrow’s market share increased at the expense of its competitors after the merger took place.

There has been much criticism of the view that a merger violates section 7 because it creates the potential for predatory pricing. There is little indication that this is a common practice since there are few instances of such conduct on record. Additionally, such a strategy involves a great deal of risk. To make it worthwhile, the user must be able to recoup his losses through monopoly profits at a later time, and there is no certainty he will succeed. Furthermore, since predatory pricing is violative of section 1 of the Sherman Act and section 3 of the Robinson-Patman Act, the enforcement

> “advertising and marketing of Eastern Airline’s transportation services do not have the ready blend with fixed base operations that existed between Procter & Gamble’s detergents and Clorox’s liquid bleach.” *Id.* at 519-20.

> *309 F.2d 223* (D.C. Cir. 1962).

> *Id.* at 229, 230.

> For another example of a type of subsidization, see *Ekco Prods. Co. v. FTC*, 347 F.2d 745 (7th Cir. 1965). In this case, Ekco, a large manufacturer of household kitchen equipment, acquired McClintock, a small firm that accounted for 85 percent of the market of commercial meat handling equipment. After the merger, McClintock acquired one of its competitors, thereby increasing its market share to 90 percent. The Seventh Circuit upheld the Commission’s finding that without Ekco’s resources McClintock would have been unable to purchase Blackman, its competitor. The court stated: “This shows to our satisfaction the reasonable probability that Ekco’s purchase of McClintock may serve to entrench and preserve McClintock’s monopoly.” *Id.* at 752.

> *For an extended criticism of this view, see Turner, supra note 22, at 1343-51; Note, Conglomerate Mergers Under Section 7 of the Clayton Act, 72 YALE L.J. 1265 (1963).*


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agencies can utilize these statutes to deal with such conduct when it arises. In addition, predatory pricing in violation of the Sherman Act can subject the user to treble damage liability.46

The final form of subsidization arises not from a shifting of financial resources, but from the nature and facilities of the larger company. The question was presented in the government's suit for a preliminary injunction to block Wilson Sporting Goods' acquisition of Nissen, the leading maker of gymnastic equipment in an industry composed of small firms.47 The court found that advertising and promotion did not play a significant role in Nissen's marketing of its goods since the company spent only a small amount for these purposes each year and had ample resources to increase the amount if it so desired. However, the court did find that placing Wilson, a large firm, in the midst of small companies would have a detrimental effect on competition because Nissen would have a substantial advantage over its competitors at the dealer level. Both companies sold through dealers, but Wilson utilized more than 10,000, including 90 percent of the sporting goods dealers in the country. The court reasoned that Wilson's dealers would have a strong incentive to handle Nissen's products, even if Wilson did not compel them to do so, and that given the advantages Wilson can offer a dealer with regard to service, credit and billing, such incentive might come from the dealer himself.

The Third Circuit adopted a similar approach in United States v. Ingersoll-Rand Co.48 The court voided the merger, in part, because as a consequence of the acquisitions, Ingersoll-Rand would be able to market a full line of mining equipment to the detriment of the other small companies in that industry. And in the recent decision in Allis-Chalmers Manufacturing Co. v. White Consolidated Industries,49 part of the court's basis for issuing a preliminary injunction was that the merger would permit Blaw-Knox, a White subsidiary, to become the only company capable of designing, producing and installing a complete metal rolling mill. Such a result was regarded as being injurious to competition.

The district court in United States v. International Telephone & Telegraph Corp.50 also recognized the validity of this doctrine, although the court did not find that sufficient evidence had been presented to make a determination that Grinnell was the dominant company in its market, that a system of package selling of Grinnell's sprinklers with ITT's heating, air conditioning and industrial control products was feasible, or that the system

49 414 F.2d 506 (3d Cir. 1969).
would give Grinnell a competitive advantage over its competitors. Nonetheless, the court did recognize that if a competitive advantage could be shown in such a factual setting, it might be grounds for invalidating the merger.51

These cases are significant because they deal with a type of subsidization that does not focus solely on the wealth of the acquiring company, but rather, on the nature of the acquiring company or of the merged entity. This doctrine may well be used by the enforcement agencies to challenge conglomerate mergers between extremely large companies, such as White and Allis-Chalmers; in such instances the typical "rich parent" doctrine would have little applicability since both firms are extremely large before the merger and the mere addition of wealth would be of little consequence.

