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ANTITRUST ISSUES IN CONGLOMERATE ACQUISITIONS: TRACKING A MOVING TARGET

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INTRODUCTION

During the spring and early summer of 1969, the Department of Justice launched a series of five complaints designed to test the application of the merger act to acquisitions where the acquired company's operations were not closely aligned with those of the acquiring company. These complaints, addressed to what have been called "conglomerate" acquisitions, represented a new stage in the campaigns of the Department of Justice and the Federal Trade Commission to enforce section 7 of the Clayton Act, as amended in 1950 (the merger act).[1]

In one sense, these five cases represent a logical development of enforcement agency theory concerning the market effects of horizontal and vertical mergers, on the one hand, and mergers between close potential competitors or closely related partners, on the other.

In another sense, the five cases represent something new by way of enforcement agency action, since the allegations do not focus primarily on the effects of the challenged acquisitions on specific markets. The principal thrust of the charges is that the scale and pace of merger activity has been increasing rapidly, that the proportion of the total assets of the nation's manufacturing corporations held by the 200 largest manufacturing firms has also increased substantially, and that the bulk of this increase in aggregate concentration has resulted from mergers. The five complaints, therefore, charge, in virtually identical terms, that each of the mergers under attack will result in an increase in over-all concentration and, therefore, will substantially lessen competition in violation of Clayton 7.

This paper traces the history of current antitrust concern with conglomerate acquisitions, exploring the economic implications of the Supreme

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The statistical portions of the study would not have been formulated or carried out without the collaboration of Jack Farkas of the staff of the Antitrust Department of THE CONFERENCE BOARD; all parts of the study have benefited from careful reading by Kathleen Massarelli of the Department's staff.

[1] 15 U.S.C. § 18 (1964).

Court's decisions concerning such acquisitions in the 1962-1968 period, and going on to examine the 1969 complaints. The final section of the paper examines some of the underlying statistical data and explores the economic trajectory along which present enforcement theory is moving. Before beginning the analysis, however, some initial discussion of the semantics and the underlying concepts may facilitate an understanding of the problems involved.

THE SEMANTIC MAZE

Few words that mean so many different things to so many different observers have remained in general circulation as long as the word *conglomerate.* Indeed, the term applies today both to a form of corporate organization and to a pattern of acquisition. But since the term has no tight technical meaning, it does not automatically provide for a clear-cut category of either corporations or mergers.[2]

With some refinements, the concept has remained basically unchanged since a TNEC report on *The Structure of Industry,* published in 1941, used the term to describe acquisitions that were neither horizontal (bringing together competitors) nor vertical (bringing together a supplier-customer pair of companies).[3]

A Basic Paradox

Through the years the word *conglomerate* has, therefore, represented a residual category accounting for all acquisitions that are neither directly horizontal nor directly vertical. With so wide a coverage, however, it is not surprising that as of late in the 1960s, conglomerate acquisitions appeared to some to menace the future of the enterprise system while to others they represented viable instruments of competitive progress.

The present paper finds that this paradox arises only in part from the looseness of the underlying concept and that even with a more precise concept, the conglomerate method of company growth would present analytic dilemmas so long as one focuses on essentially structural methods of studying how industries or major segments of the economy are organized.

Focus of the Study

If a diversified company acquires a relatively undiversified partner whose operations are horizontally or vertically related to some part of its own operations, the acquisition will be treated as a horizontal or vertical acquisition by the enforcement agencies and no novel problems concerning conglomeration as such need arise.[4] But if a company, whether diversified

2 The terms *acquisition* and *merger* are used interchangeably in the present study except where the context clearly requires one or the other.

3 W. THORP & F. CROWDER, THE STRUCTURE OF INDUSTRY (TNEC Monograph No. 27, 1941).

4 *See,* B. BOCK, MERGERS AND MARKETS: 7 (NICB Studies in Business Economics No.

or not, acquires another whose operations are not related or are only minimally related to its own, additional problems going well beyond those implicit in horizontal or vertical acquisitions can present themselves.[5] It is to this last set of problems that this paper is addressed.

The paper is, therefore, concerned not with acquisitions by conglomerate (or diversified) companies, as such, but with acquisitions by any type of company of other companies, or parts of companies, whose operations are in general conglomerate to its own.

UNDERLYING COURT DECISIONS

Like all of the basic antitrust laws, section 7 of the Clayton Act, as amended in 1950, is formulated in broad terms and was designed by Congress to prevent acquisitions which might substantially lessen competition or tend to create a monopoly. Congress, however, left it up to the courts to determine the conditions under which an acquisition would have such effects. Indeed, the text of the law is virtually bare of specifics:

> [N]o corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock . . . and no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another corporation engaged also in commerce, *where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.*[6]

Theory on Horizontal and Vertical Acquisitions (1962-1963)

Brown Shoe Co. v. United States,[7] the first of the cases to reach the Supreme Court under amended Clayton 7, was decided in 1962 and concerned Brown Shoe's acquisition of Kinney, a merger that was simultaneously horizontal and vertical. Both Brown and Kinney had been manufacturers and retailers of men's, women's, and children's shoes. The Supreme Court held against the acquisition and in the process noted that the merger act applies "not only to mergers between actual competitors, but also to vertical and conglomerate mergers whose effect may tend to lessen competition in any line of commerce in any section of the country."[8] A key point of the law, said the Court was the authority given to the enforcement agencies to arrest mergers while their threat to competition was *potential* rather than

105, 1969); B. BOCK, MERGERS AND MARKETS (NICB Studies in Business Economics No. 100, 6th ed. 1968); *id.* No. 93 (5th ed. 1966); *id.* No. 87 (4th ed. 1965); *id.* No. 85 (3d ed. 1964); *id.* No. 77 (2d ed. 1962); *id.* No. 69 (1st ed. 1960).

[5] *See* B. BOCK, MERGERS AND MARKETS: 7, 59-90 (NICB Studies in Business Economics No. 105, 1969); B. BOCK, MERGERS AND MARKETS 129-62 (NICB Studies in Business Economics No. 100, 6th ed. 1968); *id.* No. 93, at 140-210 (5th ed. 1966); *id.* No. 87, at 95-107 (4th ed. 1965); *id.* No. 77, at 124-46 (2d ed. 1962).

[6] Clayton Act § 7, 15 U.S.C. § 18 (1964) (emphasis added).

[7] 370 U.S. 294 (1962).

[8] *Id.* at 317.

actual. The Court noted further that an analysis of the potential competitive effects of an acquisition should center on such effects in a product market (line of commerce) and a geographic market (section of the country).

Under *Brown Shoe,* the boundaries of the product market are to be determined by the interchangeability of the relevant products and substitutes for them; and there may also be relevant submarkets within such markets; while under *United States v. Philadelphia National Bank,*[9] decided in 1963, the boundaries of the geographic market are to be determined by the area within which the relevant product is distributed where "the effect of the merger on competition will be direct and immediate."[10]

A third decision handed down by the Court of Appeals of the District of Columbia in 1962 also contains language relevant to later decisions concerning conglomerate acquisitions. In *Reynolds Metals v. FTC,*[11] the Federal Trade Commission had challenged Reynold's acquisition of Arrow Brands. Arrow had been the largest of eight small companies producing florist foil, an aluminum foil wrap for flower pots, and Reynolds was one of the few companies producing aluminum foil. The court held that the acquisition might substantially lessen competition. It found that the assimilation of Arrow into Reynolds' enormous capital structure ("deep-pocket") had given Arrow an advantage over its competitors and that the power of a rich parent to put its resources into a small-company market gave the acquired company the opportunity to sell at prices approximating cost or below and to "undercut and ravage the less affluent competition."[12]

Problems of Conglomerate Acquisitions

With *Brown Shoe* (1962) and *Philadelphia Bank* (1963) behind it, the Supreme Court had, therefore, as of the beginning of 1964 evolved a set of basic tests for horizontal and vertical acquisitions — and these tests were phrased primarily in terms of concentration in the markets affected, the market shares of the merging companies, the potential barriers to entry that the acquisitions might effect, and the degree of foreclosure from actual or potential markets of independents that might result from vertical acquisitions.

By early in 1964, then, the Supreme Court was in a position to focus on the competitive effects of acquisitions where there were only limited prior horizontal or vertical relations between the merging companies. Although these acquisitions were conglomerate, as we understand the term today, they were not identified as such by the Department of Justice or by the Supreme Court. Instead, the Court married conventional theory concerning horizontal acquisitions to a theory of potentiality to find that each

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9 374 U.S. 321 (1963).

