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# CONGLOMERATE MERGERS AND THE ANTITRUST LAWS\*

GORDON B. SPIVACK\*\*

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## I. INTRODUCTION

We are now in the midst of what is generally regarded as the third great merger wave in our industrial history. A few statistics will indicate the nature and size of the present movement.<sup>1</sup> The amount of assets being acquired by acquisition is immense by any absolute standard. The figures have risen almost geometrically in recent years. From 1948 to 1954, the assets involved in acquisitions of medium-size corporations (those with over ten million dollars in assets) averaged less than a billion dollars per year. From 1955 through 1962, the annual average was approximately two billion dollars. In 1963 and 1964, the average rose to three billion dollars. By 1966, the annual average value of medium-sized corporate acquisitions had risen to four billion dollars. During 1967, the figure doubled. In 1968 the figure had risen to twelve billion dollars and the figures for the first three months of 1969 indicate that the annual rate will be over eighteen billion dollars.

Acquisitions by very large companies are an important part of the present wave. This country's two hundred largest industrial corporations acquired 6.98 billion dollars of assets from medium-size companies in 1968 alone—over 55% of the assets that were acquired that year from medium-size companies. The top 272 companies, those with over 250 million dollars in assets, acquired 9.2 billion dollars in assets in 1968—73% of all the assets bought from medium-size companies (those with over 10 million dollars in assets). A very significant number of medium-size firms have already been acquired, and an increasing number of very large firms have recently been acquired. From 1948 through 1968, almost

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1. These statistics appearing in the text were taken from BUREAU OF ECONOMICS, FEDERAL TRADE COMMISSION, CURRENT TRENDS IN MERGER ACTIVITY 1968, STATISTICAL REPORT No. 3 (1969).

1300 medium-size firms were acquired, 192 of them in 1968 alone. There were less than 2700 such firms in existence in 1968. Acquisitions over the past twenty years had cut their number by almost one-third. Only six companies with assets of over 250 million dollars were acquired from 1948 through 1966. However, six such firms were acquired in 1967 alone, and twelve more were acquired in 1968.

Gross industrial concentration in the country, which was already high enough to concern Congress when it amended the Clayton Act in 1950, has risen considerably since World War II. This rise has been, in large part, due to acquisitions. In 1948, the 100 largest industrial corporations in the country owned 40% of the manufacturing assets in the country; by 1967 they controlled 48% of these assets. In 1948, the 200 largest industrial corporations owned 48% of the manufacturing assets; by 1967 they owned 59%. A very substantial part of this increase was due to acquisitions by these very large companies. Indeed, approximately 90% of the increase in the share of total manufacturing assets controlled by the top 100 and the top 200 from 1960 to 1967 was directly due to acquisitions during those seven years.

Although mergers in the late 1800's and early 1900's were principally horizontal, and those in the 1920's were horizontal and vertical, mergers in the last few years have been principally conglomerate. Since 1965, over 85% of all assets acquired from medium-size companies were acquired in conglomerate acquisitions. The figure for 1968 alone was 89%.

The purpose of this paper is to outline the applicability of the anti-trust laws to the conglomerate merger wave. Two basic statutes are involved. The Sherman Act, passed in 1890 in part to deal with an earlier merger wave, prohibits "every . . . combination in the form of trust or otherwise . . . in restraint of trade" as well as every combination to monopolize.<sup>2</sup> Acquisitions, mergers, consolidations, and holding companies as well are "combinations" within the meaning of the Sherman Act. The key question is whether they are "in restraint of trade."<sup>3</sup> Section 7 of the Clayton Act was first enacted in 1914 and was amended in 1950 to close various loopholes. This section prohibits any corporate acquisition of some or all of the stock or assets of any other corporation "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>4</sup> The purpose of Section 7 is to prohibit restraints of trade in their incipiency long before they reach Sherman Act proportions; therefore, the Clayton Act is the more stringent law. It is the one always relied on except when technical procedural or substantive provisions

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2. Sherman Act, 15 U.S.C. § 1 (1964) [hereinafter cited as Sherman Act with numerical section].

