

# STUDENT COMMENTS

## RECENT DEVELOPMENTS IN ANTITRUST LAW: SECTION 7 OF THE CLAYTON ACT AND THE DEMISE OF THE CONGLOMERATE MERGER

*And it seems to me that at this time we need education in the obvious more than investigation of the obscure.*

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### INTRODUCTION

The threat posed by the post-war merger boom to the preservation or attainment of a vigorously competitive economy, and the inadequacy of existing antitrust law in dealing with this threat, provided both the occasion for and the impetus to the 1950 amendment to Section 7 of the Clayton Act.<sup>1</sup> What was felt to be needed and what Congress provided was a broadly worded statute applicable to all types of mergers and designed to curtail merger activity in a market before it reached the monopoly proportions proscribed by the Sherman Act. As amended, Section 7 provided:

No corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another corporation engaged also in commerce, where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.<sup>2</sup>

Beyond specifying "line of commerce," Congress prescribed no criteria for defining the relevant product market in which the competitive impact of a merger was to be measured. Instead, it left to the courts and the Federal Trade Commission the task of defining the relevant market in individual cases and of developing standards of general application for market definition. It also left to them the difficult problem of devising standards for determining whether a merger has the effect on competition proscribed by the statute.<sup>3</sup>

In the fourteen years since Section 7 was amended, standards for

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\* Speech to the Harvard Law School Association of New York, February 15, 1913, in *Collected Legal Papers* (1920), p. 293.

<sup>1</sup> For the legislative history of the amendments, see *Brown Shoe Co. v. United States*, 370 U.S. 294, 311-23 (1962); Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 Harv. L. Rev. 226, 233-38 (1960); Note, 52 Colum. L. Rev. 766 (1952).

<sup>2</sup> 38 Stat. 731 (1914), as amended by the Celler-Kefauver Antimerger Act, 64 Stat. 1125 (1950), 15 U.S.C. § 18 (1958).

<sup>3</sup> *Brown Shoe Co. v. United States*, supra note 1, at 320-21.

testing the legality of conventional horizontal and vertical mergers have been established,<sup>4</sup> but the fate of so-called conglomerate mergers and, therefore, the full meaning of the statute is just beginning to emerge. In the past year, the FTC and the Supreme Court handed down several significant conglomerate merger decisions. The object of this comment is to examine these cases and to discuss the standards they establish.

### THE CONGLOMERATE MERGER

The conglomerate merger is usually defined negatively; if a merger is neither horizontal nor vertical,<sup>5</sup> it is conglomerate. Since the conglomerate simply substitutes one firm, which has not sold in the market prior to the merger, for another, which has, it does not diminish the number of firms in the market. And, since the conglomerate does not effect any change in the market share of the acquired company, no immediate increase in concentration in the industry results. Accordingly, the simple market share test is unavailable.<sup>6</sup> Likewise, the "foreclosure of a substantial share of the market" test, used in vertical integration cases,<sup>7</sup> is inapplicable to the conglomerate, which by definition assumes the absence of a supplier-customer relationship.

### FEDERAL TRADE COMMISSION DECISIONS

The Federal Trade Commission has done most of the work in the development of standards for dealing with conglomerates. Exposed to more Section 7 cases than the individual district courts, the Commission has had greater opportunity to develop a unified, coherent approach. Its efforts in this area culminated in *The Procter & Gamble Co.*<sup>8</sup> case, probably the most important treatment yet of the conglomerate merger under Section 7.

An opinion as far ranging as *Procter & Gamble* is difficult to analyze. Its chief importance is as a vehicle for establishing sweeping rationales for deciding Section 7 cases, based on the Commission's view of the social and economic values which Section 7 is designed to promote. Its full import cannot be grasped by piecemeal attack. A true appreciation of its scope and impact can be gained only by reading it as a whole, in the light of prior and subsequent Commission decisions. If this is done, it soon appears that

<sup>4</sup> *United States v. Philadelphia Nat'l. Bank*, 374 U.S. 321 (1963); *Brown Shoe Co. v. United States*, supra note 1.

<sup>5</sup> A conventional horizontal merger is one between firms, operating in the same geographical area, that make or sell the same product, or products which are close substitutes for each other. A vertical merger, as usually understood, is one between firms that are actually or potentially in a customer-supplier relationship.

<sup>6</sup> This test uses the percentage of the relevant market controlled by the company resulting from the merger as the basis for inferring that the merger may substantially lessen competition. See text accompanying note 197, infra, and *United States v. Philadelphia Nat'l Bank*, supra note 4, at 363-67; Stigler, *Mergers and Preventive Antitrust Policy*, 104 U. Pa. L. Rev. 176-182 (1955).

<sup>7</sup> See *Brown Shoe Co. v. United States*, supra note 1, at 323-24, 328; Kessler and Stern, *Competition, Contract, and Vertical Integration*, 69 Yale L.J. 1, 64-78 (1959).

<sup>8</sup> 3 Trade Reg. Rep. (Trade Reg. Rep. Tr. Binder, F.T.C. Complaints, Orders, Stipulations) ¶ 16673 (Nov. 26, 1963), appeal docketed, No. 15769, 6th Cir., Feb. 13, 1964.

the economic theories adopted by the Commission in *Procter & Gamble* for appraising the competitive impact of conglomerate mergers overlap and interact in very striking fashion and that, if a unifying thread connects all these theories, it is that "bigness is bad." Despite Commissioner Elman's protests that the Commission is not propounding a per se rule, it is hard to shake the feeling that, under the Commission's standards, no large, successful company may make an acquisition—one with business utility—without violating Section 7.

#### PROCTER & GAMBLE

Procter had acquired the assets of Clorox Chemical Company, valued at \$12,600,000 in exchange for Procter stock worth approximately \$30,300,000.<sup>9</sup> At the time of the acquisition, Clorox's market share had grown steadily for almost five years, and its annual sales of just under \$40,000,000 represented almost 50% of the nation's household liquid bleach sales. Clorox and Purex Corporation together accounted for almost 65% of the total household liquid bleach sales, and, with four other manufacturers, for almost 80%. Clorox, with thirteen plants throughout the country, was the only producer selling on a national scale.

In 1957, Procter, the largest advertiser in the nation and one of the fifty largest manufacturers, had total net sales of \$1,156,000,000. Although not a producer of household bleach before the merger, it manufactured a wide range of low-priced, high-turnover, household consumer items sold through grocery, drug and department stores. In 1957, Procter's sales of packaged detergents represented 54.5% of the national total. In the household cleansing agents industry, Procter, Colgate-Palmolive, and Lever Brothers accounted for more than 80% of the total sales. Procter was, and is, the leading firm of the big three.

#### *The Type of Merger Involved*

In his opinion, Elman first disposed of Procter's contention that under the doctrine of the "law of the case" the Commission could not consider the evidence which it had previously held insufficient to support a finding.<sup>10</sup> Then, after discussing various categories of mergers, he concluded that "the merger of Clorox and Procter may most appropriately be described as a product-extension merger,"<sup>11</sup> a variant of the conventional horizontal merger since it involved the "merger of sellers of functionally closely-related products which are not, however, close substitutes." The expression "functionally closely-related" was said "only to suggest the kind of merger that may enable significant integration in the production, distribution or marketing activities of the merging firms."<sup>12</sup>

Packaged detergents . . . and household liquid bleach are used complementarily, not only in the washing of clothes and fabrics,

<sup>9</sup> The statement of facts is taken from *Id.* at 21562-65.

<sup>10</sup> *Id.* at 21561.

<sup>11</sup> *Id.* at 21566.

<sup>12</sup> *Id.* at 21565.

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but also in general household cleaning. . . . From the consumer's viewpoint . . . packaged detergents and liquid bleach are closely related products. . . . [Furthermore,] . . . household cleansing agents in general, like household liquid bleach, are low-cost, high-turnover household consumer goods marketed chiefly through grocery stores, and presold to the consumer by the manufacturer through mass advertising and sales promotions. . . .

The functional relationship between household liquid bleach and products manufactured by Procter appears to hold, even if we look beyond household cleansing agents to the food, paper and toilet products which round out the Procter line.<sup>13</sup>

After classifying Procter's acquisition of Clorox as a product extension variant of the horizontal merger, the Commission might have applied the conventional market share test.<sup>14</sup> Elman instead abandoned his classification of the merger as horizontal, styled it conglomerate, "in the broad sense of that term," and embarked on what may prove to be a historic analysis of general principles in Section 7 interpretation.

### *The Reach of Section 7*

"All mergers are within the reach of the amended Section 7, whether they be classified as horizontal, vertical or conglomerate, and all are to be tested by the same standard."<sup>15</sup> However a merger be classified, its legal status under Section 7 is the same; if the effect of a merger may be substantially to lessen competition or tend to create a monopoly, in any line of commerce, in any section of the country, it is illegal.<sup>16</sup>

### *The Nature of the Test*

Mergers are to be judged neither according to a broad rule of reason nor according to a so-called *per se* standard. "Congress declared neither that all mergers, not that mergers of a particular size or type, are *per se* unlawful. In every case the determination of illegality, if made, must rest upon specific facts."<sup>17</sup> However, "if the adverse effects on competition specified in Section 7 are proved, it will normally not be open to the respondent to show that redeeming social or economic benefits will flow from the acquisition."<sup>18</sup>

### *The Economics of Section 7*

Commissioner Elman's pronouncement of the economic first principles for Section 7 enforcement will doubtless stir up more controversy than any other part of his opinion. Elman's dissertation on economics rests on the

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<sup>13</sup> Id. at 21566.

<sup>14</sup> See note 162 *infra* and accompanying text.

<sup>15</sup> *Supra* note 8, at 21567. Accord *Brown Shoe Co. v. United States*, *supra* note 1, at 317.

<sup>16</sup> *Supra* note 8, at 21567.

<sup>17</sup> Id. at 21568.

<sup>18</sup> *Ibid.* Accord *United States v. Philadelphia Nat'l Bank*, *supra* note 1, at 371.

premise that oligopoly is bad, and that the concept of competition which Congress sought to advance in amending Section 7 is not promoted by an oligopolistic market.<sup>19</sup> He points to congressional fear of rising concentration in American industry as the motivation for amending Section 7.

In an oligopolistic market, price competition is likely to be tacitly renounced, and perhaps other forms of rivalry as well, because any attempt by one competitor to increase his market share is bound to bring retaliation. Since the competition spiral, once begun, will soon cause prices to fall too low for anyone to make money, no one will willingly start it.<sup>20</sup>

Market concentration is not the only aspect of market structure to be considered in applying Section 7. According to Elman, condition of entry into the market by new competitors was the most important other market structure variable involved in *Procter & Gamble*.<sup>21</sup> The presence of potential competitors waiting to enter the market is presumed to affect the price level set by the firms in the market: incumbents will not price so high as to encourage new rivals; instead they will adopt a lower price level to discourage them. For this reason, barriers to entry which remove the restraining influence of potential competition significantly affect conditions in an oligopolistic market.<sup>22</sup>

In Elman's view, three factors may retard entry. "The first is the possession of cost advantages by the firms presently occupying the market vis-à-vis prospective entrants."<sup>23</sup> There are two types of cost advantages: 1) absolute cost advantages, e.g., control of necessary patents by firms presently in the market, which puts a new entrant at a marked competitive disadvantage, and 2) advantages of scale. A prospective entrant must plan to operate on a scale large enough to obtain the same economies or advantages of scale enjoyed by existing firms if he is to compete with them on equal terms. "If the scale of optimum efficiency in an industry is substantial, a heavy initial investment" must be made by the prospective entrant. This is said to force the challenger to play for high stakes and virtually assures retaliation by firms already in the market.<sup>24</sup>

A more important entry-retarding factor is product differentiation, that is, "consumer preferences as between very similar, close-substitute products or brands."<sup>25</sup> An industry in which product differentiation is an important sales factor will prove a difficult one for a new firm to establish a share of the market in.

"The third entry-retarding factor is the financial size or strength of the established firms in comparison to that of prospective entrants," because the prospect of taking on a large, well-established firm would prove a much

<sup>19</sup> Supra note 8, at 21568.

<sup>20</sup> Id. at 21569.

<sup>21</sup> Id. at 21570.

<sup>22</sup> Ibid.

<sup>23</sup> Ibid.

<sup>24</sup> Id. at 21570-71.

<sup>25</sup> Id. at 21571.

stronger deterrent to entry than that of taking on a small firm or one in poor financial condition.<sup>26</sup>

All three factors interact and their entry-retarding effect is likely to be greatest in industries in which "the dominant firms have succeeded in differentiating their products through mass advertising and sales promotion. . . . Financial strength and large absolute size may be indispensable attributes in enabling a substantial market share to be acquired and maintained in industries characterized by product differentiation through advertising and promotion."<sup>27</sup> Furthermore, the acquisition and retention of a large market share correspondingly heightens the scale necessary to operate at optimum efficiency.

Moreover, the same factors which make for high entry barriers also make for domination of small competitors by firms which have a dominant position in the market, thereby tending to eliminate actual as well as potential competition. "If the large firm enjoys substantial competitive advantages by virtue of product differentiation, cost advantage, or financial strength, any attempt by a small firm to expand its market share at the expense of the large firm is unlikely to succeed."<sup>28</sup> On the other hand, a competitive venture by the large firm is apt to first injure these small firms. "The power to repel or discourage new competitors, then, is the power to control or discipline existing competitors. . . ."<sup>29</sup>

The conclusion Elman reaches is that, "in sum, high entry barriers, like excessive concentration, impair effective competition."<sup>30</sup>

#### *Social Policies Underlying Section 7*

According to Elman, the concept of competition upon which Section 7 rests is not purely economic. Congress, in enacting Section 7, clearly indicated that it was concerned with a number of social and political values. "The interest in fostering equality of opportunity for small business, and in promoting the diffusion of economic power, although it may not be identical to the economists' notion of competition, was unquestionably intended by Congress to be relevant in any scheme for the enforcement of Section 7."<sup>31</sup> The Federal Trade Commission, if *Procter & Gamble* is a reliable indicator, is not about to subvert this intent.

#### *The Scope of Section 7 Proceedings*

Elman's views on the proper scope of Section 7 proceedings are founded upon a preventive theory of antitrust law. He attributes to Congress the postulate that "certain kinds of market structure would ordinarily lead to non-competitive company behavior."<sup>32</sup> Accordingly, evidence of market structure rather than of market behavior is the most probative under Sec-

<sup>26</sup> Ibid.

<sup>27</sup> Ibid.

<sup>28</sup> Id. at 21572.

<sup>29</sup> Ibid.

<sup>30</sup> Ibid.

<sup>31</sup> Ibid. Accord *Brown Shoe Co. v. United States*, supra note 1, at 316, 344.