10 *Id.* at 357.

11 309 F.2d 223 (D.C. Cir. 1962).

12 *Id.* at 229-30.

of the acquisitions might substantially lessen competition. The theory evolved in these cases is considered in a subsequent section of this paper.

A second series of decisions, beginning in 1965 and developing through 1968, identified the acquiring-acquired company relationship as conglomerate and married conventional theory concerning horizontal and vertical acquisitions to the potentiality theory developed in the 1964 decisions and to a "deep-pocket" theory to again find that a series of challenged acquisitions might substantially lessen competition. The theory evolved here is likewise considered in a subsequent section of this paper.

But before moving forward to examine these decisions, it may be well to examine the terminology and its relationship to an analytic understanding of the problems involved.

The acquisitions of today — and particularly conglomerate acquisitions — can be thought of as representing a current stage in the evolution of economic transactions — starting with barter and moving on through the purchase and sale of perishables, semi-durables, durables, equipment and plants, to companies. Indeed, the existence of a market for companies — both listed and unlisted — represents the latest dimension of choice available to economic units, since it permits companies to restructure themselves in order to preserve economic flexibility in a rapidly changing environment.

In 1965 when the Supreme Court first considered an acquisition it identified as involving a conglomerate relation between the merging partners, it found it useful to classify such acquisition as product-extension, market-extension, and other or "pure" conglomerate acquisitions. This terminology emphasized the resemblances between that case (*FTC v. Procter & Gamble Co.*)[13] and conventional horizontal acquisitions, but it appears today to be less serviceable as additional forms of conglomeration increasingly claim our attention. For the purpose of the present study, therefore, conglomerate acquisitions will be considered in terms of two subcategories to be called "convergent" and "divergent" acquisitions.

Convergent conglomerate acquisitions will include acquisitions where there is a close community of economic interest between the acquiring and acquired company in significant parts of the operations of at least one of them. The term is, therefore, broad enough to include acquisitions involving product- and market-extension as well as those joining close potential customers or suppliers. It also covers other acquisitions where the acquired company fits into the operations of the acquiring company in ways that decrease overhead, reduce risks, and/or raise the efficiency of the operations of either or both companies.

Divergent conglomerate acquisitions will then include all other conglomerate acquisitions, *i.e.*, acquisitions where management services or financing represent the major ties between the acquiring and acquired companies, and acquisitions entered into for stock market leverage purposes.

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[13] 386 U.S. 568 (1967).

EXTENSION OF HORIZONTAL AND VERTICAL THEORY TO CONVERGENT CONGLOMERATE ACQUISITIONS (1964-1968)

During 1964 the Supreme Court was concerned with a series of cases where there were close but not fully consummated competitive relationships between the acquiring and acquired companies. In these cases the Court extended conventional theory concerning horizontal acquisitions (acquisitions of actual competitors) to acquisitions of close potential competitors. In all but one of these cases,[14] the facts concerning potential competition were clear-cut and the entry of one company into the other's market had been imminent prior to the challenged acquisition. But the term "conglomerate" does not appear in these cases. Instead, the criteria for horizontal acquisitions are stretched to cover closely aligned types of acquisitions.

Following 1964 and moving through 1965-1968, the Supreme Court dealt with an additional set of cases where the term "conglomerate" was used, but where the relationship between the acquiring and acquired company was still close and where distribution of overhead costs could result in a decrease in the unit costs of the acquired company to the detriment of weaker competitors. It was in these cases that the original interpretations of the law concerning conglomerate acquisitions, identified by name, first evolved. Each of these two sets of cases will be considered in turn.

Conglomerate Acquisitions Not Identified as Such

In 1964 the Supreme Court handed down a decision concerning El Paso Natural Gas' acquisition of Pacific Northwest Pipeline — an acquisition that would later have been called a market-extension acquisition.[15] Prior to the acquisition, El Paso had been the sole out-of-state supplier of natural gas in California. Pacific Northwest distributed along a pipeline from New Mexico to the Pacific Northwest, but had no customers in California. Shortly before the acquisition, however, Pacific Northwest had been negotiating to supply Southern California Edison, the largest industrial user of natural gas in southern California; a tentative agreement had been reached when Pacific Northwest was acquired by El Paso. In considering the competitive consequences of the acquisition, the Supreme Court noted that the California market for natural gas was expanding and that while El Paso had been the only existing out-of-state supplier, Pacific Northwest was a potential supplier, as evidenced by its negotiations with Southern California Edison. The Court then found that the acquisition might substantially lessen competition, holding that the appropriate criteria included the nature and extent of the market and the nearness of the absorbed company to it; the eagerness of the absorbed company to enter the market and its potential ability to do so; and finally, the growth potential of the market and the potential ability of the absorbed company to supply it.

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[14] United States v. Penn-Olin Chem. Co., 378 U.S. 158 (1964).
[15] United States v. El Paso Natural Gas Co., 376 U.S. 651 (1964).

The second 1964 decision concerned Alcoa's acquisition of Rome Cable — or what today would be considered a vertical and a product-extension acquisition.[16] The Court noted that Alcoa is a fully integrated aluminum producer and also manufactures aluminum conductor, accounting for 27.8 percent of the market in 1958. Rome was primarily a manufacturer of copper conductor, although it had also produced a small amount of aluminum conductor. The Court held that the acquisition might substantially lessen competition even though Alcoa did not produce copper conductor and Rome accounted for only 1.3 percent of the aluminum conductor market. While the reasoning is not spelled out, the Court appears to have been concerned with the increasing substitutability of aluminum for copper conductor and, therefore, the elimination of potential competition between Alcoa and Rome; it was also concerned because the acquisition had eliminated a viable, independent company that might have become a strong competitor in the aluminum conductor market if it had not been acquired by Alcoa.

The third of the 1964 decisions concerned Continental Can's acquisition of Hazel-Atlas Glass — an acquisition which today would be considered a horizontal and a product-extension acquisition.[17] The Department of Justice had charged that the acquisition of the third largest United States producer of glass containers by the second largest United States producer of metal containers might substantially lessen competition in the combined container market as well as in specific markets where metal and glass are used interchangeably. The Supreme Court agreed. The basic issue concerned the relevance of actual or potential competition between the two types of containers to a conclusion about the competitive effects of the acquisition. The Court found that the two lines could under many conditions be used interchangeably and that, therefore, the acquisition had brought together potential, if not actual, competitors and thus might substantially lessen competition.

The fourth decision concerned the establishment of Penn-Olin as a joint venture by Olin-Mathieson and Pennsalt to operate in the sodium chlorate market in the Southeast — a venture which today would be considered a product-extension acquisition for Olin-Mathieson and a market-extension for Pennsalt.[18] In its first decision in that case, the Supreme Court held that the way to test whether such a venture might substantially lessen competition was to ask whether absent the venture one of the parent companies might have gone into the market while the other continued on the periphery as a potential competitor. On remand, the district court found that although strong recommendations for independent internal expansion into the southeastern sodium chlorate market had been made by members of the staff in each parent company, neither management had been willing to invest on its own and that, therefore, neither had been a potential com-

16 United States v. Aluminum Co. of America, 377 U.S. 271 (1964).
17 United States v. Continental Can Co., 378 U.S. 441 (1964).
18 United States v. Penn-Olin Chem. Co., 378 U.S. 158 (1964).

petitor. On appeal, an equally divided Supreme Court left the lower court decision undisturbed.[19]

In summary, then, although the "conglomerate" concept does not appear in direct form in the 1964 decisions, the Supreme Court had in fact fitted essentially conglomerate problems into an older theoretical mold, holding that evidence of potential competition between an acquiring and an acquired company constitutes grounds for finding that an acquisition may substantially lessen competition when the combined market shares of the two companies are high, the combined market is concentrated, and barriers to entry are substantial. In these decisions, therefore, the Supreme Court gave new weight to the concept of potential competition, using it as a magnet to draw facts concerning product- and market-extension acquisitions within the analytic framework for determining the competitive effects of horizontal acquisitions.

Conglomerate Acquisitions Identified As Such

Beginning in 1965, however, the Supreme Court began to consider the competitive effects of acquisitions where the older horizontal molds, even when expanded by findings on potential competition, would not hold the conglomerate facts.