Reciprocity and Reciprocity Effect

The doctrine of reciprocity has also been used to invalidate a conglomerate merger under section 7. In the seminal case, FTC v. Consolidated Foods, Corp.52 the Supreme Court upheld the Commission's finding that the acquisition of Gentry, a producer of dehydrated onion and garlic, by Consolidated Foods, which owned a network of wholesale and retail food stores as a part of its other operations, violated section 7. Consolidated was a substantial purchaser of the products of food processors who, in turn, bought dehydrated onion and garlic for use in preparing and packaging their food. Thus, the opportunity to practice reciprocity was enhanced by the merger.53 The Court declared unequivocally that "'reciprocity' made possible by such an acquisition is one of the congeries of anticompetitive practices at which the antitrust laws are aimed."54

The Court then directed its attention to establishing the probability that reciprocity would be increased by the merger. It found that Consolidated did undertake to assist Gentry in selling after the acquisition (although Consolidated later disclaimed adherence to any policy of reciprocity). Disregarding the court of appeal's decision, based on post-acquisition evidence, that reciprocity was not probable, the Supreme Court stated that while the lower court was not in error in considering post-acquisition evidence, it had given it too much weight. The majority opinion stressed that no group acquiring the company with reciprocal buying opportunities is entitled to a "free trial" period. Moreover, the Court found that the post-acquisition evidence in this case tended to confirm the probable anti-

51 Id. at 778.
52 380 U.S. 592 (1965). In this case the Supreme Court defined reciprocity as "a threatened withdrawal of orders if products of an affiliate cease being bought, as well as conditioning of future purchases on the receipt of orders for products of that affiliate." Id. at 594.
53 Id. at 598.
54 Id. at 600. For another case in which the merger was held to violate section 7 on the basis of reciprocity, and where there was substantial evidence both that reciprocity was practiced after the merger and that the practice led to an increased market share, see United States v. General Dynamics Corp., 258 F. Supp. 86 (S.D.N.Y. 1966).
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competitive effect which the Commission attributed to the merger. Basic's product was superior to Gentry's; yet in a rapidly expanding market, Gentry was able to increase its share of the onion sales by 7 percent and to hold its losses in garlic to a 12 percent decrease. The Court then said that the finding of probability of reciprocal buying by the Commission, "whose expertise Congress trusts," should be honored if there is substantial evidence to support it. The evidence here was substantial, because "reciprocity was tried over and over again and it sometimes worked." Also, the Court described the industry structure as "peculiar," with Basic being the leader and Consolidated closing the gap. By "peculiar" the Court apparently meant peculiarly susceptible to reciprocity.

The Consolidated Foods case did not resolve a question that has an important bearing on the efficacy of the reciprocity doctrine to challenge conglomerate acquisitions, i.e., what evidence need be shown to demonstrate a probability that reciprocity will be increased by the merger. Although the majority was not called upon to resolve this question since Consolidated clearly had a reciprocity program, the opinion does point out that "[r]eciprocal trading may ensue not from bludgeoning or coercion but from more subtle arrangements." And Mr. Justice Stewart, who did address himself to the question, stated:

Clearly the opportunity for reciprocity is not alone enough to invalidate a merger under Section 7. The Clayton Act was not passed to outlaw diversification.

In several recent complaints the Justice Department has advanced the theory of "reciprocity effect." This theory, which is defined as "the tendency of a firm desiring to sell to another company to channel its purchase to that company," does not depend on a probability that the merged entity will practice reciprocal dealing. Rather, it suggests that by virtue of the creation of a proper market structure, a firm will unilaterally direct its purchases to potential customers. For instance, potential customers of the acquired firm who desire to become suppliers of the acquiring firm will consciously channel their purchases toward the acquired firm in an attempt to induce business in return. Since it is assumed that firms will act in the above described manner when the possibility is presented, the creation of a conclusive market structure satisfies this theory.

The lower courts have rendered inconsistent decisions with respect to the evidence required to find that reciprocity or reciprocity effect rendered a merger violative of section 7. Two cases have supported the view that once a market structure favorable to such practices has been created, the statute

55 380 U.S. 600.
56 Id.
57 Id.
58 380 U.S. at 594.
59 Id. at 603 (concurring opinion).
has been violated. In *United States v. Ingersoll-Rand Co.*, the Third Circuit affirmed the district court's issuance of an interlocutory injunction restraining that company's acquisition of three manufacturers of mining equipment. When the defendant asserted that there was no proof that it would take advantage of the opportunity for reciprocity, the court's answer was unequivocal:

> It is not overly speculative to assume that the judicious use of its steel-purchasing power by Ingersoll-Rand could immeasurably increase the sales by the acquired companies of machinery and equipment to the coal mining companies which acutely need the continued good will of the steel industry.