<sup>32</sup> Supra note 8, at 21574.

tion 7. The requirements of a prima facie case are met by "proof that a merger has created or aggravated a market structure conducive . . . to practices that substantially lessen competition, or tend to monopoly. . . ." <sup>33</sup>

The prophylactic function of Section 7 is also an important consideration in defining the standards of relevancy and materiality in Section 7 proceedings. <sup>34</sup> A statute designed to arrest incipient anticompetitive trends can deal only with broad probabilities, and, as a result, detailed analysis of all facts which might possibly be relevant is unnecessary. <sup>35</sup> Not only is such an investigation unwarranted, but, by prolonging the litigation, it prevents effective relief; divestiture will seldom reconstitute an acquired firm as a significant competitive factor if, as will surely happen in time, the assets, goodwill, and personnel of the two firms have become commingled. Elman stresses that, under Section 7, effective relief is early relief. "Clear and relatively simple rules, and the rigorous exclusion of evidence which bears only remotely upon the central concerns of the statute, are essential if Section 7 is not to become a judicial and administrative nullity." <sup>36</sup>

Specifically, post acquisition evidence should be excluded unless the structure of the market has changed radically since the merger, e.g., when the market share of the merged firm has dwindled to insignificance or when adverse effects on competition caused by the merger have clearly occurred. <sup>37</sup> Because a company will be on its best behavior while Section 7 litigation is in progress, post acquisition good-conduct evidence is likely to be unreliable. Likewise, evidence of non-competitive practices developing after the merger should not be admitted because a causal relationship between the merger and these practices will not be clear in most cases. <sup>38</sup> In sum, post acquisition evidence is of little value in determining what changes in market structure have resulted from the merger, and its consideration serves only to hinder efforts to enforce the statute with effective relief.

#### *The Decision in Procter*

Applying these general principles, the Commission held that Procter's acquisition of Clorox substantially lessened competition.

Analyzing the market structure of the household liquid bleach industry prior to the merger, the Commission found that it was "manifestly" highly concentrated and oligopolistic. <sup>39</sup> As the dominant firm and the only national seller in an industry characterized by product differentiation, Clorox enjoyed a decisive competitive advantage over its rivals. <sup>40</sup> Also, the industry was "concentrated, and barricaded to new entry, to a degree inconsistent with effectively competitive conditions." <sup>41</sup>

<sup>33</sup> Id. at 21573.

<sup>34</sup> Accord *United States v. Philadelphia Nat'l Bank*, supra note 4, at 362.

<sup>35</sup> Supra note 8, at 21573.

<sup>36</sup> Id. at 21574.

<sup>37</sup> Ibid.

<sup>38</sup> Ibid.

<sup>39</sup> Id. at 21575.

<sup>40</sup> Id. at 21576.

<sup>41</sup> Ibid.

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The merger of Procter and Clorox enabled "substantial cost savings and other advantages in advertising and sales promotion, especially in television advertising."<sup>42</sup> As a large multiproduct firm Procter could obtain volume discounts; more effectively utilize Clorox's advertising expenditures by buying program sponsorship on television; use joint promotions with other Procter products, jointly advertise Clorox with other Procter products in newspapers, and distribute Clorox through its own sales force; obtain from retailers, as a matter of convenience or expediency, advantages in shelf display, and acquire increased shelf space by offering the retailer a special price. There was also the danger that Procter as a multiproduct firm might, without predatory motive, engage in below cost selling of bleach, for instance, as a loss leader.<sup>43</sup> Moreover, since "market behavior is determined by the state of mind of the firms in the market, Procter's history of success, its general size and its prowess, which loom large in the eyes of the small liquid bleach firms, must for that reason alone be reckoned significant competitive factors."<sup>44</sup>

After this discussion of the way that Procter's acquisition of Clorox might affect the competitive position of Clorox, Elman proceeded to pinpoint the consequences of the merger in the light of his general principles.

The merger had "markedly heightened" barriers to entry into the bleach industry. Procter was in a position to further entrench Clorox's dominant position by utilizing its advantages in advertising and sales promotion. And, because of the substantial competitive advantages Procter enjoyed as a giant multiproduct firm, the scale of optimally efficient operation in the bleach industry was so increased that only very large firms could be expected to compete on equal terms.<sup>45</sup>

Moreover, as pointed out in his discussion of economic first principles,<sup>46</sup> a heightening of entry barriers is accompanied by a corresponding enhancement of the market leaders' power to dominate small rivals. "Given Procter's materially greater strength, compared to Clorox, as a liquid bleach competitor, vigorous competition by the small firms in the industry would appear still more effectively and substantially inhibited than prior to the merger."<sup>47</sup>

Whether Procter actually used its advantages was immaterial to the finding that "as a result of this merger, the market structure of the liquid bleach industry is significantly less conducive to competition than was the case prior to the merger . . .,"<sup>48</sup> because the firms in the industry and those contemplating entry would make decisions in view of what Procter might do, if provoked, not what it did while its position was unchallenged. Since the conditions which retard competition in an industry are to an important extent psychological, "the appropriate standpoint for appraising the impact

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<sup>42</sup> Ibid.

<sup>43</sup> Id. at 21576-78.

<sup>44</sup> Id. at 21579.

<sup>45</sup> Ibid.

<sup>46</sup> Id. at 21572.

<sup>47</sup> Id. at 21579.

<sup>48</sup> Ibid.



of this merger" was that of Clorox's rivals and of potential entrants into the industry. From this standpoint, the Commission concluded that "the merger has increased the power of Clorox, by dominating its competitors and discouraging new entry, to foreclose effective competition in the industry."<sup>49</sup>

After finding that the merger increased the power of Clorox to foreclose effective competition in the industry, the Commission addressed itself to the question whether this impairment of competition was substantial. Looking to the policy considerations underlying Section 7, it concluded that five factors enabled it to decide with reasonable probability that the merger had the "specified statutory effect, namely, of probably lessening competition substantially, or tending to create a monopoly, in the relevant market."<sup>50</sup>

The first factor was "the relative disparity in size and strength as between Procter and the largest firms of the bleach industry."

The magnitude of this size disparity was a reliable indicator that the cost advantages enabled by the merger would be substantial and warranted the inference that the merger would impart a substantial competitive advantage to the acquired firm. The inference was considered clearly warranted in this case because Procter and Clorox were functionally closely related and the cost savings resulting from the merger "depend principally on nothing more arcane than the total amount of the pooled expenditures for advertising. . . ."<sup>51</sup>

Further, the size disparity in this case was of special significance in light of Congress's intent to preserve competitive opportunities for small business because the household bleach industry was essentially a small-firm industry prior to the merger. Since Procter's great size permitted it to engage in sales promotion on a much greater scale than previously existed in the industry, other firms might also seek to merge with giant firms to gain the same advantages. "The practical tendency of the instant merger, then, is to transform the liquid bleach industry into an arena of big business competition only, with the few small firms that have not disappeared through merger eventually falling by the wayside, unable to compete with their giant rivals."<sup>52</sup> In Elman's view, it was the prevention of just such a transformation that was uppermost in Congress's mind in enacting the amended Section 7.<sup>53</sup> The Commission was not about to disregard this "manifest Congressional policy."

The second factor that convinced the Commission that the merger violated Section 7 was "the excessive concentration in the industry at the time of the merger, and Clorox's dominant position in the industry."

With the substitution of Procter for Clorox, the already formidable barriers to entry became "virtually insurmountable" and any hope of eventual deconcentration of the industry, even more remote.<sup>54</sup>

In addition, "since Procter is already a leading manufacturer of a

<sup>49</sup> Id. at 21579-80.

<sup>50</sup> Id. at 21580.

<sup>51</sup> Id. at 21581.

<sup>52</sup> Ibid.

<sup>53</sup> Id. at 21582.

<sup>54</sup> Id. at 21580.

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number of products, its acquisition of Clorox, by strengthening Procter's aggregate market position, may lead to an impairment of competition in many industries besides liquid bleach." Also, the close relationship between the products of Procter and Clorox enabled the use of Clorox bleach as a "tying product, loss leader or cross-coupon offering,"<sup>55</sup> familiar methods of extending market power, in promoting Procter's products.

The third factor relied on by the Commission was "the elimination, brought about by the merger, of Procter as a potential competitor of Clorox."

Procter was an aggressive manufacturer of many products in the same general line as household bleach and had frequently extended its product line in the past. By reason of its "proximity, size and probable line of growth" it was a "substantial competitive factor" in the bleach industry. The Commission felt it unnecessary to speculate whether Procter would have entered the bleach industry on its own; the "tangible possibility" of Procter's entrance was an important check on Clorox's misuse of its market power. The merger, by eliminating this possibility, removed this significant pro-competitive influence.<sup>56</sup>

The fourth factor supporting the Commission's conclusion was "the position of Procter in other markets."

It was not unlikely that Procter could use its manifest strength in other markets to enhance Clorox's position in the bleach industry. But if the record would not support this inference, at least Procter's strength in other markets rebutted any notion that it would be unable to wield the advantages it enjoyed over its liquid bleach competitors.<sup>57</sup>

Procter's position in other markets also had an important bearing on the "psychological response of the members of the liquid bleach industry to Procter as a competitor."

To the extent that Procter is thought by them to be not only a large and affluent firm, but also a powerful firm, in terms of market power enjoyed in related markets and possibly transferable into the bleach market, its prowess as a competitor gains an added and even sinister dimension in the eyes of its liquid bleach rivals—a factor of considerable importance to the impact of the merger on competition in the bleach industry. . . .

Thus, just as ownership of Clorox may enable Procter to enhance its competitive edge in other markets, so Procter's position in other markets may enhance its dominance, through its acquisition of Clorox, of the liquid bleach industry.<sup>58</sup>

Summing up, Elman states, "the short of it is that a conglomerate merger involving firms which have dominant power in their respective markets tends to reinforce and augment such power."<sup>59</sup>

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<sup>55</sup> Id. at 21583.

<sup>56</sup> Id. at 21584.

<sup>57</sup> Ibid.

<sup>58</sup> Id. at 21585.

<sup>59</sup> Ibid.

The last factor relied on by the Commission was "the nature of the 'economies' enabled by the merger."

The Commission's short answer to Procter's argument that a merger productive of such efficiencies as this one should not be proscribed merely to protect inefficient small firms was that "efficiencies" are pertinent in a Section 7 proceeding only insofar as they promote competition, and those in this case served only to impair competition.<sup>60</sup>

The "more complete" answer was a scathing attack on the use of heavy advertising to preserve and further entrench the market power of large companies in oligopolistic industries as "independently offensive to at least the spirit, if not the letter, of the antitrust laws."<sup>61</sup> The large scale advertising "economies" involved in *Procter & Gamble* were characterized as "price concessions available only to giant firms . . .," and the intensive advertising of a "homogeneous product, such as liquid bleach, produced under conditions of oligopoly," was felt to be of no benefit at all to the consumer. In the mind of the Commission, "the undue emphasis on advertising which characterizes the liquid bleach industry is itself a symptom of and a contributing cause to the sickness of competition in the industry."<sup>62</sup>

Reiterating once more that the Commission's decision in no way rested on the post-acquisition evidence in the case,<sup>63</sup> Elman ordered Procter to divest itself of the assets acquired from Clorox, but allowed Procter to spin off the assets to a new corporation and distribute the stock to Procter's stockholders, if it wished.<sup>64</sup>

#### ENTRY BARRIERS, COMPETITIVE ADVANTAGES AND THE "DEEP POCKET"

Although Elman's opinion utilized nearly every weapon in the Commission's antitrust arsenal to strike down the Procter-Clorox merger, the theories of barriers to entry and decisive competitive advantages form the backbone of the decision.

Before examining these theories it will be helpful to consider an earlier Commission case decided on a decisive competitive advantage theory. In *Reynolds Metals Co.*,<sup>65</sup> the acquisition of Arrow Brands, Inc. by Reynolds Metals Company was held to violate Section 7. Reynolds, an integrated producer of primary aluminum and fabricated aluminum products, including aluminum foil, with net annual sales of \$446,578,767, acquired Arrow, a firm which bought and decorated aluminum foil for resale to the florist trade. One of eight firms in the florist foil industry, Arrow, with total sales of \$497,000, had a market share of about 33%. Expressly refusing to base the decision on the obvious vertical aspect of the case, both the FTC and the District of Columbia Court of Appeals held that the acquisition violated Section 7 on the theory that the financial resources and size of Reynolds imparted a decisive competitive advantage to Arrow.

<sup>60</sup> Ibid.

<sup>61</sup> Ibid.

<sup>62</sup> Id. at 21586.

<sup>63</sup> Id. at 21586-87.

<sup>64</sup> Id. at 21587.

<sup>65</sup> 56 F.T.C. 743 (1960), enforced, 309 F.2d 223 (D.C. Cir. 1962).

The truer picture of anti-competitive effect emerges from even the most cursory consideration of the post acquisition competitive postures of the eight previously independent florist foil converters vis-à-vis one another. Arrow's assimilation into Reynolds' enormous capital structure and resources gave Arrow an immediate advantage over its competitors. . . . The power of the "deep pocket" or "rich parent" . . . opened the possibility and power to sell at prices approximating cost or below and thus to undercut and ravage the less affluent competition.<sup>66</sup>

A decisive competitive advantage may arise when a merger results in a firm that has far greater financial resources than its competitors. This is the "rich parent" or "deep pocket" theory. *Reynolds Metals* illustrates two ways in which the "deep pocket" creates a competitive advantage: by conferring the ability to maintain lower prices longer than any other firm in the event of a price war and by making available greater capital for plant improvements.<sup>67</sup>

This so-called "deep pocket" theory appears prominently in the theories of entry barriers and decisive competitive advantages. As used in *Procter & Gamble*, however, the "deep pocket" theory is not limited to the customary applications appearing in *Reynolds*; it is extended and transformed from the simple notion that having more money than competitors is an advantage into a sophisticated economic concept in Elman's analysis of product differentiation, one of the major factors which retard entry.

Basically, Elman's reasoning is as follows. Product differentiation is the major factor in the sale of consumer goods like household bleach because it enables a company to establish and maintain a substantial share of the market. Successful product differentiation is accomplished through advertising. The efficacy and inexpensiveness of advertising is directly proportionate to the volume of a firm's advertising expenditures.<sup>68</sup> The addition of Procter's financial resources to Clorox enabled it to advertise on a greater scale and to obtain advertising economies not available to other bleach producers. The result was a significant advantage over competitors.

This reasoning need not be limited to the bleach industry. It applies to all industries characterized by product differentiation. Elman's description of the class of consumer goods to which household bleach belongs<sup>69</sup> and the importance of product differentiation to successful marketing of these goods<sup>70</sup> could just as well be applied to any industry which primarily sells to the consumer through grocery stores, department stores and the like. No detailed economic data are needed to appreciate the countless industries which this reasoning encompasses.

Product differentiation combines with two other factors, exhibiting a more conventional reliance on the "deep pocket" theory, to form the basis of

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<sup>66</sup> 309 F.2d at 229-30.

<sup>67</sup> 56 F.T.C. at 775.

<sup>68</sup> Supra note 8, at 21571.

<sup>69</sup> See text accompanying note 13, supra.

<sup>70</sup> Supra note 8, at 21563.

the Commission's theories of entry barriers and decisive competitive advantages.