The first such decision, *FTC v. Consolidated Foods Corp.*,[20] concerned Consolidated Foods' acquisition of Gentry. Consolidated Foods was primarily a food wholesaler; Gentry manufactured dehydrated onion and garlic. The record showed that Gentry's sales manager had sought to increase sales by notifying prospective buyers that Consolidated's purchases from them would depend on their purchases from Gentry. The Supreme Court found that the acquisition might substantially lessen competition because it gave Consolidated the advantage of a reciprocal buying position in competing for business for Gentry. It noted that reciprocal trading may ensue not from bludgeoning or coercion but from more subtle arrangements such as a threatened withdrawal of orders if products of an affiliate are not bought. The Court was careful to note that it had not ruled that every acquisition which might permit reciprocal sales practices violated Clayton 7; but where the acquiring company commands a substantial share of a market and there is a clear probability of reciprocal buying, the Commission's findings of probable anticompetitive effects should be honored.[21]

In 1967, the Supreme Court went further when it upheld the Commission's finding that Procter & Gamble's acquisition of Clorox might substantially lessen competition.[22] The facts are familiar. Clorox had been the leading manufacturer of household liquid bleach, with 40 percent of the

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19 United States v. Penn-Olin Chem. Co., 389 U.S. 308 (1967), *aff'g* 246 F. Supp. 917 (D. Del. 1965).

20 380 U.S. 592 (1965).

21 *Id.* at 600.

22 FTC v. Proctor & Gamble Co., 386 U.S. 568 (1967).

national market. Its nearest rival accounted for approximately 16 percent of the market. The industry was highly concentrated, with the first four firms accounting for almost 80 percent of the market.[23] At the time of the acquisition, Procter & Gamble was not producing household liquid bleach. It was, however, a major manufacturer of low-priced, high-turnover soaps and detergents; it was the nation's largest advertiser and was said to receive substantial cost advantages on its advertising and sales promotion.[24] Prior to the acquisition, Procter had been diversifying and had considered the household liquid bleach market. The Supreme Court held that the acquisition had eliminated Procter as a potential independent competitor in Clorox's market.[25] It also held that anticompetitive effects may result from the substitution of a powerful firm for a smaller but already dominant firm in a concentrated industry, since this may substantially raise barriers to entry and dissuade smaller firms from competing aggressively.

And, in 1968, the Supreme Court denied certiorari to the Third Circuit ruling in *General Foods Corp. v. FTC*[26] that General Foods' acquisition of S.O.S. might substantially lessen competition. General Foods was a major manufacturer of a diversified line of food products sold through grocery stores and supermarkets. S.O.S. had been the leading United States manufacturer of household steel wool pads. Like Procter & Gamble, General Foods had large-scale resources and a substantial advertising and promotion program into which S.O.S.'s advertising and promotion could fit.

Consolidated Foods (1965), *Procter & Gamble* (1967), and *General Foods* (1968) taken together indicate that broad-gauge criteria were developing for judging the competitive consequences of mergers between companies whose products are not in direct competition but are reciprocally related or can be distributed through the same outlets. Factors that had made these acquisitions vulnerable included an acquiring company with substantial resources; an acquired company with a major position in a concentrated market; reciprocity sales tactics in the case of *Consolidated Foods*; and joint distribution arrangements in the case of *Procter & Gamble* and *General Foods*. In all three cases the economic ties between the acquiring and acquired companies were close and clear and the pressures on third companies were real and immediate.

Emerging Theory on Convergent Conglomerate Acquisitions

As 1968 drew to a close, the Supreme Court had evolved firm lines of reasoning concerning the competitive effects of convergent conglomerate acquisitions but had not considered divergent conglomerate acquisitions,

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23 *Id.* at 571.

24 *But see* Blank, *Tonypandy Once Again*, 42 J. Bus. U. Chi. 104 (1969); Blank, *Television Advertising: The Great Discount Illusion, or Tonypandy Revisited*, 41 J. Bus. U. Chi. 10 (1968).

25 386 U.S. at 580-81.

26 386 F.2d 936 (3d Cir. 1967), *cert. denied*, 391 U.S. 919 (1968).

nor had either enforcement agency begun to test the merger act along this vector.

Existing decisions had established broad principles for analyzing situations where the acquiring and acquired companies had close economic ties. While these principles were based on too few cases to represent a general theory, their congruence and consequent thrust is strong in cases where: (1) the acquiring company is one of the largest in the country, (2) the acquiring company's resources loom large by comparison with those of most third companies in the market it is entering by way of acquisition, (3) this market is highly concentrated and the market share of the newly combined firm is substantial, and (4) the acquired company's product-mix is relatively homogeneous. Latent in all of the decisions, although not referred to as such, is a "deep-pocket" theory that suggests that the size and resources of the acquiring company, as evidenced by the market power it can bring to bear — through its total assets, sales, or advertising expenditures — on smaller companies in concentrated markets, is of prime signficance to the Court's conclusions.[27]

Task Force Recommendations

Completed as 1968 drew to a close, but not yet published, were two appraisals of antitrust policy by professional groups: one commissioned by President Johnson and the other by President Nixon as a presidential candidate. The first was the *White House Task Force Report on Antitrust Policy* (the *Neal Report*), released in May 1969,[28] the second, released in June 1969, was the *Report of the Task Force on Productivity and Competition* (the *Stigler Report*).[29]

The *Neal Report* adopts a hard line on conglomerate acquisitions and recommends a new statute to supplement section 7 of the Clayton Act to prevent large firms from acquiring leading firms in concentrated industries, and vice versa.

The *Stigler Report* reaches totally different conclusions concerning conglomerate acquisitions. The *Report* notes that antitrust has seemed to some to be a convenient weapon with which to attack large conglomerate mergers and that if one interprets "elimination of potential competition," "reciprocity," and "foreclosure" as threats to competition, one can always bring and usually win a case against the merger of any two large companies. But, the economic threat to competition from reciprocity is either small or nonexistent, since monopoly power in one commodity cannot be effectively used

27 The *Merger Guidelines* of the Department of Justice, issued May 30, 1968, contains a section on conglomerate mergers; this section represents a general summary of the decisional law. DEPARTMENT OF JUSTICE, MERGER GUIDELINES, 1 TRADE REG. REP. ¶ 4430 (1968).

28 1968 PRESIDENTIAL TASK FORCE REPORT ON ANTITRUST, 115 CONG. REC. 5642 (daily ed. May 27, 1969).

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

to manipulate the price of an unrelated commodity. And while elimination of a potential competitor may have anticompetitive effects, a merger will not have this effect if entry into a field is relatively easy. If entry is difficult, the independence of the few companies capable of entry should be preserved. But the identity of potential entrants should not be established by introspection but by evidence.

> If the producer of X is truly a likely entrant into the manufacture of Y, the likelihood will have been revealed and confirmed by entrance into Y of other producers of X (here and abroad), or by the entrance of the firm into markets very similar to Y in enumerable respects.[30]

The Stigler group urges the Department of Justice to resist the natural temptation to utilize the antitrust laws to combat social problems not related to the competitive function of markets and expresses doubt as to whether the Department should undertake an active program of challenging conglomerate enterprises on the basis of nebulous fears of size and economic power. These fears should either be confirmed or dissipated. To this end, the *Report* recommends an early conference of appropriate specialists to present explicit and specific theories and evidence on the subject. If, says the *Report*, there is a genuine securities market problem, new legislation is probably necessary. Further, if there is a real political threat in giant mergers, then the critical dimensions should be estimated. But "vigorous action on the basis of our present knowledge is *not* defensible."[31]

As the new administration came to office in 1969, it, therefore, had inherited strong tools for dealing with convergent conglomerate acquisitions, no tools and no tradition for dealing with divergent conglomerate acquisitions, and conflicting professional recommendations concerning the competitive effects of conglomerate acquisitions and what to do about them. This situation presented several options to the enforcement agencies: they could confine their actions to attempts to extend existing theory to additional forms of convergent conglomerate acquisitions; they could request new legislation or studies; or they could attempt to explore the reach of Clayton 7 along radically new lines.

NEW THEORY ON DIVERGENT CONGLOMERATE ACQUISITIONS (1969)

As 1969 opened, the Department of Justice elected all three options. Its activities along the first two lines were traditional in form, but when it also elected the third option in the spring of the year, it launched a series of complaints designed to test the applicability of the merger act to divergent conglomerate acquisitions. Five such cases were initiated by the Department in rapid succession and all five were interlinked both in format and in style of allegation.[32]

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[30] *Id.* at 6476.
[31] *Id.* (emphasis added).
[32] United States v. International Tel. & Tel. Corp., 306 F. Supp. 766 (D. Conn. 1969)

Each begins by noting the horizontal, vertical, and convergent conglomerate relationships between the acquiring and acquired companies and then goes on to make essentially new allegations concerning potential competition, potential reciprocity, aggregate concentration, and the contribution of mergers to increases in aggregate concentration.