And directly to the point of the reciprocity effect theory, the court said:

> Moreover, the mere existence of this purchasing power might make its conscious employment toward this end unnecessary; the possession of the power is frequently sufficient, as sophisticated business men are quick to see the advantages in securing the good will of the possessor.

The recently decided *White-Allis-Chalmers* case also offers support for the theory that the creation of a market structure conducive to reciprocity is sufficient to invalidate a merger under section 7. The Third Circuit explicitly stated:

> An acquisition which creates a market structure conducive to reciprocal dealing presents the acquiring company with an advantage over competitors, an advantage which by its very nature is anticompetitive.

To support its position the court pointed out that the tremendous purchasing power of a White-Allis combine, coupled with White's subsidiary's (Blaw-Knox's) enhanced position in the rolling mill market, would foreclose White's competitors in the sale of rolling mill machinery to the steel industry.

On the other hand, the district court in *United States v. Penick & Ford, Ltd.* refused to preliminarily enjoin Reynold's acquisition of the fourth largest seller of starch on the theory of probability of reciprocal dealing, even though it was shown that reciprocity had been practiced in the starch industry for several years. The Government argued that since Reynolds was a major buyer of paper and Penick & Ford sold starch to paper companies, the merger created the opportunity of reciprocal dealing. In ruling against the preliminary injunction motion the district court reasoned that the *Consolidated Foods* result was dependent upon the existence of high market concentration in the dehydrated garlic and onion...
industry. The starch business was rather evenly divided between 10 or 11 competitors; Penick & Ford had only 12 percent of the market in comparison with Gentry’s 35-50 percent. In addition, the court noted that Reynolds had submitted affidavits attesting that it espoused a firm policy against reciprocal dealing and instructed its purchasing agents to base their choice on price, quality and service, and nothing else. Given these facts, the court did not see how it could be concluded prior to a full trial that reciprocal dealing was probable. It should be noted, however, that this case still leaves open the possibility that if the market were oligopolistic, an express policy against reciprocity would not be sufficient to overcome the inference that the practice probably would occur.

The district court directly confronted the question of opportunity for reciprocity and reciprocity effect in United States v. ITT. The court squarely rejected the government’s argument that, as a matter of law, once it has shown a merger will create an opportunity for reciprocity dealing, that is sufficient to halt the merger. The court distinguished both Consolidated Foods and General Dynamics, since in those cases there was evidence that a reciprocity program was actually practiced by the defendant companies. The court also found differences between Ingersoll-Rand and Allis-Chalmers, and the ITT situation. While reading these cases to hold that the opportunity for reciprocity was sufficient to violate section 7, the court distinguished them on the ground that the defendant companies involved therein, unlike ITT, did not have an explicit company policy against reciprocity. In support for this position the district court cited Penick & Ford and United States v. Northwest Industries. In both of these cases the court refused to issue a preliminary injunction on the theory of reciprocity, because of evidence submitted by the defendants that they had a company policy against this practice. The court also felt that ITT’s position was even stronger than Penick & Ford's or Northwest Industries', since the Government did not establish the existence of an organized reciprocity program or a prior history of reciprocal dealing by defendants or their suppliers.

As with the preceding theories, reciprocity and reciprocity effect have significant limitations as methods of challenging conglomerate mergers. There is no guaranty that the merger will substantially increase opportunities for reciprocity; and even if it does, proof of probability may be difficult in many cases.

**Economic Concentration Theory**

In recent cases attacking conglomerate acquisitions, the Justice Department has advanced the theory that a merger is forbidden by section 7 if it
results in a substantial increase in economic concentration. This term includes not only concentration in specific markets, which has been attacked successfully in the past, but also aggregate concentration, involving the size of business firms and the proportion of the economic activity of the nation as a whole which they represent, or a broad classification of that activity, such as manufacturing.