The major factors which retard entry are product differentiation, financial strength or size, and advantages of scale. Product differentiation, we have seen, is merely a matter of how much money is spent on advertising. Financial strength operates as a barrier to entry quite simply: the richer the firm, the less likely that it will be challenged. Advantages of scale, by definition, are governed by the size of a company. High entry barriers are anticompetitive in that they discourage potential competitors from entering the market and thereby enable the firms in the industry to fully exploit the advantages of their pre-eminent position in an oligopolistic market. In essence, then, the Commission's analysis of barriers to entry is no more than the expression of the belief that a good big company will always beat a good little company in any competitive battle, and that the little company, knowing this, will refuse to enter the ring.

The same factors which make for high entry barriers—advantages of scale, product differentiation, and financial strength—likewise discourage actual competition from firms presently in the market. Faced by a big firm which enjoys a substantial competitive advantage due to its product differentiation, large scale operation, and superior financial strength, the small firms in an industry will not provoke a crushing retaliation from the dominant firms by engaging in vigorous competition, especially when attempts to increase their market shares are doomed to fail. This theory of decisive competitive advantage—like the theory of entry barriers—is based on the belief that a big company will always triumph over a little one, and that the small company knows this. In the Commission's view of the business arena, David never gathers the courage to meet Goliath, let alone defeat him.

As the above discussion indicates, since the same factors operating in the same way both heighten entry barriers and impart competitive advantages, the Commission will now be able to rely, in a proper case, on this dual aspect of a merger's anticompetitive effect—injury to both potential and actual competition. Thus, it can be expected that more cases like *Procter & Gamble* will appear in which concern over heightened entry barriers will alternate with solicitude for the plight of the competitors of the merged company, and fewer cases will rest on as narrow grounds, or as blunt a rationale, as the *Reynolds Metals* decision.

As the above discussion also indicates, naked size and financial power hold a pre-eminent position in the Commission's theories of barriers to entry and decisive competitive advantages. Elman fails conspicuously in his attempts to detract from the heavy emphasis on Procter's size and the mechanical operation of his theories by indicating situations in which size disparity might not be significant. After finding that the size disparity present in *Procter & Gamble* warranted the inference that substantial cost savings imparting a decisive competitive advantage would be effected by the merger, Elman stated: "To be sure, we might hesitate to draw such an inference in the case of a merger between firms in unrelated industries, or where the obtaining of cost advantages as a result of the merger depended

on complex technological factors."<sup>71</sup> Common sense dictates that no firm would attempt a merger of this type unless it felt capable of effectively competing in the industry. If the acquiring firm feels it has the experience, knowledge, and ability to handle the technological problems of the industry, and to obtain cost advantages, it is doubtful the Commission will disagree. A company that entered a new industry without the experience, knowledge, and ability to compete effectively or to solve the technological problems involved in obtaining cost advantages need not be attacked under Section 7; with management possessing the business acumen to negotiate so judicious a venture, no doubt the company will fail before litigation is instituted.

In the same vein, Commissioner Elman's statement, "the acquisition by Procter of, say, a small automobile manufacturer, even if the acquisition enabled substantial cost savings, would not be likely to impart a decisive competitive advantage to the acquired firm, given the scale of its competitors,"<sup>72</sup> emphasizes the unrealistic—cases involving mergers of this type are unlikely to plague the courts; nor is business likely to rejoice at the knowledge it can legally gather grapes from thorns.

The fact of the matter is that Elman's theories of entry barriers and decisive competitive advantages operate to prohibit any large, successful company from entering an industry populated by smaller firms for precisely those reasons that make the merger a sound one from a business viewpoint.

The striking fact about the Commission's theories of entry barriers and decisive competitive advantages is that they have a virtually automatic operation. Product differentiation, advantages of scale, and financial strength are merely different expressions of bigness in operation. The entrance into an industry of a larger firm than any now present cannot help but raise entry barriers. Since it is an economic first principle that barriers to entry and decisive competitive advantages—like undue concentration—impair effective competition,<sup>73</sup> the only real question is whether the impairment is substantial within the meaning of Section 7.

#### HOW LITTLE IS SUBSTANTIAL

By relying on factors other than the size disparity between Procter and the firms in the bleach industry in determining that, as a result of the merger, the probable lessening of competition would be substantial, Elman appears to discount the role that Procter's size played in the decision of this case. Closer examination of these other factors, however, merely reinforces the belief that Procter's size was the key to this decision, *for they relate to, and are the expression of, the competitive consequences of Procter's status as a large, successful company.*

In deciding that the probable lessening of competition in the *Procter & Gamble* case would be substantial, the Commission stressed the huge size disparity between Procter and firms in the bleach industry: measured by its sales, Procter was twenty times larger than the biggest firm in the industry. But this is hardly the minimum size disparity that will result in an im-

<sup>71</sup> Id. at 21581.

<sup>72</sup> Ibid.

<sup>73</sup> Id. at 21572.

pairment of competition sufficient to support a finding that the merger will probably substantially lessen competition. Would five times the size of any firm in the industry be sufficient? Two? Perhaps less? The Commission also emphasized the already high entry barriers and Clorox's dominant position in the bleach industry. But are these facts really necessary to the decision?

Suppose the bleach industry were oligopolistic, populated by a dominant firm and several major ones. Could a firm with greater resources than any firm presently in the industry acquire one of the major firms?

The distinction between this situation and *Procter & Gamble* is that Clorox, as the *dominant* firm, had built up a consumer preference for its product. This successful product differentiation made it difficult to pry customers away from Clorox, and, since it obtained a premium price for its bleach, Clorox had a flexibility in pricing which a new company would lack. In short, Clorox had attained the market power made possible by successful product differentiation. In the case of a major firm being acquired by one larger than any in the industry, the immediate anticompetitive effects of the merger are not so great because the acquired firm has not differentiated its product as successfully as the dominant firm. However, serious anticompetitive effects can be expected.

The acquiring firm, by using its greater financial resources, can advertise on a scale greater than had hitherto been known in the industry. Since the heavier advertising will necessarily increase its market share, the potential exists for the new firm to displace the dominant one. And this heavier emphasis on advertising increases the scale of optimum efficiency in the industry. As a larger firm the new company may be able to utilize certain advantages of scale in aid of the acquired company. The financial strength of the new company makes potential competitors even less anxious to enter the industry. In sum, barriers to entry are now higher.

Actual competition is also injured in this situation. The size, financial strength, and ability to differentiate its product possessed by the new firm will make present competitors less likely to compete vigorously, since any competitive venture which threatens to increase the small firm's market share will now provoke forceful retaliation from two sides—the dominant firm and the major firm, both of which have the resources to crush their smaller rivals.

Would the impairment of effective competition in this case be substantial? This question really depends on the relative size disparity between the new firm and those presently in the industry, both in and of itself and as the keystone of other factors.<sup>74</sup> The disparity need not be great. As Elman puts it, "... a merger involving a leading firm in a market that is already well on its way to a non-competitive structure may be unlawful under Section 7 even where the aggravation of non-competitive market conditions by the merger may seem relatively slight because of the already advanced oligopoly condition of the market."<sup>75</sup>

<sup>74</sup> Supra p. 267.

<sup>75</sup> Supra note 8, at 21583.

## STUDENT COMMENTS

Suppose the bleach industry were oligopolistic, dominated by a few major firms of roughly equal size. Could a firm with greater financial resources and larger size than any of the firms in the market acquire one of these major firms?

Once again the size and wealth of the entering firm compared with that of the firms in the market triggers the automatic operation of the Commission's economic principles. The new firm's size, its advantages of scale, its "deep pocket," and its ability to differentiate its product give it the power to effectively repel potential competitors and to discipline present ones. Presumably, potential competitors are now even less anxious to enter the market. More important, if the new firm fully exploits its competitive advantages the probability is that it will leap to a decisive competitive advantage over the other major firms in the industry. As a result, the unhealthy competitive structure of an oligopolistic industry takes a turn for the worse, and the spectre of monopoly appears.

In view of the heavy emphasis that Section 7 is designed to prevent further concentration in the economy, and in light of the fact that monopoly, or single firm dominance, is considered an even greater evil than oligopoly, the size disparity, in this case also, need not be great to result in a finding that the merger substantially lessens competition.

Perhaps a larger firm with greater resources than any firm presently in the market can acquire one of the smaller firms in an oligopolistic industry? This is also unlikely. First of all, credit for some intelligence must be granted to American business. No firm enters an oligopolistic industry by acquiring a company hamstrung by an irremediable absolute cost disadvantage. As a practical matter, then, the advent of a firm larger than any now present in the industry, by acquisition of a small one, will occur only in circumstances that assure the acquiring firm an opportunity to effectively compete against the major ones. The adverse effects on entry barriers and the anticompetitive consequences that flow from them can be expected in this instance also, although at a more remote point in time.

There is another anticompetitive consequence to this merger. Since a competitive foray by a major company into an oligopolistic industry presumably first injures the small companies that do not have the financial resources necessary to compete, is it not probable that the acquisition may be proscribed on the following theory?

The acquisition, by thrusting a new power into the industry, is likely to result in a battle of the leaders in which the first casualties will be the small firms. The loss of the small competitors not only results in increased concentration but also seriously impedes any chance of deconcentration ever taking place. "[I]f concentration is already great, the importance of preventing even slight increases in concentration and so preserving the possibility of eventual deconcentration is correspondingly great."<sup>76</sup>

Suppose the bleach industry were deconcentrated, populated by medium size firms competing on an equal footing, and marked by low entry barriers. Could a firm such as Procter acquire one of these firms? Clearly not. Once

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<sup>76</sup> *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 365 n.42 (1963).



more, given the direct relation between financial strength and size and entry barriers, the barriers to entry will be heightened if such a merger takes place. The acquired firm's greater resources will impart a competitive advantage.

The pernicious quality of this merger lies in its tendency, by initiating a series of mergers designed to enable the small firms to compete more effectively with the new giant, to convert a small business market into a concentrated one populated by a few large corporations. Both Congress and the Supreme Court have indicated that mergers of this type are to be scrutinized carefully, so that trends of concentration may be curtailed in their incipency. Here again the lessening of competition need not be great in order to be "substantial" within the meaning of Section 7.

As we have attempted to show in the above examples, in many situations the slightest lessening of competition may be substantial within the meaning of Section 7. Although Elman did not have to rely on some of these principles because of the facts presented in *Procter & Gamble*, there is every reason to believe that the Commission will use them in a proper case.

#### *Procter & Gamble* AS PRECEDENT

Since Elman wrote the opinion in *Procter & Gamble* with the avowed purpose of establishing broad guidelines for deciding Section 7 cases, we have attempted to give some indication of the potential ramifications of the decision, rather than try to limit and distinguish the case by its particular facts. In this respect it is important to keep in mind that many of Elman's ideas indicate that the size of companies involved in a merger will be an important consideration in cases involving industries not characterized by product differentiation.

For instance, the fact that Procter's strength and success in other markets had created a corporate image which struck fear in the hearts of competitors, was itself a reason Procter's success, general size and prowess must be reckoned significant competitive factors.<sup>77</sup> Procter need not in fact have been a well-managed, aggressive competitor; by so impressing the firms in the bleach industry it created a psychological climate inimical to competition.<sup>78</sup> Certainly this reasoning is applicable to industries other than the bleach industry. The situation posed by Elman would be present whenever a large, successful company moves into a different field populated by smaller companies, and the only defense against this position is to deny it.

The statement, "since Procter is already a leading manufacturer of a number of products, its acquisition of Clorox, by strengthening Procter's aggregate market position, may lead to an impairment of competition in many industries besides liquid bleach,"<sup>79</sup> also embodies a concept of universal application. Any large firm looking for an opportunity to diversify would necessarily have been successful in its own field; the transference of market power which Elman refers to would be present, to some extent, in any conglomerate where the acquired company is in sound business condition.

<sup>77</sup> Supra note 8, at 21579.

<sup>78</sup> Id. at 21585.

<sup>79</sup> Id. at 21583.

## STUDENT COMMENTS

Finally, the mere fact that Procter was in a related field in and of itself made it a potential competitor of Clorox. And there need be neither immediate nor projected plans to enter an industry. It is sufficient that the particular industry be one into which a firm is likely to expand because its experience and knowledge would be of use in competing therein.<sup>80</sup> Under this view any large, successful company is automatically a potential competitor in every field which is a logical extension of its product line in any diversification.

As we noted at the beginning of our discussion, *Procter & Gamble* must be read in the light of other Commission decisions involving conglomerate mergers in order to gain a full appreciation of its significance. Standing alone, this case could be explained away on its facts, some statements could be disregarded as dicta, or merely loose language, and through numerous devices of this sort one could convince himself that the decision is not really as sweeping as it seems. But the Commission's action in other cases belies any notion that the emphasis on bigness present in the *Procter & Gamble* case is unique, and confirms that the principles, concepts, and theories promulgated in the case are meant to apply generally in Section 7 cases.

### OTHER COMMISSION DECISIONS

*Reynolds Metals* was bottomed on nothing more esoteric than that Reynolds had too big a bankroll.<sup>81</sup>

*Foremost Dairies, Inc.*,<sup>82</sup> an early case involving conglomerate mergers, contains the rough framework of some of the ideas which emerged full blown in *Procter & Gamble*. The Commission ruled that Foremost, a diversified giant, violated Section 7 by acquiring Philadelphia Dairy Products, Inc. on the ground that the merger foreclosed potential competition between the two. Although at one time small independent firms could easily enter the dairy business, recent technological changes and the growth of giant diversified companies had created substantial barriers to entry into the industry, and, as a result, the chief source of new competitors in local milk markets was territorial expansion by firms already established in other markets.<sup>83</sup> The growth patterns of the two companies indicated they were likely to clash as competitors in the Philadelphia area.<sup>84</sup> The likelihood of such a clash was deemed an important factor affecting competition: "When market concentration is high, the main, and sometimes the only, restraint on the use of market power by oligopolistic sellers is potential competition."<sup>85</sup>

Throughout its opinion the Commission emphasized the trend toward concentration in the dairy industry, and that the transformation of deconcentrated industries into oligopolistic ones was what Congress intended Section 7 to prevent. It also pointed to the danger to competition posed by the

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<sup>80</sup> Supra note 8, at 21584.

<sup>81</sup> See text accompanying note 66 supra.

<sup>82</sup> *Foremost Dairies, Inc.*, Trade Reg. Rep. Tr. Binder, 1961-1963 F.T.C. Complaints, Orders, Stipulations ¶ 15877 (April 30, 1962), appeal pending 5th Cir.

<sup>83</sup> Id. at 20689.

<sup>84</sup> Id. at 20688.