3. *Id.*

4. Clayton Act, 15 U.S.C. § 18 (1964) [hereinafter cited as Clayton Act with numerical section].

make the Sherman Act alone applicable to a particular merger. The application of the Clayton Act alone will be discussed later in detail.

Mergers are usually classified as either "horizontal"—involving firms selling the same product in the same area, "vertical"—involving firms in a supplier-customer relationship, or "conglomerate"—which is descriptive of all others. Often conglomerate mergers are subdivided into "product extension"—involving firms with complementary products, "market extension"—involving firms selling the same product in different areas, and "other." Sometimes the category "other" is subdivided into "concentric"—involving firms whose products are related in terms of sources of raw materials, product development, production technology, or marketing channels, and "pure conglomerate"—involving firms with unrelated products. However, since the same legal standard applies to all mergers, and since most substantial mergers have horizontal and vertical aspects as well as congeneric or conglomeric aspects, it appears most fruitful to regard all mergers involving one or more multi-market companies as conglomerate mergers and to discuss the various ways in which such mergers may substantially lessen competition. Such mergers may violate the Clayton Act, because they may eliminate actual competition, eliminate potential competition, foreclose competitors from sources of supply or customers, increase reciprocity, or reduce the vigor of competition within specific markets.

## II. HORIZONTAL COMPETITION

A conglomerate merger may involve two companies which are, among other things, engaged in purchasing, producing, or distributing the same or competitive products in the same area. In the pending *Northwest Industries-B. F. Goodrich* litigation, for example, the government has alleged that both Northwest and Goodrich are engaged in the manufacture and sale of caustic soda in the inland waterway area served by the Mississippi and Ohio rivers.<sup>5</sup> The law applicable to mergers of firms engaged in such direct competition is fairly clear in many respects. The Supreme Court has held that competition in concentrated markets is usually so much less vigorous than competition in unconcentrated markets, that any acquisition which substantially increases concentration or substantially lessens the possibility of eventual deconcentration, may substantially lessen competition within the meaning of the Clayton Act.<sup>6</sup> The key factors in determining illegality in this area are: (1) the shares of the market held by the leading companies in the market; (2) whether those shares have been increasing, decreasing, or stable in the past several years; (3) the shares of the market held by the companies involved in the acquisition; and (4) the competitive vigor of the company whose inde-

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

6. *See United States v. Philadelphia Nat'l Bank*, 374 U.S. 321 (1963).

pendence is being eliminated by the acquisition. The higher the degree of concentration in the market, the longer that degree of concentration has been in existence, the greater the degree of increasing concentration, the larger the shares of the market of the companies engaged in the acquisition, and the more vigorous the competition of the company being acquired, the more likely it is that the Supreme Court will hold the merger illegal. Some specific cases will throw light on the state of the law in this area. In *United States v. Philadelphia National Bank*,<sup>7</sup> the Court held that any merger creating a company with around 30% of the market would violate the Clayton Act, at least if the acquired company was not of *de minimus* size. The Court further indicated that an even lower figure might violate the statute in some cases. In *United States v. Continental Can*,<sup>8</sup> the Court held that a merger creating a company with 25% of the market was illegal. In *United States v. Von's Grocery Co.*,<sup>9</sup> the Court held that since the grocery market in the Los Angeles County-Orange County area had shown a steady tendency toward concentration for over a decade, a merger of two of the top six grocery chains in the area was illegal; although their total share of the market was only 7.5%. In *United States v. Pabst Brewing Co.*,<sup>10</sup> the High Court stated that since there had been a constantly increasing degree of concentration in the beer industry for over three decades, a merger of the tenth largest brewer with the eighteenth was illegal on the national level although their combined share of the national market was only 4.49%. In *United States v. Aluminum Co. of America*,<sup>11</sup> the Court regarded the aluminum conductor market as "highly concentrated" where there were nine manufacturers with 96% of the market. The Court, in *Pabst*, was concerned with a market in which there were 162 producers, a decrease of 44 producers in five years. The top ten producers had increased their share of that market from 45.06% to 52.6% during the same period.<sup>12</sup> In *Vons*, the Court was concerned about a market with almost 4,000 sellers. The number of sellers had dropped almost 30% in 11 years, and the share controlled by the top eight firms had risen from 34% to 41%.<sup>13</sup> The Court in *Continental Can* was concerned about the elimination of Hazel Atlas as an independent factor in the can-glass market because although, Hazel Atlas controlled only 3% of that market, the six top companies in the market had 70% of total sales.<sup>14</sup> In *Alcoa-Rome*, the Court was concerned with the elimination of Rome as an independent factor. Although it had only 1.3% of the market, it was an aggressive efficient company, and there were only a