The Form of the 1969 Complaints Against Divergent Conglomerate Acquisitions

A complaint issued in May 1969, and addressed to Northwest Industries' attempt to acquire The B. F. Goodrich Company may serve as an example for analysis — since the charges in that case had been adjudicated by the time this study was completed early in October 1969.[83]

The Department of Justice brought suit in May 1969, for a preliminary injunction to prevent Northwest from carrying out an exchange offer to the common stockholders of Goodrich, which, if successful, would have given Northwest more than 50 percent of Goodrich's common stock.

The complaint alleged that Northwest is a holding company and one of the nation's 130 largest industrial corporations in sales and among the 55 largest in assets. It conducts a diversified business through the sales of its subsidiaries, running the 4th largest railroad in the nation in trackage and the 13th largest in operating revenues; it also produces and sells a range of industrial and consumer products.

Goodrich was, at the time, the nation's 83rd largest industrial corporation in terms of sales. It was a highly diversified company, ranking 4th among United States tire manufacturers; it also produced and sold a variety of other industrial and consumer products.

The complaint alleged that Northwest and Goodrich competed in the manufacture and sale of muriatic acid in the inland waterway area. It also alleged that each company was likely to enter many of the chemical markets that at the time were served by the other, that these markets were on the whole highly concentrated, and that the acquisition would eliminate potential independent competition in these markets.

Up to this point the complaint resembled conventional complaints concerning convergent conglomerate acquisitions. But then the complaint went on to what were essentially new types of allegations, although similar charges had also been made in April 1969, concerning LTV's acquisition of J & L Steel and ITT's acquisition of Canteen Corp. And similar com-

(Grinnell Corp.) (decided with United States v. International Tel. & Tel. Corp.) (Hartford Fire Ins. Co.); United States v. Northwest Indus., Inc., 301 F. Supp. 1066 (N.D. Ill. 1969); United States v. International Tel. & Tel. Corp., 5 TRADE REG. REP. (1969 Trade Cas.) ¶ 45,069 (N.D. Ill., filed April 28, 1969); United States v. Ling-Temco-Vought, Inc., Civil No. 69-438 (W.D. Pa., filed April 14, 1969).

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

On October 21, 1969, the District Court in Connecticut handed down a decision denying a preliminary injunction in the case of ITT's proposed acquisitions of the Hartford Fire Insurance Company and Grinnell Corporation. These denials were, however, issued too late for inclusion in the present study. *See* United States v. International Tel. & Tel. Corp., 306 F. Supp. 766 (D. Conn. 1969).

plaints were brought in August 1969, concerning ITT's proposed acquisitions of Grinnell Corporation and The Hartford Fire Insurance Company. The *United States v. Northwest Industries, Inc.*[34] complaint alleged that Northwest and Goodrich had each individually been considering entry into numerous specified markets and that potential competition between the companies in these markets might be substantially lessened by the acquisition.

The *Northwest* complaint also alleged that Goodrich is a major purchaser of transportation services in the area served by Northwest and that Northwest is a present and potential purchaser of many products manufactured by Goodrich. Both Goodrich's and Northwest's purchasing power were cited to show that each would be in a position to buy from industrial companies that are potential customers of the other. The complaint alleged that these relationships would result in "reciprocity effects" and that a firm's reciprocity power and its ability to benefit from reciprocity dealing grow as its purchasing capacity and product diversity increase. The complaint noted, for example, that Goodrich's sales of tires might be benefited by Northwest's purchase of railroad equipment and petroleum products from companies that are significant buyers of tires.

Then the complaint went on to new allegations concerning the relations between aggregate concentration and a substantial lessening of competition in a Clayton 7 sense. It alleged that acquisitions of mining and manufacturing concerns with assets of more than $10 million have been rising rapidly, that the total assets involved in such acquisitions have risen even more rapidly, and that the proportion of the total assets of the nation's manufacturing corporations held by the 200 largest firms increased from 48.1 percent in 1948 to 54.2 percent in 1960 and to 58.7 percent in 1967 and that the bulk of this increase has resulted from mergers and acquisitions.

In July 1969, the District Court for the Northern District of Illinois refused to grant the requested injunction but required that the two corporations be maintained as separate functional entities pending a final court decision. The court's refusal to grant the injunction was based on its finding that the actual and potential horizontal and vertical relations between the companies posited by the Department of Justice did not constitute sufficient grounds for a finding of a violation of Clayton 7.

On the issue of aggregate concentration, the court held that whatever contribution the merger movement might be making to the increased share of manufacturing assets accounted for by the 200 largest manufacturing corporations, there was no specific proof that the merger might result in a substantial lessening of competition or a tendency to monopoly in any relevant product or geographic market. The court held that it did not read Clayton 7 to prohibit a merger on the basis of an over-all trend to economic concentration without a specific demonstration of a substantial lessening of competition in a specific market.

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[34] 301 F. Supp. 1066 (N.D. Ill. 1969).

> The issue of concentration raises a special question, for the Government is here urging that given a trend to economic concentration, the consolidation of two of the country's one hundred largest corporations constitutes a violation of Section 7 without any specific demonstration of a substantial lessening of competition in any section of the country. We do not so read Section 7.[35]

Finally, the court noted that whereas there may be good reason to limit the growth of the largest corporations, particularly through acquisition, the law as it stands makes adverse effects on competition the test of validity, and until Congress broadens the criteria, the court must judge proposed transactions on that standard.[36]

As of the early fall of 1969, the Department of Justice had, therefore, brought five complaints designed to test whether Clayton 7 can be applied to divergent conglomerate acquisitions. The Federal Trade Commission had also announced that it was concerned.[37] Both agencies had, therefore, in effect served notice that they were exploring possible new dimensions for theory concerning the Clayton 7 consequences of such acquisitions. How clear-cut are the facts presented in the allegations and what is the trajectory along which the enforcement process is moving?

Data Questions

What is totally new in the five complaints issued by the Department of Justice in the months from April through August 1969, concerning divergent conglomerate acquisitions is a common series of essentially mathematical allegations. The thrust of the argument is that the scale and pace of merger activity has been increasing rapidly; that the proportion of the total assets of the nation's manufacturing corporations held by the 200 largest firms has also increased substantially; and that the bulk of the increase in aggregate concentration has resulted from mergers.

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35 *Id.* at 1096.

36 One other lower court decision during the same period, however, resulted in the grant of a temporary injunction. In that case, Allis-Chalmers had brought suit to prevent White Consolidated from acquiring it. The Court of Appeals for the Third Circuit reversed a district court decision refusing the injunction. It found that the merger would permit the combined company to become the only company in the country capable of designing, producing, and installing a complete metal rolling mill and that this would create significant barriers to entry and would permit reciprocal dealing pressures because the major purchasers of rolling mills are steel companies and White Consolidated was a significant purchaser of steel. The majority adopted the basic reasoning of all of the Department of Justice complaints and of a projected Federal Trade Commission complaint concerning the link between growing aggregate concentration and the market power conferred by concentration in individual markets.

The court's findings were taken in large part from a proposed Federal Trade Commission complaint, which was published in March 1969. The Commission announced at the time that if it could not negotiate a consent arrangement with White to prevent takeover, it would issue the complaint. As of October 1969, the Commission's case had not surfaced in the form of a complaint or a consent order. Allis-Chalmers Mfg. Co. v. White Consol. Indus., Inc., 414 F.2d 506 (3d Cir. 1969), *cert. denied*, — U.S. — (1970).

37 White Consol. Indus., Inc., 3 TRADE REG. REP. ¶ 18,688 (Mar. 6, 1969) (proposed FTC complaint).

The complaints also allege that as large companies diversify and move by way of acquisition into more and more markets which they might otherwise have entered by internal growth, they eliminate themselves as independent potential competitors in these markets. At the same time, by moving into wider ranges of markets, they increase their actual and potential reciprocity relationships with actual and potential customers and suppliers. In the process, they also discourage other companies from entering these markets or from growing aggressively there. The facts and inferences taken together add up to a powerful argument that diversification acquisitions which take any of the largest industrials into a new market through the acquisition of any leading company already in the market may substantially lessen competition or tend to monopoly in violation of Clayton 7.

While it is not possible within any brief scope to examine the data underlying these propositions in detail, it is possible to raise limited questions concerning the statistical measurements on which they are grounded. These questions are essentially technical and can be resolved only through study of the fact-base from which the data are drawn. Since, however, under our adversary procedures the parties to the cases can be expected to provide attacks on and defenses of the data, discussion of the results of this process must necessarily await adjudication of the joinder of the factual and legal issues involved. A few comments on the statistical problems are, however, in order.