<sup>85</sup> Id. at 20689.

competitive advantage which a large diversified firm enjoys over its small rivals.<sup>86</sup>

In discussing the nature of the test to be applied to conglomerates, the Commission concluded that "under Section 7, the necessary proof of violation of the statute consists of types of evidence showing that the acquiring firm possesses significant power in some markets or that its over-all organization gives it a decisive advantage in efficiency over its smaller rivals."<sup>87</sup>

In *Ekco Products Co.*,<sup>88</sup> decided after *Procter & Gamble*, Ekco Products acquired all the assets of the McClintock Company, which had a virtual monopoly of the commercial meat-handling equipment industry. Ekco, a producer of pans, houseware, kitchenware and the like, was in a closely related field. The decision rested squarely on a "deep pocket" or "rich parent" theory. The addition of the Ekco bankroll to McClintock could not help but entrench McClintock's monopoly position. A concrete illustration was that subsequent to the acquisition the Ekco-McClintock firm purchased all the assets of a significant competitor, thereby eliminating it. The evidence showed this could not have been done by McClintock prior to the merger because of its strained financial resources.<sup>89</sup>

Commissioner Elman postulated that the facts of the case called for a presumption of illegality. "Where a single firm monopolist . . . is acquired by a corporation having many times the resources of the acquired firm . . . that fact in itself makes the merger highly suspect under Section 7. We need not dwell on the many ways in which the substitution of a large firm such as respondent for a very small firm such as McClintock would have a tendency to entrench the monopoly position of the acquired firm and, in particular, to strengthen the latter's ability to repulse new competition. See *Procter & Gamble Co.* . . ." (Emphasis supplied.)<sup>90</sup>

The Ekco-McClintock merger also removed the restraining influence of Ekco's potential competition, since Ekco, as a large diversified manufacturer of a related product line, was a "prime prospect" to challenge McClintock's dominant position in the commercial meat-handling equipment industry.<sup>91</sup>

This case is an excellent indication that the principles and theories promulgated in *Procter & Gamble* are meant to apply in cases involving industries not characterized by product differentiation.

Note the reliance on *Procter & Gamble* as authority for the central proposition in the case.

Also, Elman criticized the reliance on post-acquisition evidence by complaint counsel in this case and reiterated the views of its usefulness which he expressed in *Procter & Gamble*.<sup>92</sup> In fact, he did not bother to rely on

<sup>86</sup> Id. at 20686.

<sup>87</sup> Id. at 20687.

<sup>88</sup> 3 Trade Reg. Rep. (Trade Reg. Rep. Tr. Binder, F.T.C. Complaints, Orders, Stipulations) ¶ 16879 (April 21, 1964), final order 3 Trade Reg. Rep. (Trade Reg. Rep. Tr. Binder, F.T.C. Complaints, Orders, Stipulations) ¶ 16956 (June 30, 1964).

<sup>89</sup> 3 Trade Reg. Rep. ¶ 16879, at 21908 (April 21, 1964).

<sup>90</sup> Id. at 21907.

<sup>91</sup> Ibid.

<sup>92</sup> Id. at 21902.

the evidence of the Ekco-McClintock firm's acquisition of a substantial competitor for his decision,<sup>93</sup> even though, since there was a clear causal relationship between the merger and the impairment of competition brought about by the demise of this competitor, such evidence came within an exception to his exclusionary rule.<sup>94</sup>

*Consolidated Foods Corp.*<sup>95</sup> did not involve product differentiation and used a theory to condemn the merger which did not appear in the subsequent *Procter & Gamble* decision. But Elman's opinion in this case, as in *Procter & Gamble*, demonstrates his belief that the large conglomerate corporation poses dangers to competition. And, once again, the greater size of the acquiring corporation, compared with that of companies in the industry, was at the core of the theory used to strike down the merger.

Consolidated, a large diversified processor and seller of food products, acquired the assets of Gentry, Inc., a company primarily engaged in the production of dehydrated onions and garlic. In 1951, the year of the acquisition, Consolidated had net sales of \$174,006,801 and assets of approximately \$60,000,000. At the time of the acquisition, Gentry had assets valued at \$1,600,000, and, as one of the two dominant firms in a four-firm industry, it accounted for 28% of the onion and 51% of the garlic sales.<sup>96</sup> In Elman's words,

the gravamen of this proceeding was that the merger was illegal under Section 7 of the Clayton Act because it created the serious danger that Gentry would acquire a protected market, in which fair competitive opportunities would be denied to other sellers of dehydrated onion and garlic, as a result of the trade practice known as "reciprocity."<sup>97</sup>

Reciprocal buying was described as "nothing more than the simple idea that 'I will buy from you if you will buy from me,' or the unspoken 'If I buy from him, he will buy from me.'"<sup>98</sup> It was said to be anticompetitive because it injects a foreign element into business relationships: price, quality, and service may be offset by the attempt or inclination to curry favor, or to protect one's relations with the other party.<sup>99</sup>

The way in which a conglomerate merger enhances the likelihood that reciprocity may be practiced was felt to be clear. Diversification increases the number of opportunities for reciprocal buying because a firm that makes a number of products is more likely to find a supplier that is also a potential buyer of one of its products than a small single-line company. Of course, if the firm is a large purchaser, its purchases are likely to be of such economic

<sup>93</sup> 3 Trade Reg. Rep. ¶ 16956, at 22019 (June 30, 1964).

<sup>94</sup> *Supra* note 89, at 21903.

<sup>95</sup> Trade Reg. Rep. Tr. Binder, 1961-1963 F.T.C. Complaints, Orders, Stipulations ¶ 16182 (Nov. 15, 1962), order set aside, 329 F.2d 623 (7th Cir. 1964), cert. granted, 33 U.S.L. Week 3066 (U.S. August 21, 1964) (No. 422).

<sup>96</sup> *Id.* at 20974.

<sup>97</sup> *Ibid.*

<sup>98</sup> *Id.* at 20975.

<sup>99</sup> *Id.* at 20977.

importance to its supplier that it will have little difficulty persuading the supplier to buy from it.

To the extent that a diversification, or conglomerate, merger produces an industry structure that facilitates and furthers reciprocal buying, it is likely to lead to the most serious of anticompetitive consequences, *viz.*, to confer upon large, diversified corporations a crushing weapon against small, single-line competitors.<sup>100</sup>

Other established onion and garlic producers, lacking Consolidated's size and diversification, could not respond to Consolidated's use of reciprocity in kind, and "it is in the context of just such an industry structure that a reciprocal buying policy has the greatest chance of success and therefore poses the most serious threat to competition."<sup>101</sup> According to the Commission,

since Consolidated acquired the power to extort or simply attract reciprocal purchases from suppliers when it acquired Gentry, the causal relationship between the merger and the injury to competition implicit in reciprocal buying is patent.<sup>102</sup>

In determining the substantiality of the anticompetitive potential of the Consolidated-Gentry firm, the Commission analogized reciprocal buying to tying agreements in its anticompetitive effect. The acquisition of Gentry provided Consolidated with "a basis on which to 'tie' sales to its supplier to purchases from them."<sup>103</sup> Since Consolidated's acquisition of Gentry placed it in a position to influence firms that both supplied Consolidated and bought in volume from Gentry, and the purchases of these firms amounted to more than 25% of the onion produced by the industry and almost 25% of the garlic, the area of prospective market foreclosure was "not merely significant, but exceptionally large."<sup>104</sup>

Other considerations buttressed the Commission's conclusions. Consolidated had actually used reciprocity in pushing Gentry's products even though only sporadically and with limited success;<sup>105</sup> the industry was so highly concentrated that it was desirable to remove such obstacles to the creation of genuinely competitive conditions as respondent's reciprocal buying power;<sup>106</sup> and the preservation of competitive vigor in the industry required that the acquisition be struck down because it created the opportunity for Gentry to acquire a protected market share immune from competition as to price, quality and service, thereby posing a barrier to new competition.<sup>107</sup> In summation the Commission said:

the acquisition . . . has conferred upon [Consolidated] . . . the power to foreclose competition from a substantial share of the mar-

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<sup>100</sup> *Id.* at 20978.

<sup>101</sup> *Ibid.*

<sup>102</sup> *Ibid.*

<sup>103</sup> *Id.* at 20979.

<sup>104</sup> *Id.* at 20980.

<sup>105</sup> *Ibid.*

<sup>106</sup> *Ibid.*

<sup>107</sup> *Id.* at 20981.

kets for dehydrated onion and garlic, thereby jeopardizing the competitive opportunities of its small, relatively undiversified competitors and tending to lend further rigidity to an already heavily concentrated industry and to discourage the entry of new competitors, all "without producing any countervailing competitive, economic, or social advantages."<sup>108</sup>

Since a cease and desist order "could not remove the attraction, implicit in the Consolidated-Gentry relationship . . . for suppliers or prospective suppliers of Consolidated to purchase from Gentry solely or principally in the hope of maintaining or enhancing their sales position with Consolidated," divestiture was the only remedy which could alleviate the worsening of the market structure of the industry caused by the acquisition.<sup>109</sup>

One cannot read the Consolidated opinion without being impressed by the scope of the concepts used by the Commission to invalidate the acquisition. It virtually sets up a presumption of illegality where an acquisition by a large diversified firm creates the possibility of utilizing reciprocal buying to influence a substantial share of the market. There need be no showing that this power was actually used; the mere fact that the possibility exists, or, in other words, that the market structure is conducive to reciprocal buying, is sufficient to invalidate the acquisition. While it has been argued that reciprocal buying is not necessarily anticompetitive or a bad practice,<sup>110</sup> this position does not carry much weight with the Commission.<sup>111</sup> The attraction implicit in the relationship between the acquired and acquiring companies is said to be the crux of the anticompetitive effects flowing from the acquisition.

*Procter & Gamble*, and the decisions discussed above, give a good picture of the Commission's approach to Section 7 enforcement. It has unequivocally taken the position that market structure, as opposed to market behavior, is to be examined in merger cases, and the effects of a merger must be gauged in terms of broad probabilities, with a view to its overall implication. The Commission has exhibited a keen awareness of the dangers to competition posed by large, conglomerate corporations, and a wholehearted acceptance of the social and political values underlying the statute. Although no per se rule, as such, has been adopted, and the Commission attempts to evaluate each merger in the light of the particular characteristics of the industry and companies involved in the case, the economic theories it has embraced and the standards it applies in testing the legality of conglomerate mergers leave little room, if any, for sound business acquisitions by large corporations.

<sup>108</sup> Id. at 20981-82, quoting court of appeals opinion in *Reynolds Metals Co.*, supra note 65, at 230. For this holding Elman also quoted, in a footnote, the language in *Reynolds* reproduced in text accompanying note 66 supra.

<sup>109</sup> Supra note 95, at 20982.

<sup>110</sup> Handler, *Emerging Antitrust Issues: Reciprocity, Diversification and Joint Ventures*, 49 U. Va. L. Rev. 433, 433-40 (1963).

<sup>111</sup> "[I]t is difficult to see how the quasi-tying-agreement effect of reciprocal buying fostered by the union of Consolidated and Gentry can be anything but anticompetitive." Supra note 95, at 20981.

# SUPREME COURT DECISIONS

Until last spring, the decisions of the Federal Trade Commission represented the dark side of the picture for business, because the other enforcement agency, the Justice Department, was consistently losing Section 7 cases in the district courts.<sup>112</sup> And although the Supreme Court held that the statute had been violated in the first two cases to reach it, it disclaimed any per se rule. In fact, the Court emphasized that the decision of a Section 7 case requires an understanding of the state of competition in the particular industry involved. Even the use of presumption of illegality by the Court in the *Philadelphia Bank* case was palatable, given the facts of the case. Then the axe fell. In four decisions, the Court elaborated its views on Section 7, and served notice that the statute severely limits the permissible merger activities of large corporations.

## POTENTIAL COMPETITION

In *United States v. El Paso Natural Gas Co.*,<sup>113</sup> the Court held that a merger which eliminated potential competition violated Section 7. The case involved the acquisition by El Paso, which, as the only actual out-of-state supplier, sold 50% of all gas consumed in California, of Pacific Northwest Pipeline Corporation, characterized by the Court as "the only other important interstate pipeline west of the Rocky Mountains." Attempts by Pacific Northwest to break into the California market, the section of the country for purposes of the case, were credited by the Court with having a beneficial effect on competition; indeed an agreement between the two companies prior to the merger was described as "a 'treaty' . . . that protected El Paso's California markets."<sup>114</sup>

The Court applied the following test:

The effect on competition in a particular market through acquisition of another company is determined by the nature or extent of that market and by the nearness of the absorbed company to it, that company's eagerness to enter that market, its resourcefulness, and so on.<sup>115</sup>

Under this test, the fact that Pacific Northwest had never sold in California and had failed in its attempts, while that "might be weighty if a market presently saturated showed signs of petering out . . . [was] . . . irrelevant in a market . . . where incremental needs are booming."<sup>116</sup> Pacific Northwest had "proximity to the California market" and "adequate reserves and managerial skill."<sup>117</sup>

<sup>112</sup> E.g., *United States v. Continental Can Co.*, 217 F. Supp. 781 (S.D.N.Y. 1963); *United States v. Penn-Olin Chem. Co.*, 217 F. Supp. 110 (D. Del. 1963); *United States v. Aluminum Co. of America*, 214 F. Supp. 501 (N.D.N.Y. 1963); *United States v. El Paso Natural Gas Co.*, 1962 Trade Cases ¶ 20571 (D. Utah).

<sup>113</sup> 376 U.S. 651 (1964).

<sup>114</sup> *Id.* at 658-59.

<sup>115</sup> *Id.* at 660.

<sup>116</sup> *Ibid.*

<sup>117</sup> *Id.* at 661.

"Unsuccessful bidders are no less competitors than the successful one. The presence of two or more suppliers gives buyers a choice."<sup>118</sup> This statement combined with the Court's belief that "one purpose of Section 7 was 'to arrest the trend toward concentration, the *tendency* to monopoly, before the consumer's alternatives disappeared through merger . . .,'"<sup>119</sup> indicates that elimination of potential competition will be an important area of inquiry in Section 7 cases. This is borne out by the Court's subsequent decision in *United States v. Penn-Olin Chem. Co.*<sup>120</sup>

In 1960, Pennsalt Chemicals Corporation and Olin Mathieson Corporation jointly formed Penn-Olin Chemical Company to construct a plant and to produce and sell sodium chlorate in the southeastern part of the United States.

Prior to 1961, Pennsalt and two other companies were the only domestic producers of sodium chlorate.<sup>121</sup> Pennsalt, with assets of some \$100,000,000 and sales of about the same amount, was engaged solely in the production of chemicals and chemical products. From its one sodium chlorate plant, located in Portland, Oregon, it accounted for 57.8% of all sodium chlorate sales west of the Rocky Mountains. However, because of the distance from its plant to the southeastern market, Pennsalt was unable to compete effectively in this area, and its share of the market was only 8.9%. As a result, the rapidly growing southeastern market had long been dominated by Pennsalt's two competitors, which between them accounted for better than 90% of sodium chlorate sales in the area.

In 1960, Olin, a large diversified corporation, had sales of some \$690,000,000 and assets of \$860,000,000. Although not a manufacturer of sodium chlorate, Olin had developed and made available under royalty-free licenses a patented process for its use in the paper and pulp industry, and possessed extensive experience in the technical aspects of bleaching pulp, the main use for sodium chlorate. As a result, Olin had excellent contacts with the pulp and paper mills, the major purchasers of sodium chlorate.

The trial court found that both Pennsalt and Olin, prior to the joint venture, had long been interested in the possibility of entering the market independently; both had the resources and capability to compete effectively in the market; both could have done so at a profit; and neither had finally rejected the possibility of individual entry at the time the joint venture was formed.<sup>122</sup> However, the district court held that only in the event that both companies would have entered the market individually, absent Penn-Olin, would the joint venture have foreclosed potential competition between them. And the court found it "impossible to conclude that as a matter of reasonable probability *both Pennsalt and Olin* would have built plants in the Southeast if Penn-Olin had not been created." (Emphasis in original.)