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7. *Id.*

8. 378 U.S. 441 (1964).

9. 384 U.S. 270 (1966).

10. 384 U.S. 546 (1966).

11. 377 U.S. 271 (1964). *See also* *United States v. Phillipsburg Nat'l Bank & Trust Co.*, 306 F. Supp. 645 (D.N.J. 1969).

12. *United States v. Pabst Brewing Co.*, 384 U.S. 546, 550-51 (1966).

13. *United States v. Von's Grocery Co.*, 384 U.S. 270, 272-73 (1966).

14. *United States v. Continental Can Co.*, 378 U.S. 441, 460-61 (1964).

dozen companies in the market with 1% of total sales.<sup>15</sup> In summary, the Court has fully embraced oligopoly theory and decided that any acquisition that eliminates an effective competitor, adds to the market shares of the leaders in a concentrated market, reduces the possibility that a presently concentrated market will deconcentrate through natural economic forces, or is part of a trend that threatens to transform an unconcentrated market into a concentrated market over a period of several decades is illegal under Section 7 of the Clayton Act.<sup>16</sup>

#### A. Definition of Markets

If market concentration and shares of markets are crucial indicia to illegality, proper definition of markets is essential to sound decision making. In the *Reynolds* case, for example, if the proper product market was "aluminium foil," the acquired company's share of the market was .25%, while, if the proper product market was "florist foil," its share of the market was 33%.<sup>17</sup> If the proper market was "the nationwide market for rolled steel products," the acquired company's share of the market in the *Columbia Steel* case was .4%. If the proper market was "plates and shapes in the West," the appropriate figure was 13%.<sup>18</sup> A proper market is one in which the sellers within the market have *some* advantage over sellers outside the market, so that it is meaningful to insist on maintaining competition among sellers within the market although they compete to some degree with sellers outside the market.<sup>19</sup> But no group of sellers has any advantage over any other group of sellers that cannot be overcome in time at some cost. The key question is how much of a cost-time advantage a group of sellers must have over another group of sellers before it can be said that the group belongs in a separate market for Section 7 purposes. There is no simple answer to that question. All that can be done is to exercise the best judgment based on all of the facts relating to a particular situation in the light of the underlying values which the antitrust laws are designed to promote. In view of the antitrust laws' traditional concern with the political and social implications of industrial concentration and the welfare of small business, and the merger wave we are currently experiencing, it is reasonable to expect that courts will—and *Alcoa-Rome*<sup>20</sup> and *Continental Can*<sup>21</sup> indicate the Supreme Court will—regard any non-gerrymandered product or geographic market as a market

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15. *United States v. Aluminum Co. of America*, 377 U.S. 271, 278 (1964).

16. See *United States v. Pabst Brewing Co.*, 384 U.S. 546 (1966); *United States v. Von's Grocery Co.*, 384 U.S. 270 (1966); *United States v. Continental Can Co.*, 378 U.S. 441 (1964); *United States v. Aluminum Co. of America*, 377 U.S. 271 (1964); *United States v. Phillipsburg Nat'l Bank & Trust Co.*, 306 F. Supp. 645 (D.N.J. 1969).

17. *Reynolds Metals Co. v. Federal Trade Comm'n*, 309 F.2d 223 (D.C. Cir. 1962).

18. *United States v. Columbia Steel Co.*, 334 U.S. 495, 509 (1948).