Mr. Roland Donnem, Director of Policy Planning for the Antitrust Division, recently outlined the government's theory in some detail. Preliminarily, he argued that the statutory language "in any line of commerce in any section of the country" can be construed to mean the economy and nation as a whole. They seem to be the relevant measurements if the subject of concern is the size of business firms and the resulting aggregate concentration in the economy. Furthermore, it can be urged that the word "competition" in section 7 encompasses more than competition in the economist's sense of business rivalry or performance. Mr. Donnem urged that Congress intended the word competition to include "characteristics of the competitive framework such as the size of firms and the contribution they add to concentration in the economy." Mr. Donnem further argued that cases such as Brown Shoe and United States v. Von's Grocery Co. indicate that as evidence concerning qualitative evil to our economic life increases, the need to show other anticompetitive elements decreases. Thus, where a qualitative harm to the country's economic life, such as the erosion of local control of business and the concentration of economic power into a few hands, can be demonstrated, there is no need to demonstrate specific anticompetitive effects in particular markets.

In its recent cases, the Department has also urged that conglomerate mergers result in demonstrable, probable anticompetitive effects in many of their individual product lines. For instance, many companies are eliminated as independent decision-makers, thereby leading to a lessening of competition in several markets.

The Government has argued that with the increasing number of business relationships due to diversification, firms seem to develop a network of harmonious interests that also may tend to decrease competition in the various relevant markets in which they operate. For example, a firm which

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71 See notes 9-12 and accompanying text supra.
72 Address by Roland W. Donnem, supra note 8.
73 Id. at 55,578-79.
74 Id. at 55,579. It is by no means clear that the legislative history can be read in this fashion. See United States v. El Paso Natural Gas Co., 376 U.S. 651, 658, 660 (1964).
75 384 U.S. 270 (1966). In this case the Supreme Court held that a horizontal merger between grocery chains violated section 7, although the merged entity controlled only 7.5 percent of the market and the merger increased the market share of the two largest firms only 1.1 percent. The Court found a trend toward concentration in the relevant market and reasoned that even a slight increase in concentration had a probability of lessening competition.
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is the price leader in market A may be reluctant to compete vigorously in market B, where it is a less substantial factor, against a diversified firm that it meets in both markets; its competitor may also be its customer or supplier in other markets which may further interdependence among firms.

Moreover, Mr. Donnem noted that in certain horizontal merger cases, where a trend toward concentration is shown, elaborate proof of competitive harm is not required. This principle, he urged, can be carried over to aggregate concentration to prevent conglomerate mergers. He pointed to the Supreme Court's statement in United States v. Continental Can Co.77 to support this view. The Court said:

Where a merger is of such a size as to be inherently suspect, elaborate proof of market structure, market behavior and probable anticompetitive effects may be dispensed within view of § 7's design to prevent undue concentration.78

Finally, Mr. Donnem pointed out that the courts have an obligation to halt anticompetitive effects in their incipiency, rather than waiting until after competition has been harmed.

No court has yet handed down a final decision on the economic concentration theory, but the question has been considered by two district courts on hearings for preliminary injunctions. In both cases the government's argument was explicitly rejected. In the Justice Department's attack of Northwest Industries' attempted takeover of B. F. Goodrich, the court admitted that there may indeed be good reasons to limit growth by merger of the country's largest industrial corporations:

The desirability of preserving the maximum number of competing units in any given line of commerce so long as they can compete effectively, the desirability of keeping entry barriers as low as possible, the increased potential for anticompetitive practices which may result from bigness, all are factors which may warrant a prohibition based on size alone.79

But the court then said:

The law as it now stands, however, makes the adverse effect on competition the test of validity and until Congress broadens the criteria, the Court must judge proposed transactions on that standard.80

Likewise, in the ITT case, the court noted that the legislative history of section 7 does reflect congressional concern about the rising tide of economic concentration in American industry. But the court also pointed out that "amended Section 7, as enacted proscribes only those mergers the effect of which 'may be substantially to lessen competition,' not those the

77 378 U.S. 441 (1964).
78 Id. at 458; See also United States v. Philadelphia Nat'l Bank, 374 U.S. 321. (1964).
79 301 F. Supp. at 1096.
80 Id.
effect of which may be substantially to increase economic concentration.”

The court noted that a trend toward concentration in a particular product line is important in determining if a merger diminishes competition in that line. However, a merger which increases economic concentration does not necessarily indicate a lessening of competition. Finally, the court agreed with the Northwest court that the decision to change the standard determining a merger’s illegality under section 7 to include an increase in economic concentration should be left Congress.