The court did not determine whether one company would have built

<sup>118</sup> Ibid.

<sup>119</sup> Id. at 659, quoting *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 367 (1963).

<sup>120</sup> 378 U.S. 158 (1964).

<sup>121</sup> The statement of facts is taken from Id. at 162-67.

<sup>122</sup> *United States v. Penn-Olin Chem. Co.*, 217 F. Supp. 110, 128-29 (D. Del. 1963).



"while the other continued to ponder." But assuming this, whether Penn-Olin substantially lessened competition would depend on a comparison of the competitive impact which Penn-Olin will have with that which might have resulted if either Pennsalt or Olin had entered the market individually.<sup>123</sup> This impact could not be determined from the record in the case, and "solely as a matter of theory . . . no reason exists to suppose that Penn-Olin will be a less effective competitor than Pennsalt or Olin would have been."<sup>124</sup> Accordingly, the district court dismissed the complaint.

On appeal, the Supreme Court held that Section 7 is applicable to joint ventures<sup>125</sup> and, reaching the merits, that the district court erred in not considering the "fact that Penn-Olin eliminated the potential competition of the corporation that might have remained at the edge of the market, continually threatening to enter."<sup>126</sup>

The Court clearly indicated that potential competition is an important factor in Section 7 cases:

The existence of an aggressive, well equipped and well financed corporation engaged in the same or related lines of commerce waiting anxiously to enter an oligopolistic market would be a substantial incentive to competition which cannot be underestimated.<sup>127</sup>

The evidence in the case so impressed the Court that it stated "unless we are going to require subjective evidence, this array of probability certainly reaches the *prima facie* stage." However, stating "we prefer that the trial court pass upon this question . . .," the Court remanded the case for a finding "as to the reasonable probability that either one of the corporations would have entered the market by building a plant, while the other would have remained a significant potential competitor."<sup>128</sup>

In light of the Court's statement that, "overall, the same considerations apply to joint ventures as to mergers, for in each instance we are but expounding a national policy enunciated by the Congress to preserve and promote a free competitive economy,"<sup>129</sup> the decision in Penn-Olin should be perused by anyone interested in the fate of conglomerate mergers under Section 7. The criteria suggested by the Court for assessing the probability of a substantial lessening of competition<sup>130</sup> indicate that joint ventures will be scrutinized closely in regard to the actual and potential competitive relationship of the parties involved, their ability to go it alone in the venture, and the effect of joint entry on both competition and competitors in the market. These criteria also indicate that the power of the new entry in relation to the power of the companies already present in the market will be an important consideration in conglomerate merger cases.

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<sup>123</sup> *Id.* at 130.

<sup>124</sup> *Id.* at 131.

<sup>125</sup> 378 U.S. at 167-72 (1964).

<sup>126</sup> *Id.* at 173.

<sup>127</sup> *Id.* at 174.

<sup>128</sup> *Id.* at 175-76.

<sup>129</sup> *Id.* at 170.

<sup>130</sup> *Id.* at 177.

## STUDENT COMMENTS

Penn-Olin establishes the Court's high regard for potential competition as a deterrent to the abuse of market power by firms in oligopolistic industries.

But even more important is the Court's emphasis on the fact that Section 7 speaks in terms of *probability*, not certainty. The Court reiterates this point time and again, in marked contrast to the trial court opinion, which emphasized that Section 7 spoke in terms of probability, not *possibility*.

The Court's patent concern over potential competition and its heavy emphasis on the fact that Section 7 speaks in terms of probability seemingly stems from its view of competitive realities in the highly diversified American economy. Realizing full well that a large conglomerate corporation's impact on competition cannot be assessed adequately by examining only a compartmentalized segment of industry, the Court intends to discard artificial concepts when dealing with corporations whose diversified character is such that they are not bound by classic industry lines, and judge the effect of a merger in a broad framework, with a view to its full ramifications. Nowhere is this attitude better illustrated than in the Court's decision in *United States v. Continental Can Co.*<sup>131</sup>

### LINE OF COMMERCE

Unlike the cases discussed so far, which dealt with whether a merger was likely substantially to lessen competition, *Continental Can* turned on the determination of the "line of commerce," or relevant market, issue. The concept of the relevant market plays a critical role in Section 7 enforcement. Definition of the market area affected by a merger is a prerequisite to a final evaluation of the competitive impact of a merger.<sup>132</sup> Upon definition of the relevant market depend the classification of a merger as horizontal, vertical, or conglomerate and the applicable test for determining whether there has been a probable lessening of competition. Before its decision in *Continental Can*, the Supreme Court's approach to market definition, and, to a great extent, the fate of mergers involving large diversified firms seeking further diversification, was largely a matter of conjecture. In deciding *Continental Can*, the Court, by unequivocally adopting a "competitive realities" approach to market definition, went a long way in dispelling the uncertainty and sealing the fate of such mergers.

Before treating the *Continental Can* decision it will be helpful to consider some background on the market concept and the landmark Supreme Court Section 7 decision, *Brown Shoe Co. v. United States*.<sup>133</sup>

The concept of the "market" is an economic one, used to locate and identify the competitive factors which restrain the economic behavior of a firm. Many Section 7 cases in which delineation of the relevant market has been an important, or the controlling, issue, have treated the problem of market definition as a matter of applying the highly theoretical and technical

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<sup>131</sup> *United States v. Continental Can Co.*, 378 U.S. 441 (1964).

<sup>132</sup> *Brown Shoe Co. v. United States*, 370 U.S. 294, 324 (1962); *United States v. E. I. du Pont de Nemours & Co.*, 353 U.S. 586, 593 (1957).

<sup>133</sup> *Supra* note 132.

economic concept of "cross-elasticity of demand."<sup>134</sup> As described by Professor Stocking,

Cross-elasticity reflects the extent to which price changes in one product affect the amount of another product that buyers will buy. Where the cross-elasticity of demand for rival products is great, a decline in the price of one decreases the sale of the other and may lead to a decline in its price. The production of numerous similar products with a high cross-elasticity of demand may perform about the same economic function as does the existence of numerous sellers of the same product.<sup>135</sup>

In economics the concept of cross-elasticity is used to gauge product substitutability. If products are functionally interchangeable and buyers respond to a price change in one by an increase or decrease in their purchases of the other, the products may be said to occupy the same market. For example, if housewives believe that household aluminum foil and waxed paper are about equally fit for the purpose of wrapping food and they react to a price increase in aluminum foil by buying more waxed paper, aluminum foil and waxed paper occupy the same product market. Any attempt to analyze the competitive effect of a merger must take into account the extent to which consumers will go in substituting one product for another. If the merging firms produce the same or close substitute products, the analysis often need go no further than a comparison of the strength and power of the merging firms in the product market and an assessment of the new firm's position. If the analysis discloses that the merger results in a highly concentrated product market or aggravates an already highly concentrated market, that alone is enough for holding a Section 7 violation.

The problem is that market definition in terms of product substitution frequently affords a narrow, one-dimensional view of the market area affected by a merger. This would suffice if the American economy consisted chiefly of firms that made and sold a single product line. But market definition solely in terms of product substitution can scarcely provide an adequate context for determining the competitive impact of a merger between two highly diversified, multiproduct firms.

According to economist Irving Lipkowitz, a better approach to market definition would be to look at the "market" and "competition" through the eyes of the businessman, looking to all the factors. As the businessman sees it,

. . . the relevant market is the area of competition, and that will change from company to company, not just from industry to industry, and also from time to time, depending upon the battle of materials, depending upon international competition. It is not a fixed thing, and it is never these days limited to a single product.

<sup>134</sup> *Brown Shoe Co. v. United States*, supra note 132, at 325; *United States v. E. I. du Pont de Nemours & Co.*, 351 U.S. 377, 394 (1956); *United States v. Columbia Pictures Corp.*, 189 F. Supp. 153, 183-85 (S.D.N.Y. 1960).

<sup>135</sup> Stocking, *The Rule of Reason, Workable Competition, and Monopoly*, 64 *Yale L.J.* 1108, 1110-11 (1955).

## STUDENT COMMENTS

... As early as 1958, more than 60 per cent of the manufacturing companies in this country were in multi-product industries. So you have an overlap of not only competition in the sale of a particular product, but competition between materials, and also competition between corporations, which, in effect, overlaps all of these areas. From the business firms' viewpoint, they are competing simultaneously on all these different planes. Too often the antitrust case not only operates on a single plane, but also carves that single plane up into very narrow slices . . . and they ignore all the rest of the three dimensional market place in which the corporation really lives.<sup>136</sup>

If the concept of the relevant market is to serve as a useful device for identifying the competitive environment of mergers, several factors besides product substitutability must be considered. "[Market] definition requires a balanced consideration of a number of characteristics or dimensions to meet the analytical needs of the specific problem under consideration."<sup>137</sup> Lawyer-economist Mark Massel suggests looking into the following factors:

Among the important dimensions to be considered in the definition of a market are: physical characteristics, attractiveness to buyers, cross-elasticity of demand, sellers' costs, relative prices, end uses, stages of marketing, integration and stages of manufacture, methods of production or origin, . . . and actual and potential competition.<sup>138</sup>

Numerous other factors, such as similarity of marketing techniques, complementarity of products, market position in related fields, could be added at random. The point is that all of these factors share one common aspect: each represents a particular way of looking at a market.

"End uses of products," for example, looks at consumer needs; "cross-elasticity of demand" at consumer response. "Method of production" considers the market from the supply point of view; can the manufacturer shift easily from the production of one product to production of another related product? "Similarity of marketing techniques" relates to the comparative ease or difficulty with which a product can be adapted to the marketing practices of a seller of related products.

Moreover, each of these factors often has an important bearing on the operation of the others. Consider the relationship among the physical characteristics, end uses, production flexibility, marketing techniques, and market position in related product lines in a hypothetical merger of one of the cigarette giants and a small independent cigar manufacturer. Cigarettes and cigars have similar physical characteristics; they compete for the same end use; in certain stages of production—the buying of raw materials, processing, and manufacturing—the same employees, procedures, and equip-

<sup>136</sup> Panel Discussion sponsored by the American Bar Association Committee on the Clayton Act in 24 A.B.A. Antitrust Section 113, 134 (April 1964).

<sup>137</sup> Massel, *Competition and Monopoly* 248 (Anchor-Doubleday ed. 1964).

<sup>138</sup> *Id.* at 249-50.

ment might be adapted for use on both; both are marketed in the same manner through the same distributors; and a strong position in the cigarette market would greatly facilitate the sale and distribution of cigars. In light of all this, there would be a good case for defining the relevant market not only as cigarettes or cigars, but also as the combined cigarette and cigar market, or even the tobacco industry. Yet the cross-elasticity of demand between cigarettes and cigars is probably very low. One of them would no doubt have to be independently priced out of the market before a significant increase in demand for the other made itself felt.

It may also happen, however, that in a particular case one factor may so overshadow all the others as to justify drawing the boundaries of the relevant market solely with reference to it. For example, the slight adjustment in labor, equipment, and materials that might be required to switch from the manufacture of low-priced men's clothing to production of medium-priced men's clothing would justify defining the relevant market as the combined low- and medium-priced men's clothing market in a case involving a merger between a firm that made one and a firm that made the other.

There are, then, any number of factors which singly or in combination might provide the basis for delineating the relevant market. Congress in amending Section 7 stated no preference for any one of them. It provided only that a merger with the proscribed effect in "any line of commerce" violated Section 7. It left to the courts, and, ultimately, to the Supreme Court, the task of developing standards for market definition. To date, there have been three important Supreme Court decisions on the relevant market. These decisions, while they fall short of a definitive treatment of the problem, reveal that the Supreme Court entertains a flexible and expansive notion of the relevant market, and that the market concept is destined to play a far more important and devastating part in Section 7 enforcement than even the most pessimistic corporation counsel might have imagined.

### *Brown Shoe*

*Brown Shoe Co. v. United States*,<sup>139</sup> the first Supreme Court decision under the amended Section 7, was a fairly easy line of commerce case. In 1955, the government filed a Section 7 civil complaint in the United States District Court for Eastern Missouri, challenging the contemplated merger between the Brown Shoe Company and the G. R. Kinney Company.<sup>140</sup> Brown was the third largest seller of shoes by dollar volume in the United States, the fourth largest manufacturer of men's, women's, and children's shoes, and a retailer that owned, operated, or controlled over 1230 retail outlets. Kinney was the eighth largest company in dollar volume in shoe sales, the twelfth largest manufacturer of shoes, and a retailer with over 350 outlets. The government contended that the effect of the Brown-Kinney

<sup>139</sup> Supra note 132.

<sup>140</sup> The district court opinion is reported in 179 F. Supp. 721 (1959). The summary of facts is taken from the four opinions given in this case, including the district court's, the Supreme Court's, Justice Harlan's, and Justice Clark's.

merger "may be substantially to lessen competition or tend to create a monopoly" by eliminating actual or potential competition on the national wholesale shoe market and in the sale of shoes at retail throughout the nation. It urged the district court to define the relevant product market as either "footwear," generally, or as men's, women's, and children's shoes, separately considered. Brown, on the other hand, argued that if the lines of commerce were properly determined, the merger would be shown not to endanger competition. It urged several narrower lines of commerce, based not only on considerations of the age and sex of the intended customers, but also on considerations of grades of materials, quality of workmanship, price, and customer use of shoes.

The district court rejected the extreme contentions of both parties, finding that "there is one group of classifications which is understood and recognized by the entire industry and the public—the classification into 'men's,' 'women's' and 'children's' shoes separately and independently."<sup>141</sup> It then went on to hold that, in both its horizontal and vertical aspects, Brown's acquisition of Kinney violated Section 7.<sup>142</sup>

On appeal, the Supreme Court, drawing an apparently unnecessary distinction, first declared that, in market definition, both the broad outer market and its component submarkets must be considered: ". . . within this broad market, well-defined submarkets may exist which, in themselves, constitute product markets for antitrust purposes."<sup>143</sup> The limits of the outer market are to be drawn with reference to "the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it."<sup>144</sup> In determining the submarkets, several "practical indicia" are to be consulted, among them: "industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors."<sup>145</sup>

Applying its submarket criteria, the Supreme Court affirmed the district court's finding of three lines of commerce. In response to Brown's objection that the medium-priced shoes it manufactured occupied a different product market from the low-priced shoes sold by Kinney, the Court stated that to hold that low- and medium-priced shoes constituted separate markets would be to ignore the realities of the price competition between them.<sup>146</sup> In assessing the relevance of the price factor, the Court stated:

This is not to say, however, that "price/quality" differences, where they exist, are unimportant in analyzing a merger; they may be of importance in determining the likely effect of a merger. But the boundaries of the relevant market must be drawn with sufficient breadth to include the competing products of each of the merging

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<sup>141</sup> *Supra* note 140, at 732.

<sup>142</sup> *Id.* at 741.

<sup>143</sup> *Supra* note 132, at 325.