The Arithmetic of Acquisitions

One problem concerns the figures on the number and size of acquisitions. Once its merger notification program is in place, the Federal Trade Commission may be in a position to compile definitive data for the acquisitions its program covers. At present, however, the data it publishes are based on acquisitions recorded in *Moody's Industrials* and *Standard & Poor's*. According to these figures, the total of recorded acquisitions of manufacturing and mining units increased from 589 to 2,442 between 1958 and 1968; "large" acquisitions (where the acquired unit had $10 million in assets or more) increased from 28 to 192 and the assets involved in these "large" acquisitions increased from approximately $1 billion to approximately $12 billion over the 10 year period.

These figures have led some commentators to suggest that at the present rate, acquisitions will wipe out a high proportion of, if not all but a small number of, independent companies in some finite period of time.[38] But these conclusions are drawn from raw data and do not take account of changes in the company population that forms the matrix for the

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[38] *See, e.g.*, United States v. Pabst Brewing Co., 384 U.S. 546, 553-55 (1966) (appendix to the concurring opinion of Douglas, J.); *see also Measuring the Surge of Mergers*, BUS. WEEK, Mar. 23, 1968, at 69, which quotes Senator Philip Hart, chairman of the Senate antitrust subcommittee, as warning that if some action concerning acquisitions is not taken "some future generation is going to find 10 hands holding all industrial output."

acquisitions. The available data are not ideal, but some exploratory work by the Conference Board suggests that the manufacturing and mining population has been expanding both in number and in total assets at such a rate that the increase in acquisitions and the assets taken over through these acquisitions is not having the effects suggested.[39]

Examination of the returns of manufacturing and mining corporations to the Internal Revenue Service shows, for example, a steady increase in the number and assets represented by all returns taken together and increases for all size classes of returns. Since the returns are consolidated to different degrees, the word *return* cannot, however, be equated with the word *company* or *corporation.* A related body of statistics on manufacturing corporations published by the Federal Trade Commission and the Securities and Exchange Commission does not present sufficient data on the number of manufacturing corporations so that the *number* of acquisitions can be compared with them — but the *total assets* of acquired manufacturing and corporations can be compared with the total assets of manufacturing corporations and while one finds increases in the total assets of the largest corporations, one also finds increases for all lesser size-classes.[40] (See Tables I, II ,and III)

Aggregate Concentration

For any given year, "aggregate concentration" is a percentage figure derived from a fraction whose denominator represents total economic activity in some sector of the economy and whose numerator represents the share of that activity accounted for by a specified number of companies ranking highest in that activity.

None of the key words used in this description is, however, self-explanatory, nor are the data to which they refer self-evident. The 1969 complaints refer specifically to the share of total manufacturing assets accounted for by the 200 largest manufacturing companies.[41] The figures appear to come directly from the *Studies of the Cabinet Committee on Price Stability,* published in January 1969.[42] But since the study tables lack complete statements showing how the basic data were compiled, it is not possible to derive the percentage figures independently or to determine with precision what they mean. Three separate sets of problems are, however, evident. These concern: (a) methods of determining the level of aggregate

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39 Bock, *The Arithmetic of Acquisitions,* THE CONFERENCE BOARD RECORD, Aug. 1969, at 24.

40 *See id.* for the data problems in making these comparisons.

41 Complaint (Grinnell Corp.) at 7-8 & Complaint (Hartford Ins. Co.) at 7, United States v. International Tel. & Tel. Corp., 306 F. Supp. 766 (D. Conn. 1969); Complaint at 11-13, United States v. Northwest Indus., Inc., 301 F. Supp. 1066 (N.D. Ill. 1969); Complaint at 9, United States v. International Tel. & Tel. Corp., 5 TRADE REG. REP. (1969 Trade Cas.) ¶ 45,069 (N.D. Ill., filed April 28, 1969); Complaint at 6-8, United States v. Ling-Temco-Vought, Inc., Civil No. 69-438 (W.D. Pa., filed April 14, 1969).

42 STAFF OF COMM. ON PRICE STABILITY, CABINET STUDIES (1969).

TABLE I
ACQUISITIONS OF MANUFACTURING AND MINING UNITS, 1958-1968

		Assets by Size-Class		
			$10 Million and Over	
Year	Total (All Size-Classes)	Under $10 Million	Total Units Acquired	Units Acquired by 200 Largest Firms
		Number of Acquired Units		
1958	589	551	38	21
1959	835	771	64	38
1960	844	782	62	35
1961	954	895	59	30
1962	853	781	72	34
1963	861	793	68	46
1964	854	763	91	39
1965	1,008	915	93	34
1966	995	894	101	33
1967	1,496	1,327	169	67
1968P	2,442	2,250	192	74
		Total Assets of Acquired Units (millions of dollars)		
1958	n.a.	n.a.	$ 1,107	$ 638
1959	n.a.	n.a.	1,960	1,270
1960	n.a.	n.a.	1,710	1,041
1961	n.a.	n.a.	2,129	1,728
1962	n.a.	n.a.	2,194	1,227
1963	n.a.	n.a.	2,917	2,051
1964	n.a.	n.a.	2,798	1,815
1965	n.a.	n.a.	3,900	2,151
1966	n.a.	n.a.	4,100	2,385
1967	n.a.	n.a.	8,222	5,417
1968P	n.a.	n.a.	12,616	6,890

SOURCE: BUREAU OF ECONOMICS, FTC, STAT. REP. NO. 3, CURRENT TREND IN MERGER ACTIVITY, 1968, Tables 2, 5 (1969). Column (2) has been derived by substraction of column (3) from column (1).

concentration for a given year, (b) methods of measuring changes in aggregate concentration, and (c) inferences to be drawn from the results. More specifically, one may, among many possible questions, ask:

(a) First, what is the makeup of the numerator and the denominator of the fraction from which the aggregate concentration ratio for a given year is determined? How are the largest companies identified? Does the figure include corporations only or does it include all forms of business organization? Are the assets figures for individual companies consistent with each other and do the assets figures in the numerator refer to company operations consistent with the assets figures in the denominator of the fraction?

For the numerator, or the 200 largest company figure, for example, how are manufacturing corporations distinguished from other companies? Are the nonmanufacturing operations of manufacturing corporations in-

TABLE II

RETURNS OF MANUFACTURING AND MINING CORPORATIONS, 1958-1966

Year	Total A (All Size-Classes)	Asset Size-Class: Under $10 Million	Asset Size-Class: $10 Million and Over	Asset Size-Class: $10 Million to $50 Million	Asset Size-Class: $50 Million to $100 Million	Asset Size-Class: $100 Million and Over
		Number of Returns				
1958	156,502	154,224	2,278	1,687	288	303
1959	163,645	161,307	2,338	1,711	304	323
1960	173,956	171,550	2,406	1,749	322	335
1961	182,232	179,790	2,442	1,767	325	350
1962	192,925	n.a.	n.a.	n.a.	312	369
1963	192,475	189,859	2,616	1,894	336	386
1964	194,915	192,207	2,708	1,952	333	423
1965	194,543	191,714	2,829	2,037	331	461
1966P	196,621	193,433	3,188	2,293	385	510
		Total Assets Reported on Returns (millions of dollars)				
1958	$250,898	$60,407	$190,491	$34,684	$20,003	$135,804
1959	268,174	63,819	204,355	35,703	21,170	147,482
1960	279,258	65,284	213,974	36,360	22,441	155,173
1961	293,908	67,863	226,045	37,187	22,789	166,069
1962	310,582	n.a.	n.a.	n.a.	22,070	178,309
1963	327,549	73,180	254,369	39,969	23,705	190,695
1964	352,913	74,631	278,282	41,296	23,487	213,499
1965	388,071	79,560	308,511	43,836	23,438	241,237
1966P	429,156	86,974	342,182	47,740	26,936	267,506

Note: The number of returns and the assets in any given size-class will differ from the actual figures, depending on the degree to which companies consolidated their returns to the Internal Revenue Service.

A Excludes returns with zero assets.

P—Preliminary

SOURCES: I.R.S., DEP'T OF TREASURY, CORPORATION INCOME TAX RETURNS, ANNUAL STATS. OF INCOME (1958-1965, prelim. 1966). For 1958, Table V, at 42, 45; 1959 Table IV, at 68, 71; 1960, Table IV at 63, 66; 1961 Table II, at 43, 52; 1962, Table II, at 60, 66; 1963, Table IV, at 70, 73; 1964, Table VI, at 104, 108; 1965, Table V, at 34-37; 1966, Table II, at 22.

cluded or excluded? Are the manufacturing operations of nonmanufacturing companies included or excluded?