**Administrative Reaction to Conglomerate Mergers**

Since the advent of the Nixon Administration, the Department of Justice has taken the view that section 7 does apply to the purer forms of conglomerate mergers. As indicated above, the Department has challenged five conglomerate acquisitions, and in each instance, has based its attack, in part, on the theory that an increase in economic concentration violates section 7. In addition to dangers to competition, the Department has expressed increasing concern over the broad economic, political and social changes that it feels can be wrought by the conglomerate merger trend. For example, the Attorney General has spoken at length of the danger that America’s smaller cities may become “branch cities” due to conglomerate acquisition of local business and subsequent relocation of their headquarters to distant, large metropolitan areas. He has also expressed concern that if the current trend to concentration continues to increase, direct regulation of business by government will result, thereby altering America’s traditional dependence upon the largely self-regulating economy which has served the country well over the years.

In response to these possible dangers, the Administration has given notice (by words as well as action) that it intends to go beyond the Department of Justice Merger Guidelines (Guidelines) in challenging conglomerate acquisitions. The present Guidelines, issued on May 30, 1968 under Donald Turner, generally do not venture very far from the developing case law in delimiting which conglomerate mergers will be challenged. They are restricted to the theories of potential competition, reciprocity, and entrenchment (the deep-pocket or subsidization theory), which demand that probable anticompetitive effects be demonstrated in a relevant market. The Guidelines do contain the open-ended caveat that since the conglomerate merger area involves novel problems not yet subjected to as extensive or sustained analysis as vertical or horizontal mergers, mergers not covered by the explicit prohibitions may be challenged.

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82 Id. at 796-97.
83 See supra note 3, at 55,506.
84 Id. at 55,506-07.
86 Id. at 312.
The Attorney General, on the other hand, has announced that there is a "probability" that the Justice Department will challenge mergers that would not violate section 7 under established case law. He has stated that the Department "may well oppose" any merger among the top 200 manufacturing firms or firms of comparable size in other industries. In addition, he has warned that the Department "will probably oppose" any merger by one of the top 200 manufacturing firms of any leading producer in any concentrated industry. Finally, the Department will continue to challenge mergers which may substantially lessen potential competition or develop a substantial potential for reciprocity.87

However, the Department has stated that it is not opposed to all conglomerate mergers. Readily admitting that in certain circumstances conglomerate mergers are pro-competitive, the Division has made it clear that it would welcome a large firm's acquisition of a small factor in a concentrated industry. Such a "foothold acquisition" would be beneficial to the market structure since the revitalized merged company will be able to compete more effectively against the industry leaders.88

The Bureau of Economics of the Federal Trade Commission, in its recent Economic Report on Corporate Mergers (Report),89 agreed that Congress enacted the Celler-Kefauver Act to prevent further increases in not only market but also overall economic concentration. The Report pointed out dangers to the country's socio-political system as well as to the economy if economic power is concentrated in too few hands. The FTC Staff stated that the Commission should direct its merger enforcement resources to focus specifically on large conglomerate mergers, since it too was of the opinion that acquisitions by large, diversified companies of leading firms in concentrated industries should be challenged, to ensure that entry by internal growth or by the acquisition of small factors in the industry will be encouraged. The Staff argued for a broad definition of potential competitors since history indicates that technological and other developments have brought quite unrelated companies into competition at later times. And the Staff further recommended that the enforcement agencies should evaluate individual acquisitions within the broad context of the merger induced structural changes which it feels are occurring within the economy.90 These recommendations were adopted, virtually in their entirety, by Chairman Weinberger speaking for a unanimous commission.91

Thus, both enforcement agencies have adopted a similar approach to

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87 See supra note 8, at 55,509.
88 Address by Assistant Att'y Gen. McLaren, Northwestern University Law School Eighth Annual Corporate Counsel Institute, Chicago, Oct. 8, 1969, in 5 TRADE REG. REP. ¶ 50,258, at 55,544 (Oct. 8, 1969); Address by Mr. McLaren, May 12, 1969, in 5 TRADE REG. REP. ¶ 50,244, at 55,500 (June 9, 1969).
89 FTC REPORT at 9.
90 Id. at 12-18.
conglomerate acquisitions. Both agree on the "leading firm" doctrine and conversely that foothold acquisitions into concentrated industries should be encouraged. The FTC, however, appears to adopt a stricter view as to those mergers between large firms that should be challenged. The Commission has stated that, based upon current knowledge of industrial structure, every merger in which each of the parties has assets exceeding $250 million is likely to be anticompetitive within the meaning of section 7.92 Thus, while the Justice Department has suggested it will contest any merger between the top 200 industrial corporations (or their equivalents), the FTC recommends that any merger between firms of over $250 million should be challenged. Overall, conglomerates appear to be in for a difficult time from the antitrust enforcement agencies.

92 FTC REPORT at 18.