<sup>144</sup> *Ibid.*

<sup>145</sup> *Ibid.*

<sup>146</sup> *Id.* at 326.

companies and to recognize competition where, in fact, competition exists.<sup>147</sup>

In disposing of Brown's other objection that "age/sex" differences, especially with regard to children's shoes, required narrower lines of commerce, the Court granted some factual validity to these differences, but denied their legal relevance. "[W]e do not think in this case the District Court was required to employ finer 'age/sex' distinctions than those recognized by its classification of 'men's,' 'women's,' and 'children's' shoes. Further division does not aid us in analyzing the effects of this merger."<sup>148</sup> The Court then held that the Brown-Kinney merger was likely substantially to lessen competition in both its horizontal and vertical aspects.

The majority in *Brown*, using the submarket device, defined the relevant market from the consumers' viewpoint. Justices Clark and Harlan, concurring separately on the merits, looked at the market from the manufacturer's and seller's viewpoint. Justice Clark, emphasizing the marketing aspect of the case, saw the line of commerce as

shoes of all types. This is emphasized by the nature of Brown's manufacturing activity and its plan to integrate the Kinney stores into its operations. . . . Brown's business is on a national scale and its policy of integration of manufacturing and retailing is on that basis. . . . [I]t would be more reasonable to define the line of commerce as shoes—those sold in the ordinary retail store. . . .<sup>149</sup>

Justice Harlan, looking to the production aspect, concluded that,

because of . . . flexibility of manufacture, the product market with respect to the merger between Brown's manufacturing facilities and Kinney's retail outlets might more accurately be defined as the complete wearing-apparel shoe market . . . . For if a manufacturer of women's shoes is able, albeit at some expense, to convert his plant to the production of men's shoes, the possibility of such a shift should be considered in deciding whether the market for either men's shoes or women's shoes can be monopolized or whether a particular merger substantially lessens competition among manufacturers of either product.<sup>150</sup>

The three opinions in *Brown* perfectly illustrate both the various angles from which the market may be viewed and how one factor may be of sufficient importance to justify drawing the line of commerce on the strength of it alone. However the market was regarded, anticompetitive effects were seen to flow from the Brown-Kinney merger. In the majority's view, the anticompetitive effects would be felt most by the consumer, whose freedom of choice in buying shoes would be restricted. In the opinions of Justices Clark and Harlan, Brown's rivals in the shoe industry would be the ones to suffer.

<sup>147</sup> *Ibid.*

<sup>148</sup> *Id.* at 327.

<sup>149</sup> *Id.* at 356.

<sup>150</sup> *Id.* at 367.

## STUDENT COMMENTS

The importance of *Brown Shoe* as line of commerce precedent stems from the broad tack taken by the majority. As the concurring opinions indicated, the submarket division was unnecessary to the decision. Why then bother to make it?

The answer may be that the majority in deciding *Brown* regarded a one level approach to market definition as unduly restricting market analysis. Defining the relevant market only at that point or at those points where the product lines of the merging firms happen to converge cannot but result in a static representation of market activity. It is important to bear in mind that Section 7 is a broad statute, aimed at what was felt to be a broad evil—undue concentration in the economy, not in one product line, or even in one industry. That the majority so regarded Section 7 is evinced by its review of its legislative history, its emphasis on the statutory purpose to arrest incipient monopolistic tendencies,<sup>151</sup> and its insistence on seeing the competitive realities of the shoe industry. Perhaps, the majority felt that a combined wide and narrow-angle approach to market definition was necessary if a realistic picture of a post-merger market situation was to be obtained.

An examination of the rules laid down by the majority in *Brown* for defining the outer market and submarkets tends to support the conclusion that *Brown* stands for a multi-dimensional view of the relevant market. The statement "the outer boundaries of a product market are determined by the reasonable interchangeability of use or cross-elasticity of demand between the product itself and the substitutes for it" makes economic nonsense when literally applied to the outermarket in *Brown*—shoes in general. There is no cross-elasticity of demand among men's, women's and children's shoes. The statement may also, however, be taken to mean that the outermarket is to be looked upon as the sum of related component product lines, determined by reference to product substitutability or to another or others of the various elements that enter into market definition, such as production flexibility or similarity of marketing techniques. If this interpretation is correct, the majority in *Brown*, in drawing its market-submarket distinction, fashioned a flexible and potent weapon for Section 7 enforcement. For, when the concepts of the outermarket and the component submarkets are combined, the result is a simple but supple device for locating and registering concentration wherever it might appear in the economic aftermath of a merger.

### *Continental Can*

While there was no telling at the time just what *Brown Shoe* signified, any doubt that it stood for anything less than a total view of the relevant market was thoroughly dispelled in the spring of 1964, which saw the Supreme Court hand down a spate of Section 7 decisions, two of them important for line of commerce. Both cases, *United States v. Continental Can Co.*<sup>152</sup> and *United States v. Aluminum Co. of America*,<sup>153</sup> involved

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<sup>151</sup> The Court discusses both these points at great length at 311-23.

<sup>152</sup> 378 U.S. 441 (1964).

<sup>153</sup> 377 U.S. 271 (1964).



reversals of district court judgments, and both evoked charges that the Supreme Court was finding facts in violation of Rule 52(a)<sup>154</sup> of the Federal Rules of Civil Procedure. More importantly, both cases establish once and for all that the Supreme Court's approach to market definition is multi-dimensional.

In 1956 the government initiated a Section 7 action challenging Continental Can Company's acquisition of all the assets of Hazel-Atlas Glass Company.<sup>155</sup> In 1955, the year prior to the merger, Continental, with assets of \$382 million, was the second largest manufacturer of metal containers. It shipped 33% of all the metal containers sold in the United States, and together with American Can Company, the industry leader, accounted for 71% of all the metal containers shipped in the United States. Continental had enjoyed a steady history of expansion, accomplished chiefly through mergers. Its assets after acquiring Hazel-Atlas and two other companies in 1956 rose to more than \$633 million; its net sales from \$666 million in 1955 to more than \$1 billion.

Hazel-Atlas, in 1955, had net sales in excess of \$79 million and assets of more than \$37 million. Its share of shipments in the glass industry, approximately 9.6% of the glass container shipments in 1955, placed it third in the industry. Together with Owens-Illinois Glass Company, the leader with 34.2%, and Anchor Hocking, second with 11.6%, it accounted for 55.4% of the total glass container shipments in 1955.

In the district court, both parties agreed that the can industry and the glass container industry were lines of commerce. Beyond this, the government urged several other lines of commerce, some of them defined in terms of various end uses for which metal and glass containers compete. These end use claims included containers for the beer industry, the soft drink industry, the toiletry and cosmetic industries, the medicine and health industries, and containers for the household and chemical industries. The district court recognized that there was vigorous inter-industry competition among glass, metal and plastic containers for various end uses.

[T]here was substantial and vigorous inter-industry competition between these three industries and between various of the products which they manufactured. Metal can, glass container and plastic container manufacturers were each seeking to enlarge their sales to the thousands of packers of hundreds of varieties of food, chemical, toiletry and industrial products . . .<sup>156</sup>

But it refused to define the relevant market along the lines of the inter-industry competition, holding that "the fact that there is inter-industry or inter-product competition between metal, glass and plastic containers is not determinative of the metes and bounds of a relevant product mar-

<sup>154</sup> Rule 52(a) provides in relevant part that: "Findings of fact shall not be set aside unless clearly erroneous . . ."

<sup>155</sup> The summary of facts is taken from the district court and the Supreme Court majority opinions. The district court opinion appears in 217 F. Supp. 761 (S.D.N.Y. 1963).

<sup>156</sup> *Supra* note 155, at 780.

ket.”<sup>157</sup> As the district court, quoting *Brown*, saw it, the outer boundaries of the relevant market were to be determined according to the principle of cross-elasticity of demand, and the cross-elasticity of demand among glass, metal, and plastic containers was too low to constitute them a single line of commerce.

Attempts by the Government here to combine these separate industries and their products or to combine separate and distinct products from separate and distinct industries into single product markets necessarily failed because appropriate distinctions were not made between inter-industry or overall commodity competition and the type of competition between products with reasonable interchangeability of use and cross-elasticity of demand which has Clayton Act significance.<sup>158</sup>

The district court then held that the merger was a conglomerate and that the government had failed to sustain its burden of proving that the merger, as a conglomerate, was likely substantially to lessen competition.

On appeal, the Supreme Court reversed on the ground that the district court erred in defining the relevant market. In giving the Court's reason for taking the case, Mr. Justice White, writing for the majority, stated: “We noted probable jurisdiction to consider the specialized problems incident to the application of § 7 to inter-industry mergers and acquisitions.”<sup>159</sup> At this point, it is important to note what the Court understood by “industry” and “inter-industry.”

Both parties and the district court refer to this as an inter-industry merger. The word “industry” is susceptible of more than one meaning. It might be defined in terms of *end uses for which various products compete*; so defined it would be roughly equivalent to the concept of a “line of commerce.” According to this interpretation the glass and metal container businesses, to the extent they compete, are in the same industry. On the other hand, “industry” might also denote an aggregate of enterprises employing *similar production and marketing facilities and producing products having markedly similar characteristics*. In many instances, the segments of economic endeavor embraced by these two concepts of “industry” will be substantially coextensive, since those who employ the same types of machinery to turn out the same general product often compete in the same market. Since this is not such a case, it will be helpful to use the word “industry” as referring to similarity of production facilities and products. So viewed, “interindustry competition” becomes a meaningful concept. (Emphasis supplied.)<sup>160</sup>

It is worth comparing these two descriptive definitions of industry. The

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<sup>157</sup> Id. at 781.

<sup>158</sup> Id. at 781-82.

<sup>159</sup> Supra note 152, at 444.

<sup>160</sup> Id. at 444 n.2.

first definition, "in terms of end uses for which various products compete," looks at "industry" from the standpoint of consumer wants and needs. The second definition considers the production and marketing aspects of "industry." The problem confronting the Court was largely semantic and logical. The merger of Continental and Hazel-Atlas, and the competition between cans and bottles, was concededly inter-industrial. To treat the glass and metal container industries as separate industries from the end use standpoint, according to which an industry is "roughly equivalent to a line of commerce," would be to admit that they occupy different lines of commerce or product markets and there would be nothing on which to predicate a Section 7 violation. If, however, the glass and can businesses were regarded as separate industries solely from the production and marketing standpoint, nothing would prevent the Court from holding that the end use competition among cans and bottles was strong enough to place them in the same product market. In effect, the Court held that the glass and metal container industries constituted a significant submarket of one end use industry, the container industry; it excluded the end use concept of industry from its inquiry, regarded the metal and glass container industries from the production and marketing standpoint, analyzed the inter-industry end use competition, and, finally, reverted to its end use definition of industry in holding that bottles and cans constituted a single line of commerce.

The majority's handling of the concepts of "industry" and "inter-industry competition" is a good illustration of its broad competitive realities approach to market definition. The important element of market definition in *Continental Can* was end use competition. There is no reason to doubt, however, that in a proper case, such as where the products of the merging companies are not directly competitive, a broad line of commerce would be drawn on the strength of other market elements. In its second definition of "industry," the Court spoke of "an aggregate of enterprises employing *similar production and marketing facilities and producing products having markedly similar characteristics.*" (Emphasis supplied.) Consider the *Procter & Gamble* case.<sup>161</sup> Procter manufactured and sold a broad line of household cleansing agents, toiletries, food and other supermarket products, none of them directly competitive with Clorox's lone product, household liquid bleach. Viewed from the end use competition standpoint, all of these products occupy separate lines of commerce and separate industries. Considered from other standpoints, however, various lines of commerce are seen to emerge. Procter leads the nation in the production of household soaps and detergents. These products and liquid bleach, while not directly competitive, share many common features. They are closely related in use; all are low-cost, high-turnover supermarket items; all are sold to the same customers through the same distribution channels. Might not household soaps, detergents, and liquid bleach be classified as products of the same "aggregate of enterprises employing similar production and marketing facilities?" In other words,

<sup>161</sup> The Procter & Gamble Co., 3 Trade Reg. Rep. (Trade Reg. Rep. Tr. Binder, F.T.C. Complaints, Orders, Stipulations) ¶ 16673 (Nov. 26, 1963), appeal docketed, No. 15769, 6th. Cir., Feb. 13, 1964.

from the marketing and production standpoints, especially the former, the household soap and detergent business and the liquid bleach business are in the same industry. And, since Procter and Clorox each enjoys a strong position in its respective field, the chances are that the combined soap-detergent and liquid bleach businesses will be held a market or significant submarket for Section 7 purposes.<sup>162</sup>

A close examination of the process by which the Court delineated the relevant market in *Continental Can* and the reasons it gave for this delineation demonstrates even more forcefully the breadth of its notion of the relevant market.

The Court stated the central issue of the case to be "whether the admitted competition between metal and glass containers for uses other than packaging beer was of the type and quality deserving of § 7 protection and therefore the basis for defining a relevant product market."<sup>163</sup> This statement of the issue gives the tenor of the Court's approach to market definition. Section 7's broad legislative design, to nip increases in economic concentration in the bud, is placed in the forefront of market analysis. The degree of concentration in the container industry in general and in the bottle and can industries, instead of relating solely to the issue of lessening of competition, now appears to bear directly on the issue of the relevant market. Whether the inter-industry competition in *Continental Can* had Clayton Act significance depended to some extent on the amount of concentration in the container industry, and the container industry, as the Court saw it, was highly concentrated.

After stating the issue, the Court declared that the proper approach to market definition is neither unduly narrow nor unduly broad. Instead, it reiterated, "in defining the product market between these terminal extremes, we must recognize meaningful competition where it is found to exist."<sup>164</sup>

Having thus charted its course, the Court proceeded to analyze the inter-industry competition between cans and bottles. It conceded that there were many significant differences between metal and glass containers "which may

<sup>162</sup> Commissioner Elman, in classifying Procter's acquisition of Clorox as a product extension horizontal, suggested this result. One of the lines of commerce drawn by Elman was household cleansing agents. In 1957, Procter, with net sales of \$514 million, Colgate-Palmolive, with \$291 million, and Lever Brothers, with \$250 million, accounted for 80% of the total net sales in the household cleansing agent line. Purex was fourth, with about \$50 million, and B. T. Babbitt, Inc., fifth, with less than \$22 million. Elman did not include household liquid bleach in the household cleansing agents line, confining it to soaps, detergents, and cleansers. If, however, this line were extended to include liquid bleach, Clorox's 1957 net sales of almost \$40 million would place it fifth. It should also be noted that Purex, the fourth largest company in the household cleansing agents line, was also second to Clorox in the liquid bleach industry. *Id.* at 21562-66. The close relationship between household cleansing agents and household liquid bleach and the respective positions of Procter, Purex, and Clorox in these lines were seen to enhance the likelihood of anticompetitive effects in the liquid bleach industry, inasmuch as Purex, which "now competes with Procter in the liquid bleach as well as in the packaged detergents industry, . . . may be inclined to act cautiously in the liquid bleach market for fear of provoking Procter's retaliation along the whole front of Purex's activities." *Id.* at 21585. See also text accompanying notes 12 and 13, *supra*.