Does the set of the 200 largest corporations include publicly held corporations only or does it also include privately held corporations (and if it does, how are assets figures for these corporations obtained)?[43]

Are data on foreign subsidiaries or affiliates of domestic corporations

[43] FTC-SEC, QUARTERLY FINANCIAL REPORT FOR MANUFACTURING CORPORATIONS (3d quarter 1969), Table X. Footnotes to the number and kinds of non-registered manufacturing corporations (privately held companies, domestic subsidiaries of Foreign corporations and joint ventures) not listed in *The Fortune Directory of the 500 Largest Industrial Corporations*, FORTUNE, May 15, 1969, at 168.

TABLE III
MANUFACTURING CORPORATIONS, 1958-1968

Year	Total (All Size-Classes)	Under $10 Million	$10 Million and Over	$10 Million to $50 Million	$50 Million to $100 Million	$100 Million and Over
		Asset Size-Class		Asset Size-Class		
			Number of Corporations			
1958	n.a.	n.a.	1,798	1,302	222	274
1959	n.a.	n.a.	1,813	1,283	238	292
1960	n.a.	n.a.	1,910	1,328	265	317
1961	n.a.	n.a.	1,911	1,301	278	332
1962	n.a.	n.a.	1,988	1,362	278	348
1963	n.a.	n.a.	2,041	1,397	276	368
1964	n.a.	n.a.	2,112	1,461	270	381
1965	n.a.	n.a.	2,210	1,515	287	408
1966	n.a.	n.a.	2,320	1,578	284	458
1967	n.a.	n.a.	2,453	1,655	297	501
1968	n.a.	n.a.	2,437	1,624	284	529
			Total Assets of Corporations (millions of dollars)			
1958	$219,180	$43,809	$175,371	$26,879	$16,630	$131,862
1959	230,830	45,007	185,823	27,263	16,761	141,799
1960	248,081	45,306	202,775	28,275	18,851	155,649
1961	257,714	47,541	210,173	27,633	19,709	162,831
1962	274,832	49,731	225,101	29,058	19,905	176,138
1963	289,795	53,151	236,644	29,857	19,627	187,160
1964	305,587	53,735	251,852	31,532	19,450	200,870
1965	330,093	56,613	273,480	32,952	20,549	219,979
1966	369,035	61,725	307,310	34,883	20,602	251,825
1967	409,457	65,236	344,221	36,330	21,455	286,436
1968	448,897	65,010	383,887	36,264	20,817	326,806

Note: Numbers of corporations are those shown for the 100 percent segment of the FTC-SEC sample. Similar figures cannot be derived for the size-classes for which the sample is less than 100 percent.

FTC-SEC, SOURCES: QUARTERLY FINANCIAL REPORT FOR MANUFACTURING CORPORATIONS (1958), Number of corporations in 100 percent sample, fourth quarter report, 1958 at 2, and total assets of corporations in 100 percent sample, first quarter report, 1959, Table IX; for 1959-1968, fourth quarter report, Table XI for 1959-1961 and Table X for 1962-1968.

included or excluded? Are data on domestic corporations which are subsidiaries or affiliates of foreign corporations included or excluded?

Are joint ventures included individually or not?

Are acquired and divested assets valued by comparable methods by different companies?

Are the assets figures of different corporations affected differently by their ways of handling depreciation, tax anticipations, long-term payments for major capital investments, their methods of consolidating data on subsidiaries, *etc.*?

For the denominator, or the all-manufacturing figure, there are some additional and some overlapping questions. For example, does the universe cover corporations only or does it cover other forms of business organization as well? Is the universe based on a sample or a total survey (and if a sample, how is it made up)? What is the response rate for the survey? How are manufacturing companies distinguished from other companies? Are the nonmanufacturing operations of manufacturing companies included or excluded? Are nonregistered as well as registered companies included? How are foreign holdings of domestic companies handled? How are domestic holdings of foreign companies handled? How and when are data for newly formed or newly acquired companies introduced into totals? And are data for different companies fully comparable?

(b) Second, are the companies whose assets are included in the numerator the same in each year or do findings on changes in aggregate concentration focus on different sets of companies such as those who are the 200 largest in each year? Are biases introduced by changes in activities included in the data, but not properly classifiable in the categories covered? And what provisions have been made to assure that companies newly classifiable in manufacturing (or dropping out) will be included (or excluded)?

Obviously the answers to the first two sets of questions will be significantly affected by the type of corporate activity measured, *e.g.*, total assets, total sales, profits before or after taxes, etc., as well as by the technical data input for the numerator and the denominator of the ratio.

(c) Third, given the makeup of specific ratios, what are their implications for public policy? For example, would policy conclusions be different if the manufacturing sector of the economy were expanding or were shrinking compared with other sectors,[44] or again, would policy conclusions be different if the largest companies were in general those operating in the fastest-growing industries or were those operating in industries that were growing at a slower pace?[45]

We are, therefore, faced with questions concerning exactly what it is we want to encourage or discourage if we adopt a merger policy based on aggregate concentration data.

It should also be noted that even if we have resolved all such questions, there still remain questions concerning the relevance of particular items that might be included or excluded from the numerator and the denominator of the aggregate concentration fraction and their effect on the observed level and observed changes in the level of the ratio. Even if, for example, comparable data are fed into both the numerator and the denominator of the fraction, the implications of the results will differ with the relevance of the items to the problem under consideration. If, for example, the foreign assets of the 200 largest manufacturing corporations should not be included

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44 Corporate manufacturing assets as a percent of total corporate assets for all industries declined from 23.2 percent in 1948 to 21.9 percent in 1966. INTERNAL REVENUE SERVICE, U.S. DEP'T OF TREASURY, STATISTICS OF INCOME, CORPORATION INCOME TAX RETURNS (1948 & 1966).

45 *See* Whitney, *Mergers, Conglomerates and Oligopolies: A Widening of Antitrust Targets*, 21 RUTGERS L. REV. 187 (1967).

in an analysis of aggregate domestic concentration, the inclusion of such figures even if fed into both the numerator and the denominator will raise the ratio.[46] And if the 200 largest corporations as a group are expanding their foreign operations more rapidly than those below the 200 largest, this will, in itself, cause an increase in observed aggregate concentration, since the base of the fraction does not expand to include all assets of all domestic and foreign manufacturing corporations. Or if the 200 largest are moving into nonmanufacturing operations at a faster rate than other manufacturing corporations, this will also cause an increase in observed aggregate concentration in manufacturing.

Or consider the effects on observed changes in aggregate concentration of changes in the availability of "large" company data. If, for example, any appreciable number of "large" nonregistered companies go public during the period under consideration and are included in the numerator of the aggregate concentration fraction for a later but not for an earlier year, their inclusion would artificially inflate the observed change in aggregate concentration.

Or, as a third example, consider how the level and pace of change in the level of observed aggregate concentration will shift depending upon whether one considers the shares held in earlier years by the companies that were the largest in a later year or whether one considers the shares held in each year by the companies ranking largest in that year.

In the *Northwest* (Goodrich) merger complaint, for example, the proportion of the total assets of manufacturing corporations said to be held by the 200 largest firms was 48.1 percent in 1948, 54.2 percent in 1960, and 58.7 percent in 1967. These figures work out to an annual average rate of increase of 0.51 percentage points for the 1948-1960 period and 0.64 percentage points for the 1960-1967 period — or an *increase* in the average annual rate of increase in aggregate concentration for the later period. In the *United States v. International Tel. & Tel. Corp.*[47] (Grinnell) complaint, by contrast, the proportion of the total assets of manufacturing corporations said to be held by the 200 largest firms was 48.1 percent in 1948, 55.8 percent in 1960, and 60.1 percent in 1968. These figures work out to an average annual rate of increase of 0.64 percentage points per year for the earlier period and 0.54 percentage points for the later period—or a *decrease* in the average annual rate of increase in aggregate concentration for the later period. (See Table IV).

In the absence of further specification of the data, we cannot be certain what has happened. But examination of the price stability study from which

[46] Start, for example, with the fraction ½; add one to both the numerator and the denominator to get ⅔. Since ½ represents a ratio of 50 percent, and ⅔ a ratio of 66⅔ percent, the addition of "one" — if unjustified — raises the ratio in an unjustifiable fashion, even if it is consistently fed into both the numerator and denominator of the fraction.