19. The text states the author's view and no case precisely so holds. See notes 17 and 18 *supra*.

20. *United States v. Aluminum Co. of America*, 377 U.S. 271 (1964).

21. *United States v. Continental Can Co.*, 378 U.S. 441 (1964).

for Section 7 purposes where one of the parties to the merger is a very large company.<sup>22</sup>

There are two reasons, one substantive and one remedial, why many antitrust experts feel that the strict doctrines the Supreme Court has developed in dealing with mergers involving direct horizontal competitors will not substantially affect the current conglomerate merger pattern. On the substantive side, many conglomerate mergers have no horizontal aspects; indeed, many conglomerates purposely seek to acquire companies which are not direct competitors to avoid the impact of the horizontal rules. Furthermore, as to those conglomerate mergers which involve direct competition, many will involve markets which are not concentrated and are not tending toward concentration, or they will involve lethargic firms which are not among the leaders in the market involved. Although, as *Continental Can* illustrates, the courts will probably stretch market definitions, where very large corporations are concerned, to find that competition exists between similar products or similar technologies, the process of stretching creates a problem of substantiality.<sup>23</sup> For example, in the pending *Allis Chalmers—White Consolidated* litigation, the Federal Trade Commission has alleged that Allis Chambers and White are competitors in the production of machinery, using all types of machinery as a line of commerce.<sup>24</sup> However, once the market is defined as broadly as "machinery," there are over a thousand other competitors to consider, and Allis Chalmers and White combined have only 1.5% of the market.<sup>25</sup> No court has ever suggested, much less held, that a merger of competitors with such a small share of a market was substantial enough to violate the Clayton Act.<sup>26</sup>

### B. Available Remedies

The remedy problem is probably even more significant. The statute provides that a merger is illegal if it may substantially lessen competition in *any* line of commerce in *any* section of the country.<sup>27</sup> The Supreme Court has repeatedly held that if a merger has the requisite effect in a single line of commerce anywhere, it is illegal regardless of its effects in all other lines of commerce.<sup>28</sup> Thus, if a conglomerate merger between two multi-market companies, each of which has over a billion dollars in

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22. See *United States v. Phillipsburg Nat'l Bank & Trust Co.*, 306 F. Supp. 645 (D.N.J. 1969).

23. *Id.*

24. See *Allis-Chalmers Mfg. Co. v. White Consol. Indus., Inc.*, 414 F.2d 506 (3d Cir. 1969), *reversing*, 294 F. Supp. 1263 (D. Del. 1969), *cert. denied*, 90 S. Ct. 567 (1970).

25. See *Allis-Chalmers Mfg. Co. v. White Consol. Indus., Inc.*, 294 F. Supp. 1263, 1268 (D. Del. 1969).

26. See *United States v. Wachovia Corp.*, 5 TRADE REG. REP. (1970 Trade Cas.) ¶ 73,213 at 88,820 (W.D.N.C. 1970).

27. Clayton Act § 7 (1964).

28. See *Federal Trade Comm'n v. Proctor & Gamble Co.*, 386 U.S. 568 (1967); *United States v. Continental Can Co.*, 378 U.S. 441 (1964); *United States v. Penn-Olin Chem. Co.*, 378 U.S. 158 (1964); *United States v. El Paso Natural Gas Co.*, 376 U.S. 651 (1964).

assets and sales and each of which has 15% of the \$200,000 widget market, the entire merger is illegal due to the probability of a substantial lessening of competition in the widget line of commerce. However, in the early *Union Pacific*<sup>29</sup> case under the Sherman Act and in the 1960 *Brown Shoe*<sup>30</sup> case under the Clayton Act, the Supreme Court suggested that all the courts might do under these circumstances would be to order the companies involved to dispose of one of the company's widget businesses. The theory is that the merger is only illegal because of its probable effect in the widget market and that once that probable effect is eliminated by restoring two independent entities in the widget business, the merger is no longer illegal. The Department of Justice and the Federal Trade Commission have apparently settled several suits on this basis, and a district court adopted a similar approach in the pending *Atlantic-Richfield—Sinclair* litigation.<sup>31</sup> If this approach is sound, the 272 industrial firms with over 250 million in assets could probably acquire all of the remaining firms in the country by acquiring them and then spinning off assets in those markets where concentration was high or increasing and in which either the acquiring or acquired firm was a leading firm. With almost 300 companies to share the markets involved, the process would appear to be feasible. On the other hand, the Supreme Court may eventually prohibit the above technique using several theories.