<sup>163</sup> *Supra* note 152, at 449.

<sup>164</sup> *Ibid.*

disqualify one or the other, at least in their present form, from this or that particular use . . ." and that "the competition between metal and glass containers is different from the competition between the can companies themselves or between the products of the different glass companies." Nevertheless, in the Court's mind, these considerations were not "sufficient to obscure the competitive relationships which this record so compellingly reveals."<sup>165</sup>

The record revealed an intense and pervasive battle between cans and bottles ranging from a vast general campaign to small local skirmishes. In several areas, the competition was particularly intense. In the baby food business, long a glass stronghold, cans were beginning to pose a serious challenge. Cans were also making inroads in the soft drink business, another field long dominated by glass. In the beer industry, ". . . an intense competitive battle on behalf of the beer can and the beer bottle is being waged both by the industry trade associations and by individual container manufacturers, one of the principal protagonists being Continental."<sup>166</sup> The can-glass rivalry was also intense in the food industry, where "one type of container has supplanted the other in the packing of some products and . . . in some instances similar products are packaged in two or more different types of containers."<sup>167</sup> In other industries, ". . . glass container, plastic container and metal container manufacturers are each seeking to promote their lines of containers at the expense of other lines, . . . all are attempting to improve their products or to develop new ones so as to have a wider customer appeal,\* . . . the result being that 'manufacturers from time to time may shift a product from one type of container to another.'†"<sup>168</sup>

In light of the real and intensive competition between metal and glass containers disclosed by the record the Court concluded that the

. . . District Court employed an unduly narrow construction of the "competition" protected by § 7 and of "reasonable interchangeability of use or the cross-elasticity of demand" in judging the facts of this case. . . . These terms as used in the statute or in *Brown Shoe* were [not] intended to limit the competition protected by § 7 to competition between identical products. . . . Certainly, that the competition here involved may be called "inter-industry competition" and is between products with distinctive characteristics does not automatically remove it from the reach of § 7.<sup>169</sup>

It can be readily seen from the above excerpts from the majority opinion in *Continental Can* that the Supreme Court is not concerned with the niceties of economics in defining the relevant market. The concept of cross-elasticity of demand, as a means of gauging the intensity of commodity competition, is doomed to play a minor role in future Section 7 cases. The

<sup>165</sup> Id. at 450.

<sup>166</sup> Id. at 451-52.

<sup>167</sup> Id. at 452.

<sup>168</sup> Id. at 452, quoting the district court opinion, *supra* note 155, at 804(\*) and 805(†).

<sup>169</sup> Id. at 452-53.

emphasis now is on the broad economic realities, on whether or not the framers of Section 7 would have intended protection for an area of competition affected by a merger, in short whether the policy of Section 7 calls for such and such a market definition.

The Court concluded its discussion of the line of commerce issue by addressing itself to Continental's two objections to its combining metal and glass containers in the same product market: (1) that the record did not disclose the actual and complete extent of the competition between cans and bottles, and (2) that proper delineation of the relevant market would have to "include plastic, paper, foil and any other materials competing for the same business."<sup>170</sup> In response to the first objection the Court stated:

The claimed deficiencies in the record cannot sweep aside the existence of a large area of effective competition between the makers of cans and the makers of glass containers. We know enough to conclude that the rivalry between cans and glass containers is pervasive and that the area of competitive overlap between these two product markets is broad enough to make the position of the individual companies within their own industries very relevant to the merger's impact within the broader competitive area that embraces both of the merging firms' respective industries. . . . Since the purpose of delineating a line of commerce is to provide an adequate basis for measuring the effects of a given acquisition, its contours must, as nearly as possible, conform to competitive reality. Where the area of effective competition cuts across industry lines, so must the relevant line of commerce; otherwise an adequate determination of the merger's true impact cannot be made.<sup>171</sup>

As to the second objection, the Court simply observed that the existence of a "broader product market made up of metal, glass and other competing containers does not necessarily negative the existence of submarkets of cans, glass, plastic or cans and glass together . . . ."<sup>172</sup>

The Court's disposition of these objections emphatically reiterates its approach to market definition: in all merger cases, the line of commerce must be drawn so as to give maximum effect to Section 7's ban on incipient monopolistic tendencies; this can be achieved only by looking to the broad competitive realities; insofar as economic principles do not square with Section 7's underlying philosophy and the facts of American business life, they must yield. That is the theme of *Continental Can*, running in an unbroken thread from beginning to end, from the definitions of "industry" through the statement of the issue to the discussion of the facts, conclusion, and rebuttal.

After defining the relevant market, the Court applied the market share test developed in *Brown Shoe* and *Philadelphia Bank*<sup>173</sup> and held that the merger violated Section 7. In 1955, the year before the merger, six com-

<sup>170</sup> Id. at 457.

<sup>171</sup> Id. at 456-57.

<sup>172</sup> Id. at 457-58.

<sup>173</sup> See text accompanying note 197, *infra*.

panies, accounting for 70.1% of all the containers shipped in the United States, dominated the combined metal and glass container industries, which at the time of the merger had annual sales of almost \$3 billion. Continental's 21.9% share of the total container shipments placed it second in the container market; Hazel-Atlas, with a 3.1% market share, ranked sixth. Continental's acquisition of Hazel-Atlas, by increasing its market share by more than 14% to 25%, not only further entrenched its dominant position in the container market, but also reduced the number of its "most significant competitors" from five to four. In the Court's mind, when Hazel-Atlas's 3.1% market share was added to Continental's 21.9%, the result approached

. . . that held presumptively bad in *United States v. Philadelphia National Bank* . . . . The case falls squarely within the principle that where there has been a "history of tendency toward concentration in the industry" tendencies toward further concentration "are to be curbed in their incipency"\* . . . [and the principle that] where "concentration is already great, the importance of preventing even slight increases in concentration and so preserving the possibility of eventual deconcentration is correspondingly great."<sup>174</sup>

Mr. Justice Harlan, in a caustic dissent, bitterly assailed the majority's definition of the relevant market, labelling it a "travesty of economics,"<sup>175</sup> a "mock-statistical analysis."<sup>176</sup> The source of Mr. Justice Harlan's displeasure is not difficult to find. It stems from a notion of the role of the market concept and of the whole problem of Section 7 enforcement diametrically at odds with that of the Court.

Mr. Justice Harlan would have defined the relevant market as the separate glass and metal container industries by a strict application of the concept of cross-elasticity of demand and the other criteria established in *Brown Shoe*.<sup>177</sup> He would then have inquired into the "impact of the merger in the two lines of commerce here involved . . . ."<sup>178</sup> Absent a *showing* of actual or probable anticompetitive effect in these lines of commerce, he would hold no Section 7 violation. In short, he would affirm the district court judgment.<sup>179</sup> The majority, on the other hand, Mr. Justice Harlan insisted, was "in effect, laying down a '*per se*' rule that mergers between two large companies in related industries are presumptively unlawful"<sup>180</sup> under color of a

<sup>174</sup> Supra note 152, at 461-62, quoting *Brown Shoe Co. v. United States*, supra note 132, at 345, 346(\*), and *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 365 n.42 (1963) (†).

<sup>175</sup> Id. at 472.

<sup>176</sup> Id. at 475.

<sup>177</sup> Id. at 470-75.

<sup>178</sup> Id. at 475.

<sup>179</sup> The district court had held that the Government had failed to sustain its burden of proving the "reasonable probability of substantial anti-competitive effects." Instead, "its case was based on what it claimed to be anti-competitive effects which *might* occur in the future. . . . It is a far cry from *might* occur to a reasonable *probability* of occurring." (Emphasis in original.) Supra note 155, at 783-84.

<sup>180</sup> Supra note 152, at 476.

specious application of the "shortcut 'market share' approach."<sup>181</sup> In its undiluted form, Mr. Justice Harlan maintained, the per se approach "frankly disavows attention to a 'line of commerce.'"<sup>182</sup> Instead, it posits a test of showing that a merger may substantially lessen competition "by proving (a) the existence of substantial competition between two industries; (b) a high degree of concentration in either or both of the competing industries; and (c) the dominant positions of each of the merging companies in its respective industry."<sup>183</sup> In essence, the per se rule Mr. Justice Harlan describes is a variation on a theme by Commissioner Elman,<sup>184</sup> attuned to the fact situation in *Continental Can*, and, as Mr. Justice Harlan notes, "... there is some suggestion in the last few pages of the Court's opinion that the Court appreciates this."<sup>185</sup>

Mr. Justice Harlan's dissent points up the critical role played by line of commerce in the Court's approach to Section 7 enforcement. By adopting a flexible, all-encompassing notion of the relevant market, the Court has been able to adapt its two-step, line of commerce-market share approach to a merger that many, especially among the antitrust bar, thought a conglomerate.<sup>186</sup> It is a hard approach, perhaps it amounts to a per se approach. Whether it is a valid approach is sure to become a matter of heated controversy, with the two opinions in *Continental Can* providing the battle cries for the opposing camps.

Discussion of the validity of the Court's delineation of the relevant market will undoubtedly follow the lines of the broader debate. Proponents of a "rule of reason" will denounce it as a travesty on economics. Those favoring rigorous enforcement of Section 7 will insist that the Court is merely observing competitive realities.

Given the broad purpose of the statute, the balance probably hangs in favor of the Court. For, while its handling of the line of commerce issue does not square with a strict application of the principle of cross-elasticity of demand or any other economic principle, the most cursory glance at the market relationships between metal and glass containers supports the validity of the Court's competitive realities approach. Cans and glass containers do compete for the same end uses. The price of one and its attractiveness to the ultimate consumer bear directly on the demand for the other. While they differ in methods of production and origin, so that there is little opportunity to integrate their manufacture, both may be adapted to the same marketing and distribution facilities, since both are aimed at the same customers. Further, the market positions of *Continental* and *Hazel-Atlas* in their respective markets make it easier for both to sell their products. In sum, virtually all of the factors the businessman looks

<sup>181</sup> Id. at 475.

<sup>182</sup> Id. at 470-71 n.6.

<sup>183</sup> Id. at 470 n.6, quoting Government's brief, p. 22.

<sup>184</sup> See discussion of the Procter & Gamble case, *supra* p. 263, and the Consolidated Foods Case, *supra* p. 274.

<sup>185</sup> *Supra* note 152, at 470-71 n.6.

<sup>186</sup> See, for example, Panel Discussion, *New Frontiers in Section 7 Enforcement*, sponsored by the Committee on the Clayton Act of the Antitrust Section of the American Bar Association, August 11, 1963.



to in assessing the power of a competitor speak in favor of a combined metal and glass container market.

### *Alcoa*

The other important line of commerce case decided by the Supreme Court last spring, *United States v. Aluminum Co. of America*,<sup>187</sup> accentuates the rigor of the Court's competitive realities approach to market definition.

The Government initiated the *Alcoa* case in 1960 by filing a complaint in the Northern District Court of New York, charging that Alcoa's 1959 acquisition of the stock and assets of Rome Cable Corporation violated Section 7. The district court, after a full trial, dismissed the complaint.<sup>188</sup> The Supreme Court reversed, holding that the acquisition resulted in a probable lessening of competition in the market for aluminum conductor, and ordered divestiture.

The manner of the Supreme Court's reversal is practically impossible to reconcile with the district court's fact findings. The latter, after carefully applying all the "practical indicia" set out in *Brown Shoe*, rejected the Government's critical line of commerce claims. The Supreme Court, ostensibly on the same facts relied on by the district court, upheld these claims.

The facts of the *Alcoa* case are extremely involved, and it adds little to an understanding of the importance of the case as line of commerce precedent to review them in great detail. As precedent, the case is important for two reasons. First, and above all, it manifests the determination of the Supreme Court to give full and effective meaning to Section 7's legislative purpose. Secondly, it vividly demonstrates the potential usefulness of the submarket concept as a device for detecting undue concentration within an industry.

The Government lost its case in the district court on the line of commerce issue. It contended that the Alcoa-Rome merger would probably substantially lessen competition in the market for aluminum conductor in general. Basically, there are two types of aluminum conductor, bare aluminum conductor and insulated aluminum conductor. The parties stipulated that bare aluminum conductor was a line of commerce. To establish aluminum conductor in general as a line of commerce, the government had first to prove that insulated aluminum conductor was a line of commerce, and then that the combination of bare and insulated aluminum conductor into a broad aluminum conductor line of commerce was proper. The district court, applying the *Brown Shoe* submarket criteria, held that insulated aluminum conductor did not qualify as a line of commerce distinct from the broader insulated conductor line, made up of insulated aluminum and insulated copper conductor. Insulated aluminum conductor was not "recognized in the industry as a separate economic entity"; it was not "generally non-competitive" with copper; both insulated aluminum conductor and insulated copper conductor could be made on the same machinery; both were

<sup>187</sup> 377 U.S. 271 (1964).

<sup>188</sup> *United States v. Aluminum Co. of America*, 214 F. Supp. 501 (N.D.N.Y. 1963).

functionally interchangeable; the purchase and use of both were "principally dictated by economic factors." Although copper and aluminum conductor had some different characteristics and preferred uses and "... aluminum wire and cable is sold at prices generally distinct from copper and does not have the same price sensitivity . . ." the practical indicia established in *Brown Shoe* required the conclusion that insulated aluminum conductor and insulated copper conductor occupied the same, indivisible product market.<sup>189</sup> Accordingly, insulated aluminum conductor could not be separated from insulated copper conductor and combined with bare aluminum conductor into a broad aluminum conductor line of commerce.<sup>190</sup>

On appeal, the Supreme Court, in express contradiction of the district court's fact findings, declared both insulated aluminum and aluminum conductor in general lines of commerce. In holding insulated aluminum conductor a line of commerce, it singled out as the deciding factors the great price disparity between insulated aluminum and insulated copper conductors, the preference for insulated aluminum for overhead distribution, and the inability of fabricators of insulated copper conductor to overcome aluminum's price advantage<sup>191</sup>—in spite of the district court's findings that price was only one of several economic factors in the customer's decision to buy insulated aluminum or insulated copper and that fabricators of insulated conductor enjoyed complete production flexibility between copper and aluminum. The Court rested its conclusion that bare and insulated aluminum conductor should be combined into one line of commerce on much the same grounds: the fact that both were sold to the same customers, electrical utilities, for the same general use, conducting electricity; and the fact that aluminum, because of its great price advantage over copper, was the preferred overhead conductor, and copper, because of its smaller size and superior ductility, the preferred underground and indoor conductor.<sup>192</sup>

The most plausible explanation for the way the Court chose to reverse the district court decision in *Alcoa* is that the majority of the Court was

<sup>189</sup> *Id.* at 509. As to price, the district court found that the price of the conductor was only one of the factors in the electrical utilities companies' decision to buy aluminum or copper. "The decision requires *evaluation of numerous economic factors in addition to the cost of the wire or cable itself.*" In some instances, such factors as the added cost of connectors used with aluminum conductor made its final installed price competitive with copper. Dissent of Mr. Justice Stewart, *supra* note 187, at 285-86, quoting record, p. 1289. (Emphasis supplied by Mr. Justice Stewart.)