[47] 306 F. Supp. 766 (D. Conn. 1969).

TABLE IV

SHARE OF TOTAL ASSETS OF MANUFACTURING CORPORATIONS HELD BY THE 200 LARGEST FIRMS AS SHOWN IN DIFFERENT SOURCES*

Source	Per Cent of Total Assets of Manufacturing Corporations Accounted for by the 200 Largest Firms				Average Annual Percentage-Point Increase		
	1948	1960	1967	1968	1948-1960	1960-1967	1960-1968
Committee on Price Stability Study							
Version 1	48.1	54.2	58.7	–	0.51	0.64	–
Version 2	48.1	55.8	58.7	–	0.64	0.41	–
Department of Justice Complaints							
LTV (J&L Steel), 4-14-69; ITT (Canteen), 4-28-69; Northwest (Goodrich), 5-1-69	48.1	54.2	58.7	–	0.51	0.64	–
ITT (Grinnell), 8-1-69	48.1	55.8	–	60.1	0.64	–	0.54

* This table is designed to show that the observed share of the total assets of all manufacturing corporations accounted for by the 200 "largest" corporations varies with the method of identifying these companies and with the source used. The observed share of the 200 largest for any given year will, for example, differ depending upon whether one is examining the share of the specific companies who were the 200 largest in terms of assets in that year or the share in that year held by the companies who were the 200 largest in terms of assets in some other year.

Since neither the price stability study nor the complaints specify what companies are included in the "200 largest" figures, it is not possible to be certain why the various versions differ. It appears possible, however, that the 54.2 percent figure for 1960 represents the share of total 1960 assets held by the 200 firms which had the largest assets in 1967 and the 55.8 percent figure for 1960 represents the share of total 1960 assets held by the 200 firms which had the largest assets in 1960—a different set of companies.

If there was any turnover among the 200 largest between 1960 and 1967, a figure for 1960 computed by the first method will yield a greater apparent rate of change in aggregate concentration between 1960 and 1967 than will a figure for 1960 computed by the second method—as the table shows.

SOURCES: STAFF OF COMM. ON PRICE STABILITY, CABINET, STUDIES 79, 92 (1969); Dep't of Justice Complaints.

the figures appear to come[48] suggests that the 54.2 percent aggregate concentration figure for 1960 alleged in *Northwest* (Goodrich) may represent the share of 1960 assets held by the companies identified as the 200 largest in 1967, while the 55.8 percent figure alleged in *ITT* (Grinnell) may represent the share of 1960 assets held by the companies identified as the 200 largest in 1960 — a different set of companies. But regardless of whether this explanation is correct, it is apparent that observed aggregate concentration and observed rates of change will be affected by the year for which the 200 largest companies are identified as well as by the range of other factors suggested above.

Indeed, the longer the time span, the greater the movement of the largest companies beyond the sector under study, and the greater the

48 STUDIES, *supra* note 42.

turnover among the largest companies, the larger will be the distortion in the observed change in aggregate concentration, if one focuses solely on the companies that are the largest at the end of the period under examination.

Some Statistical Notes

The above considerations suggest several tentative generalizations:

First, large-scale acquisitions in manufacturing and mining do not appear to be decimating the corporate population as a whole or any size-class for which data are available. While existing figures are not definitive, there is no present evidence that more appropriate data would lead to significantly different results.

Second, the concept of aggregate concentration and the data appropriate for measuring it both present serious problems. These problems are compounded when one seeks to measure changes in aggregate concentration over time. Indeed, the problem of matching company operations to appropriate universes will be difficult to resolve in the face of the growing complexity of interindustry as well as intercompany activities. If we wish to find some global figure for a company which in some way measures its resources, question at once arises as to whether such a figure should then be compared with universe data covering a more limited range of resources.

Third, while problems of measuring the level of aggregate concentration and changes in the level over time are plainly difficult, still greater technical difficulties are encountered when one seeks to determine with precision the contribution of mergers to changes in aggregate concentration. Here, for example, one must ask what would have happened to the funds invested in acquisitions if specific acquisitions had not been made and what would have been the history of the "large" companies that were acquired if they had had to continue on their own?

THE TRAJECTORY

As of late 1968, the development of merger law had moved beyond the direct potential competitive effects of horizontal and vertical mergers to encompass the effects of mergers between companies making related products. But these relationships were much more like those in previous cases than their initial novelty suggested.

Rules for clear-cut *horizontal* and *vertical* mergers were grounded on facts concerning the markets of suppliers, competitors, or customers of the acquired company and on facts concerning the market shares of the merging companies and the degree of concentration in the relevant markets. Implicit in these rules, however, were assumptions that the boundaries of the relevant markets are fixed and that neither entry by additional companies nor erosion of the market boundaries by newer products or newer technologies would be likely to dilute concentration or the market share of the company under attack.

Rules for *convergent conglomerate* mergers — or mergers of companies making complementary or reciprocally related products — were as of the end of 1968 almost as firmly grounded in facts concerning market shares, concentration, and a close connection between markets that could be jointly worked by the combining partners. Clayton 7 conclusions concerning such mergers rested on facts concerning the ways in which the acquired company — with the backing of the acquiring company — could grow at the expense of rivals lacking such backing. Although the markets of the merging companies were not so simply related as in the older cases, the relations were still plain and in being — and although findings were phrased in potentiality language, they were based on facts that showed direct linkages between the market of the acquired company and the expanding operations of the company acquiring it. Implicit in the Supreme Court's decisions in these cases were assumptions concerning fixed market boundaries and the power of a "rich parent" to support a relatively strong acquired company that had been operating in a small-company market. The market boundary assumptions were, however, different in form from those in the horizontal and vertical cases — since they provided for an opening of the boundaries sufficient to permit penetration by the acquiring company but not sufficient to admit other companies or other products.

The force of these assumptions concerning market boundaries depends on the fact that without them figures on market shares and concentration have no meaning.

And so we come to the new thrust against *divergent conglomerate* mergers — where there are relatively few economic linkages among the markets of the merging partners. Here — leaving to one side acquisitions generated primarily by stock market leverage or long-term investment considerations — are the mergers where the acquiring company believes it can support the resources of the acquired company in ways that will make the company a more active and rewarding competitor in the company's own markets and potential markets.

Implications and Alternatives

The outward thrust of merger act theory beyond convergent into divergent conglomerate acquisitions raises the question of whether a general theory on conglomerate comparable to current theory on horizontal and vertical acquisitions is in process of formulation.

If the allegations concerning aggregate concentration in the 1969 complaints were to become law, they would create such a theory, since they would cover not only significant convergent and divergent conglomerate acquisitions but major horizontal and vertical acquisitions by the largest companies in the economy as well.

If, however, such a conglomerate theory does not take shape, the current progress of decisions affecting convergent conglomerate acquisitions will in time pick up acquisitions affecting markets in ways comparable to those suggested in *Brown Shoe, United States v. El Paso Natural Gas Co.,*[49] *United States v. Aluminum Co. of America,*[50] *United States v. Continental Can Co.,*[51] *Procter & Gamble, and Consolidated Foods.* The theory will not, however, necessarily pick up convergent conglomerate acquisitions in markets where technological change is making market boundaries obsolete or where high market shares and concentration are the temporary result of true innovation[52] or its obverse — approaching senility,[53] nor will it necessarily pick up divergent conglomerate acquisitions where an unrelated aggressive company acquries a modest-sized or smaller company in a market that would benefit from new competition.

If, however, the new complaints are upheld, the courts will be able to move directly from evidence that an acquiring or acquired company is one of the 200 largest and has, in fact, entered a new market by way of acquisition to a conclusion that potential competition has been eliminated; from evidence of an abstract vertical relation between the product lines of the merging companies to conclusions concerning potential reciprocity effects; and from statistics concerning aggregate concentration in manufacturing as a whole to conclusions concerning a substantial lessening of competition in a "line of commerce."

If such a theory should become the new criterion for evaluating a threat to competition, the market structuralism of the pre-1969 decisions would become super-structuralism, since the pre-1969 focus on market definitions and market structure would simply be enlarged to include wider segments of the economy. The meticulous pre-1969 type of evidence of close economic ties between the acquiring and acquired companies would be displaced by a more tenuous set of inferences concerning potential competition and potential reciprocity resting on a broad theory that the larger and more diversified the company, the more markets it can enter and the more opportunities for reciprocity will be open to it.