First, it is well established standard antitrust doctrine that one of the purposes of relief in antitrust cases is to deprive guilty defendants of the fruits of their illegal activity. One basis for the doctrine is the moral principle that no one should benefit from a violation of the law. Another basis is the practical argument that persons should be deterred from violating the law since there are not enough resources available to enforce the law through litigation alone. Preventing persons from benefiting from violations at least deters them to that extent. However, in the *Foremost Dairies* case, Foremost was allowed to acquire McKesson & Robbins with annual sales of \$844,000,000, although the acquisition violated the Clayton Act, merely because Foremost thereafter agreed to sell its SCA business, with annual sales of \$44,000,000.<sup>32</sup> It is doubtful either that any moral principle was vindicated in the *Foremost Dairies* case, or that Foremost or other companies familiar with the situation will be substantially deterred from further illegal acquisitions.

Second, well established traditional antitrust doctrine holds that in relief proceedings all doubts should be resolved against the guilty defendant and in favor of the public interest in fully restoring the competitive situation altered by the violation involved.<sup>33</sup> Where a case is settled by

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29. *United States v. Union Pac. R.R. Co.*, 226 U.S. 61 (1912).

30. *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962).

31. *United States v. Atlantic Richfield Co.*, 297 F. Supp. 1061 (S.D.N.Y. 1969), *mem.*, 297 F. Supp. 1075 (S.D.N.Y. 1969).

32. *Foremost Dairies, Inc.*, [1965-1967 Transfer Binder] TRADE REG. REP. ¶ 17,835 (F.T.C. 1967).

33. *United States v. E.I. duPont de Nemours & Co.*, 353 U.S. 586 (1957).



allowing the companies involved to spin off some assets to avoid the most obvious anticompetitive effects of the merger, the competitive situation will almost always have been changed by the illegal acquisition. In *Foremost*,<sup>34</sup> for example, it is true that after Foremost acquired McKesson and subsequently divested SCA, there were still two separate entities in the drug manufacturing and wholesaling business.<sup>35</sup> However, prior to the acquisition and divestiture, SCA had the resources of Foremost behind it in competing with McKesson and other firms in the industry; after the acquisition the giant McKesson had Foremost's resources behind it in competing with pigmy SCA and the rest of the industry. How can anyone say with any degree of certainty how effective SCA would be as a competitor after it had been acquired by Foremost, been part of its operations for some time, and then spun off as an independent entity? How, for example, can anyone measure the effect of such activity on the morale of SCA employees in general and on the short-term and long-term decisions of middle management personnel, in particular as to whether to go with SCA or stay with Foremost-McKesson? Why should the public bear the risks that SCA is no longer as effective a competitor as it was prior to the time Foremost illegally acquired McKesson?

In *United States v. Joseph Schlitz Brewing Co.*,<sup>36</sup> the trial court rejected Schlitz' contention that one way to deal with Schlitz' illegal acquisitions of Labatt stock would be to have Labatt sell its stock in General Brewing, a substantial direct competitor of Schlitz on the West Coast. The theory, in part, was that General, backed by Labatt, would be a stronger competitor of Schlitz in the West and a more likely potential national competitor of Schlitz than General would be when divested of Labatt's financial, managerial, and technical support. The point is not whether the district court was correct in its factual conclusions in *Schlitz*, but whether courts should be engaged in trying to make judgments of this sort in view of the substantial possibility of error and the additional fact that the whole situation arises only because of the defendant's illegal activity in the first place.