<sup>190</sup> *Ibid.* In the district court's view, a broad aluminum conductor line, made up of bare aluminum conductor and insulated aluminum conductor, would fail to depict the relevant market accurately, since it would not include insulated copper conductor, a substitute for insulated aluminum conductor. The Government had to establish the broad aluminum conductor line, because it could not show a substantial lessening of competition in any of the other conductor lines. While Alcoa's share of the bare aluminum conductor market was a high 32.5%, Rome's 0.3% constituted a *de minimis* addition. In the insulated aluminum conductor line, the combination of Alcoa's 11.6% market share and Rome's 4.7% was well below anything previously held bad under Section 7. The addition of Rome's 1.3% market share to Alcoa's 27.8% in the broad aluminum conductor line, however, was sufficient to invalidate the merger under the rule laid down in the *Philadelphia Bank* case. See text accompanying note 197, *infra*.

<sup>191</sup> *Supra* note 187, at 275-76.

<sup>192</sup> *Id.* at 276-77.

convinced that Alcoa's acquisition of Rome violated Section 7 and that had the case been properly tried below, the district court would have reached this result. The chief lesson of the case, then, would appear to be that, if the Court is satisfied that Congress would have intended that a particular merger be proscribed, the Court will not frustrate this intent, no matter how badly mishandled or poorly tried the case may have been below.

The reason for the decision in *Alcoa* becomes apparent on consideration of the use the majority made of the submarket device after drawing the lines of commerce. The picture the Court paints of the anticompetitive effects in the aluminum conductor industry of the Alcoa-Rome merger is convincing. Giant Alcoa leads in the production of primary aluminum, with 38.6% of the primary aluminum capacity in the United States. It also leads in the production of aluminum conductor, with a 27.8% market share. Its overall dominance is repeated in the aluminum conductor submarkets: Alcoa's 32.5% market share places it first in the production of bare aluminum conductor; it ranks third in the production of insulated aluminum conductor, with an 11.6% market share. Moreover, all of these markets and submarkets are highly concentrated. Alcoa, Reynolds, and Kaiser account for 88% of the primary aluminum capacity. Alcoa and Kaiser control 50% of the aluminum conductor market, and with two other companies, 76%; only nine companies, including Rome, with 1.3%, control 95.7% of this line. In the insulated aluminum conductor submarket, five companies produced 65.4% of the total output, and nine firms, Rome among them, 88.2%. What these lines of commerce revealed was "highly concentrated markets, dominated by a few companies but served also by a small, though diminishing, group of independents."<sup>193</sup> Rome was one of these independents; indeed, in the eyes of the Court, it was "the prototype of the small independent that Congress aimed to preserve by § 7."<sup>194</sup> While its share of the aluminum conductor market, 1.3%, was comparatively small, Rome was an important factor in the aluminum conductor industry. It ranked ninth overall in the aluminum conductor market, fourth among independents; in the insulated aluminum conductor market it ranked eighth overall, and fourth among independents. Moreover, Alcoa's absorption of Rome was only part of a pattern that saw the giant, integrated aluminum producers swallowing up small independent fabricators of insulated conductor, with the result that "there now remain only four nonintegrated fabricators of aluminum conductor whose individual shares of total industry production . . . amounted to more than 1%."<sup>195</sup> In this context, the Court held that Alcoa's acquisition of Rome violated Section 7. The aluminum industry was already oligopolistic; the presence of a small group of dynamic independents operated as the only check on the exercise of oligopoly power by the aluminum giants in the aluminum conductor market. The "preserva-

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<sup>193</sup> Id. at 278-79.

<sup>194</sup> Id. at 281.

<sup>195</sup> Id. at 279 n.6.

tion of Rome, rather than its absorption by one of the giants,"<sup>196</sup> would help maintain this restraint intact.

*Continental Can* stands for the proposition that proper market definition, for Section 7 purposes, requires an all-encompassing view of the industry or industries that a given merger is likely to affect. Little heed will be paid to highly technical economic concepts and few attempts made to apply them. Instead, the courts will view the market as the businessman assesses it, with an eye to the overall competitive consequences of a merger. And, in this broad context, the courts will realistically appraise the various business relationships—both existing and potential—between merging companies. This approach to market definition makes it more than likely that the same factors that convince a large corporation to diversify its product line by means of a merger will, in most cases, serve as the basis for defining a relevant market.

When the market-submarket division, as employed in *Alcoa*, is added to the expansive approach to market definition announced in *Continental Can*, the potential of the relevant market concept as an implement for strict Section 7 enforcement is exhausted.

The use of so broad a concept of "line of commerce" establishes a "hard line" toward mergers because it paves the way for using the market share test in a great number of cases.

The market share test, as expounded in *Philadelphia Bank*, makes no pretensions; it simply measures the size of the company resulting from the merger and the degree of concentration in the relevant market. The test operates quite simply, lends itself to easy application, and obviates the need for detailed analysis of market structure, market behavior, and the probable anti-competitive effect of a merger.

[A] merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market, is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects.<sup>197</sup>

When combined with principles such as "tendencies toward concentration in industry are to be curbed in their incipency"<sup>198</sup> and . . . "if concentration is already great, the importance of preventing even slight increases in concentration and so preserving the possibility of eventual deconcentration is correspondingly great,"<sup>199</sup> the test is a very strict standard.

### CONCLUSION

*Continental Can* and *Alcoa* show that business and the Court disagree over what constitutes a conglomerate merger or diversification move. Both cases were widely thought by business and the bar to involve conglomerate

<sup>196</sup> *Id.* at 281.

<sup>197</sup> *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 363 (1963).

<sup>198</sup> *Brown Shoe Co. v. United States*, 370 U.S. 294, 346 (1962).

<sup>199</sup> *United States v. Philadelphia Nat'l Bank*, *supra* note 197, at 365 n.42.

mergers and were expected to establish some standards for testing conglomerate mergers.<sup>200</sup> But the Court's treatment of the "line of commerce" issue in these two cases enabled it to dispose of them by applying the market share test used to determine the legality of horizontal mergers.

In light of these decisions, one wonders about the fate of the standards adopted by the FTC. The FTC has ventured boldly into economic theory in an attempt to develop standards for assessing the probable lessening of competition resulting from a conglomerate merger. The Supreme Court, however, taking a different tack in approaching Section 7, has concentrated on developing a fluid "line of commerce" concept, while clinging to the market share test. Is the only word from the Court, then, that some, perhaps most, "conglomerate" mergers are not conglomerate?

After applying the market share test in *Continental Can*, the Court proceeded to answer some of Continental's arguments. This rebuttal indicates that when forced to deal with a merger as conglomerate the Court will adopt standards similar to those developed by the FTC.

There was a probability that the Continental-Hazel-Atlas merger would foreclose actual and potential competition between the two firms in the field of containers for non-food purposes, produced by both companies.<sup>201</sup> As for the lack of current competition between the firms for some important container end uses, "Continental might have concluded that it could effectively insulate itself from competition by acquiring a major firm not presently directing its market acquisition efforts toward the same end uses as Continental, but possessing the potential to do so."<sup>202</sup> And as an independent firm Hazel-Atlas might have expanded its soft drink and baby food container lines, but its acquisition by Continental, a firm vigorously attempting to divert business in these lines to metal containers, could not but "diminish the likelihood of Hazel-Atlas realizing its potential as a significant competitor in either line."<sup>203</sup> Thus, the lack of current competition between the two firms for some end uses was felt to "actually enhance the long-run tendency of the merger to lessen competition."<sup>204</sup> Note in these statements the use of the concepts of potential competition developed in *El Paso* and *Penn-Olin*.<sup>205</sup> But more importantly, note the striking similarity between the Court's obvious belief that this merger would eliminate any possibility of the two firms meeting competitively in the course of the probable extension of their product lines and Elman's use of potential competition in the *Procter & Gamble* and *Ecko Products Co.* cases.<sup>206</sup>

On another point, in answer to the argument of Continental that the merger was an acceptable effort to gain competitive advantages by diversifying its product lines, thereby strengthening competition which the anti-

<sup>200</sup> See, Panel Discussion, New Frontiers in Section 7 Enforcement, *supra* note 186, at 26.

<sup>201</sup> *United States v. Continental Can Co.*, 378 U.S. 441, 463 (1964).

<sup>202</sup> *Id.* at 464.

<sup>203</sup> *Id.* at 465.

<sup>204</sup> *Ibid.*

<sup>205</sup> See text accompanying notes 115, 118 and 127 *supra*.

<sup>206</sup> See text accompanying notes 56 and 91 *supra*.

trust laws are designed to promote, the Court stated: "But we think the answer is otherwise when a dominant firm in a line of commerce in which market power is already concentrated among a few firms makes an acquisition which enhances its market power and the vigor and effectiveness of its own competitive efforts."<sup>207</sup> This statement echoes the idea, appearing throughout Elman's opinions in conglomerate merger cases, that the large diversified corporation, possessing strong market power and significant advantages over small competitors, is a prime example of what Congress intended to prevent by enacting Section 7. And, in Elman's view, to allow such companies to consummate mergers that enhance their power, add other markets to their conquests, and increase their size would be to betray the underlying purpose of the Act.<sup>208</sup>

Another interesting point of similarity between Elman's views and those of the Supreme Court appears in *Continental Can*. According to the Court, the district court erred in relying heavily on Continental's management of Hazel-Atlas after the merger "while Continental was under some pressure because of the pending government antitrust suit."<sup>209</sup> The crucial point to the Court was that as a result of the merger Continental acquired the "power to guide the development of Hazel-Atlas consistently with Continental's interest in metal containers."<sup>210</sup>

Also, the merger of Continental and Hazel-Atlas would tend "to endanger a much broader anticompetitive effect by triggering other mergers by companies seeking the same competitive advantages sought by Continental in this case."<sup>211</sup> Commissioner Elman used the same argument in the *Procter & Gamble* case.<sup>212</sup>

Finally, in the Court's view, the possibility that customers might switch containers was a "deterrent against attempts by the dominant members of either industry to reap the possible benefits of their position by raising prices above the competitive level or engaging in other comparable practices."<sup>213</sup> This sentiment is reminiscent of Elman's analysis of entry barriers in its concern over the preservation of restraints on the market power of large firms.<sup>214</sup>

*Continental Can* is not the only grounds for believing that the standards formulated by Elman for applying Section 7 to conglomerate mergers will be adopted by the Supreme Court if it is forced to deal with a merger as a conglomerate. As the cases discussed in this comment clearly show, the Court and the FTC agree on the major policy questions involved in in-

<sup>207</sup> Supra note 201, at 464.

<sup>208</sup> Supra note 161, at 21585.

<sup>209</sup> Supra note 201, at 463. "It is possible . . . that the pendency of the instant proceeding has had a deterrent effect upon expansionist activities by Procter in the liquid bleach industry." The Procter & Gamble Co., supra note 161, at 21587 (discussing post-acquisition evidence).

<sup>210</sup> Supra note 201, at 463. Compare Commissioner Elman's discussion of evidence of market behavior, note 33 supra and accompanying text.

<sup>211</sup> Supra note 201, at 464.

<sup>212</sup> Note 52 supra and accompanying text.

<sup>213</sup> Supra note 201, at 465-66.

<sup>214</sup> Note 22 supra and accompanying text.

terpreting Section 7. Both believe that the primary purpose of Section 7 is to prevent undue concentration in the American economy; both have adopted the premise that oligopoly offends the concept of competition embodied in Section 7; both recognize—and intend to foster—the social and political values that Congress intended to promote by preserving opportunities for small independent businesses. The Court and the FTC are well aware that Section 7 speaks in terms of probability, not certainty; both are attempting to assess the long range effects of mergers; both recognize the diversified character of the American economy, and, as a result, both are evaluating the effect of mergers in a broad context with a view to their full implications for competition. Both place great value on potential competition as a deterrent to misuse of market power by large firms and are scrutinizing mergers closely to determine their impact on potential competition. Administratively, both are attempting to formulate clear, simple standards; both are concerned with the effect of mergers on market structure rather than market behavior; both place little reliance on post-acquisition evidence; and both intend to give Section 7 full scope and effect.

*Consolidated Foods Corp.*,<sup>215</sup> the Court's first opportunity to pass on the Federal Trade Commission's work interpreting Section 7, should shed light on the fate of the Commission's standards. In *Consolidated Foods*, one of the FTC's major efforts to interpret Section 7, Elman's detailed analysis of the structure of the market, the power placed in Consolidated's hands by the merger, and the potential injury to competition if that power were used was dismissed by the Court of Appeals, on the basis of post-acquisition evidence, as "speculation" and "conjecture."<sup>216</sup> The court of appeals decision knocks the foundation out from under the standards the FTC has been developing. Allowing post-acquisition evidence to contradict evidence of market structure and the inferences drawn therefrom seriously impairs the attempt of the FTC to limit the scope of Section 7 proceedings and to formulate clear, workable standards. Thus, this case squarely presents the issue of what relative weight should be given to post-acquisition evidence of market behavior, as opposed to evidence of market structure.

Moreover, it will be interesting to see whether the Court handles this merger as a conglomerate,<sup>217</sup> as did the FTC and Court of Appeals, or uses

<sup>215</sup> Trade Reg. Rep. Tr. Binder, 1961-1963 F.T.C. Complaints, Orders, Stipulations ¶ 16182 (Nov. 15, 1962), order set aside, 329 F.2d 623 (7th Cir. 1964), cert. granted, 33 U.S.L. Week 3066 (U.S. August 21, 1964) (No. 422).

<sup>216</sup> 329 F.2d 623, 627.

<sup>217</sup> If treated as a conglomerate merger, the case would have far reaching consequences. Reciprocity is a widespread business practice among large corporations, and the rationale of Elman's opinion has been said to establish a per se rule. Handler, Emerging Antitrust Issues: Reciprocity, Diversification, and Joint Ventures, 49 U. Va. L. Rev. 433, 433-40 (1963). See supra note 111 and accompanying text. It is worth noting that one of the criteria suggested by the Court in *Penn-Olin* for determining the probability of a substantial lessening of competition was "the adaptability of [Penn-Olin's] . . . line of commerce to non-competitive practices," 378 U.S. 158, 177, because the reciprocity theory of *Consolidated Foods* had been argued by the Justice Department in the district court.

### STUDENT COMMENTS

the "line of commerce" concepts developed in *Continental Can* to convert the merger into a horizontal.<sup>218</sup>

Throughout the history of [the antitrust statutes] . . . it has been constantly assumed that one of their purposes was to perpetuate and preserve, for its own sake and in spite of possible cost, an organization of industry in small units which can effectively compete with each other.<sup>219</sup>

Both the FTC and the Supreme Court are wholeheartedly implementing this underlying purpose of Section 7. To business, then, speculation on the difference between their approaches to Section 7 must seem academic, for the Supreme Court and the FTC send the same message: if a merger is a sound business move by a large, successful corporation, it probably violates Section 7.

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<sup>218</sup> See supra note 96 and accompanying text for a discussion of the lines of commerce involved.

<sup>219</sup> *United States v. Aluminum Co. of America*, 148 F.2d 416, 429 (2d Cir. 1945) (per Judge Learned Hand).