Any attempt to replace current theories of market structuralism with a theory of super-structuralism would, however, have to face the same ambiguities as earlier theory which failed to distinguish between relatively stable markets where structural tests are most relevant and dynamic markets where they are less relevant. If, however, such a theory of super-structuralism does not become law, we would, in effect, be acknowledging that scalar changes in economic complexity require something more than an abstract extension of earlier theory—and would be holding that such changes require

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[49] 376 U.S. 651 (1964).

[50] 377 U.S. 271 (1964).

[51] 378 U.S. 441 (1964).

[52] *See, e.g.,* United States v. Ling-Temco-Vought, Inc., 5 TRADE REG. REP. (1961 Trade Cas.) ¶ 70,160 (D. Tex. 1961).

[53] United States v. FMC Corp., 218 F. Supp. 817 (N.D. Cal.), *appeal dismissed,* 321 F.2d 534 (9th Cir.), *application denied,* 84 S. Ct. 4 (Goldberg, Circuit Justice, 1963).

a feedback theory that will permit competitive policy to follow moving targets in an open-end economy.

Tracking a Moving Target

As market boundaries break down with the development of new patterns of supply and use[54] and as new technologies develop to meet new needs, new theories of competition of the type appropriate for tracking a moving target might well be developed. How such a theory would differ from a theory appropriate for a more static economy can only be suggested.

If one works up through known theory toward an unknown, it is plain that in an atomistic economy no antitrust policy would be necessary. In a nonatomistic but relatively stable or slowly changing economy, antitrust policy can be, and is, designed to preserve market balance through enforcement programs designed to compensate for excessive market controls, undue restraint of trade, or excessively destructive competitive techniques. Such a policy can channel company growth into new areas and moderate forms of hypercompetition that threaten to destroy competition itself. In such an economy, appropriate antitrust policy will, therefore, aid in motivating companies to modify anticompetitive behavior in ways that benefit economic growth.

In a complex and rapidly changing economy, antitrust policy based on a theory of super-structuralism combined with assumptions appropriate for stable or slowly changing markets may create damaging wobble-effects. If, for example, the resources used in making acquisitions during recent years had gone into internal growth, question arises as to whether the total demand would not have put strains on scarce resources while leaving lacunae in areas where new technical and product approaches to today's problems need to be developed. Meanwhile, if the medium-size and larger companies seeking to be acquired would have had to find buyers smaller and less significant than themselves, they would have faced a different and harsher set

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54 The rate of breakdown of existing boundaries is indicated by the degree to which the Census Bureau finds it necessary to realign its SIC categories.

The 1954 *Census of Manufactures*, for example, listed 455 industries; the 1958 *Census of Manufactures*, 430 industries. Furthermore, a relatively large number of individual industry definitions were changed to allow for new or growing industries as separate classifications or to eliminate industries considered economically insignificant.

Of the 455 industries in the 1954 Census, 235 retained the same definition in the 1958 Census; the code for 46 of these industries was, however, changed. A shift in definition occurred for 48 industries, which retained the same code in both Census years, but parts of other industries were transferred to them. A change in definition and a change in code were experienced by 76 industries; these industries were merged with other industries, or parts of other industries were added to them; about 25 of the 76 industries were eliminated as separate classifications and merged into "not elsewhere classified" groups. The remaining 96 industries were split into two or more parts. BUREAU OF THE CENSUS, U.S. DEP'T COMMERCE, HISTORICAL COMPARABILITY OF CENSUS OF MANUFACTURERS INDUSTRIES, 1929-1958, at 7 (Bureau of the Census Working Paper No. 9, 1959).

of alternatives: they could have found a small or, by antitrust standards, neutral acquirer, invited in inexperienced management, or liquidated.

Or to put the matter differently, tests of competitive effects that depend on such factors as size of company, market shares, concentration, and barriers to entry were developed primarily to fit a market theory that posited stable market boundaries with demand growing roughly in proportion to population, supplied by small single-product firms moving into attractive and out of unattractive markets instantaneously. And tests that depend on essentially the same factors for manufacturing as a whole have now been posited to fit larger but still ultimately fixed sector boundaries as if the economy were so stable that simple rules would yield appropriate policy results.

In today's economy a major company is, however, not a simple unit, but a complex of domestic and foreign subsidiaries, joint ventures, and affiliates, linked to a range of other companies though subcontracting, licensing, or long-term supply or purchase contracts. In short, companies are not atomistic units dealing with other atomistic units.

Meanwhile, the older simplified concept of an industry or a market is also changing so that for many markets one can no longer think of sets of producers of closely related sets of products who confront each other and only each other wherever they buy or sell. Instead, one finds sets of operations by multifaceted companies transacting business in different areas in order to meet expanding industrial and consumer requirements. And these operations are fed by a flow of interrelated resources that are continuously transformed through the product and service systems of varying sets of companies. If this delineation of the current economic process is correct, economic analysis of what used to be called industrial organization will translate into analysis of industrial process.

Classical economic theory points to the desirability of large numbers of companies, small market shares, and ease of entry into an exit from a market where all other conditions are equal. In such a world, the composition and boundaries of markets are given, as are conditions of entry and exit, so that the concept of "structure" has a clear and definite meaning. In such a world, conclusions concerning competition and, therefore, concerning antitrust policy follow directly from data concerning market structure.

But where other conditions are not equal and new technologies are forcing the development of new market systems and new intercompany relations, "market" structure becomes a less reliable index of competitive behavior. Under such conditions, application of market share or even aggregate concentration tests can erroneously give anticompetitive answers to critical questions. Indeed, it may be appropriate to ask whether, in identifying "large" conglomerate acquisition with aggregate concentration — and aggregate concentration with a substantial lessening of competition and a tendency to monopoly — we may be resolving issues concerning new growth against new forms and methods of competition.

Conglomerate Acquisitions in an Open-End Economy

Granted an increasing population, a multiplying need-base, and rapidly changing technologies of production, distribution, and use, what questions are relevant to antitrust policy on conglomerate acquisitions? The critical questions would perhaps be: first, what is desirable and undesirable company "growth" in a growing economy, and second, what mix of incentives and constraints on company flexibility is appropriate to the range of national goals — including, but not limited to, the goal of competition.

Leaving to one side, as outside the range of this study, acquisitions powered by stock market leverage considerations, it will, within the next decade, be necessary for those concerned with public policy on competition to decide whether we want to move beyond existing antitrust tests for convergent conglomerate acquisitions and develop supermarket theory for divergent conglomerate acquisitions. Our methods of resolving this puzzle will determine the environmental future of the economy, for wherever the economy is changing rapidly, highly structuralized tests — whether of concentration or super-concentration — may give anticompetitive results. This will be particularly true wherever national goals are generating new and exploding needs, *e.g.*, urban renewal needs, needs for pollution controls, provisions for growing leisure time, etc.

The major companies now seeking to meet these needs are, of necessity, crossing market boundaries and are, therefore, increasing their antitrust liabilities, under an aggregate concentration theory of vulnerability, as they become potential competitors or potentially reciprocally related in wider and wider ranges of markets.

In today's world, maximization of national and of individual choice at lowest cost will not necessarily be served by a deconglomeratization policy based on a theory of super-structuralism. Indeed, we may be driven to accept the fact that, as in planning-programming-budgeting analysis (PPB), priorities among goals and choices of efficient systems for meeting these goals may be appropriate modes of competitive analysis.[55] Competing systems for meeting wants, not the gross size of a company or the range of markets it serves, might then be the focus of competitive policy.

Finally, there would appear to be need for a painstaking review of whether essentially static theory — whether based on market or supermarket concentration — is appropriate to the antitrust problems of dynamic areas of the economy. As major companies increasingly apply systems analysis to their own long-range planning and seek to think in terms of broadly

[55] *See* J. WESTON, CONGLOMERATE FIRMS AND BUSINESS DIVERSIFICATION (1969); Jacoby, *The Conglomerate Corporation*, THE CENTER MAGAZINE, July 1969, at 40; Rubel, *Systems Management and Industry Behavior*, in PUBLIC POLICY TOWARD MERGERS 208 (J. Weston & S. Peltzman eds. 1969).

defined needs and alternative methods of meeting them, there appears to be a parallel need to ask whether antitrust policy that does not take a similar approach will not in the end choke off emerging forms of competition. Our ability to correct our own course where necessary to adjust our enforcement trajectory to a moving target will determine the quality of our economic environment. The corrections may be small or large, but they should, it is suggested, be designed in terms of criteria for enhancing competition among major systems for supplying changing national needs and — within these systems — for maximum flexibility in the range of sizes of companies and the range of competitive choices open to them.