Third, and probably most important, is the basic issue of the purpose of Section 7 of the Clayton Act. If Section 7 was designed solely to deal with probable effects on competition in specific markets, then it makes sense to say that once the probable effect on competition is clearly and fully eliminated, the merger is not obnoxious under the statute. But Congress was not solely interested in specific economic effects in specific markets when it passed Section 7.<sup>37</sup> The Congressional reports and debates indicate a concern for small business, local ownership of business, and the

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34. See note 32 *supra*.

35. See *United States v. R.J. Reynolds Tobacco Co.*, 1969 Trade Cas. ¶ 72,886 at 87,336 (D.N.J. 1969).

36. 253 F. Supp. 129 (N.D. Cal. 1966), *aff'd*, 385 U.S. 37 (1966).

37. For a comprehensive discussion of the legislative history of the 1950 amendment see *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962).

political and social implications of increasing control of the nation's total assets in the hands of fewer and fewer corporations.<sup>38</sup> In both the House and Senate reports, for example, the committees pointed with alarm at the degree of gross industrial concentration in the country, not merely at concentration in specific markets.<sup>39</sup> In *Brown Shoe*,<sup>40</sup> Chief Justice Warren said that the statute must be interpreted not only in terms of "the probable effects of the merger upon the economics of the particular markets affected but also . . . its probable effects upon the economic way of life sought to be preserved by Congress."<sup>41</sup> In *Procter & Gamble*,<sup>42</sup> Justice Harlan, who represents a conservative approach to merger problems, recognized that "congressional concern in enacting Section 7 extended not only to anti-competitive behavior in particular markets, but also to the possible economic dominance of large companies which had grown through merger."<sup>43</sup> Following this approach, the Court may eventually hold that Congress adopted the "may substantially lessen competition in any line of commerce"<sup>44</sup> language solely as a test of legality—as opposed to a flat prohibition on all mergers or on all mergers by companies with assets over a specific amount (e.g., \$250,000,000) or on all mergers involving acquisitions of assets over a specific amount (e.g., \$10,000,000)—but that once a merger is illegal under that test of legality, the only proper remedy to fully carry out the values Congress intended to protect by amending Section 7 is to order complete divestiture of the assets acquired and permanently enjoin the entire transaction. The Court is particularly likely to so hold if the present conglomerate merger wave continues to threaten a transformation of the industrial structure of our country into one inconsistent with the "economic way of life" Congress sought to preserve by enacting Section 7. The closest case in point is the *duPont-General Motors*<sup>45</sup> remedy opinion of 1961; an opinion recently reaffirmed in unusually strong terms in the Court's recent *El Paso Natural Gas* remedy opinion.<sup>46</sup> In *duPont-General Motors*, the District Court<sup>47</sup> held elaborate hearings and entered a very detailed injunctive decree, including provisions depriving duPont of stock voting rights.<sup>48</sup> The decree was designed to eliminate the possibility that retention by duPont of its ownership of 23% of General Motors stock would cause GM to dis-

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38. See, e.g., 95 CONG. REC. 11486, 11489-1495, 11498 (1949); 96 CONG. REC. 16444, 16448, 16450, 16452, 16503 (1950).

39. See Senate Report on the original Act. S. REP. No. 698, 63 Cong., 2d Sess. (1914); S. REP. No. 1775, 81st Cong., 2d Sess. 4-5 (1950); H.R. REP. No. 1191, 81st Cong., 1st Sess. 8, 10-11 (1949).

40. *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962).

41. *Id.* at 333.

42. *Federal Trade Comm'n v. Procter & Gamble Co.*, 386 U.S. 568 (1967).

43. *Id.* at 589 (concurring opinion).

44. Clayton Act § 7 (1964).

45. *United States v. E.I. duPont de Nemours & Co.*, 366 U.S. 316 (1961).

46. *United States v. El Paso Natural Gas Co.*, 376 U.S. 651 (1964).

47. *United States v. E.I. duPont de Nemours & Co.*, 177 F. Supp. 1 (N.D. Ill. 1959).

48. *Id.* at 41.

criminate in favor of duPont in purchases of auto seat covers and auto parts, the only line of commerce which led to a finding of illegality in the case.<sup>49</sup> The District Court decided to use an elaborate injunctive decree rather than order duPont to sell its stock, because (1) it felt the injunctive decree would be effective to eliminate discrimination, and (2) the hearings convinced the Court that the tax and market consequences of forcing duPont to sell its General Motors stock or to distribute it to its shareholders would cost duPont and its shareholders well over a billion dollars.<sup>50</sup> The Supreme Court did not dispute the fact that divestiture would cost duPont and its shareholders well over a billion dollars but stated that it was irrelevant if divestiture was necessary to fully effect relief. After evaluating the facts, the Court found divestiture to be necessary.<sup>51</sup> Close examination of the Court's opinion fails to reveal why the injunctive decree was not substantially as effective as divestiture; the most reasonable reading of the opinion is that there are some possibilities that divestiture could be more effective than any injunctive decree, and, since all doubts should be resolved against the defendants, once they are found to have violated the Clayton Act, divestiture should be ordered although the doubts would not have been sufficient to support a finding of a violation of the Act in the first place. The total annual sales of automobile seat covers and automotive paint duPont made to General Motors was less than \$20,000,000 in 1947-48.<sup>52</sup> DuPont would have been much better off getting out of the automobile seat cover and automotive paint business than selling its stock in General Motors, but nothing in the opinion suggests that duPont and its shareholders could have avoided over a billion dollar loss by having duPont divest itself of its automotive paint and automobile seat cover business. *DuPont*<sup>53</sup> and the recent *El Paso*<sup>54</sup> opinion indicate the Supreme Court will hold that full divestiture is the only proper remedy, whenever a merger violates the Clayton Act in any line of commerce. At least this will be true where a very large company is involved.

### III. VERTICAL COMPETITION

Conglomerate mergers will often involve companies in actual or potential supplier-customer relationships. In the pending ITT litigation,<sup>55</sup> for example, the government alleges that one of the effects of ITT's recent acquisitions is that Hartford may supply ITT's insurance requirements, Grinnell may supply ITT's automatic sprinkler requirements, and Canteen may supply ITT's requirements of vending and in-plant food services.

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49. *Id.* at 49.

50. *Id.* at 51-2.

51. *United States v. E.I. duPont de Nemours & Co.*, 366 U.S. 316 (1961).

52. *United States v. E.I. duPont de Nemours & Co.*, 126 F. Supp. 235 (N.D. Ill. 1954).

53. *United States v. E.I. duPont de Nemours & Co.*, 366 U.S. 316 (1961).

54. *United States v. El Paso Natural Gas Co.*, 376 U.S. 651 (1964).

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

In the *Allis Chalmers-White Consolidated* complaint, the Federal Trade Commission alleged that one of the effects of that acquisition is that competitors of Allis in the manufacture of large gyratory and cone crushers and certain types of mills and rotary kilns may be cut off from adequate supplies of very large steel castings during times of short supply.<sup>56</sup> In dealing with supplier-customer acquisitions, the courts have been concerned with the fact, as these complaints indicate, that such acquisitions may cut off competitors from adequate sources of supply or from adequate customers or outlets, or may make supplies or customers or outlets available only at discriminatory prices or on discriminatory terms. The courts have held such mergers to be illegal under the Clayton Act whenever the amount of foreclosure was sufficiently large enough to threaten an extension of market power from one level to another; to eliminate substantial amounts of cross market bargaining pressure; to increase barriers to entry, for example, by increasing capital costs or product differentiation; or to appear unfair to competitors of the merging parties.<sup>57</sup>

Here again, as with horizontal mergers, the key factors have been the degree of concentration in the markets involved, the trend of concentration in those markets, and the share of the markets involved. Intent and prior dealings between the parties involved and between them and others have often been important because of the "fairness" element. The cases illustrate the range of figures the courts consider substantial. In the *duPont-General Motors* case, the Court held that duPont's stock holdings in GM violated the Clayton Act because they gave duPont a preference as to a substantial share of GM's requirements of automobile paints and finishes as long as duPont was able to meet competitive offers in terms of quality, price and terms of sale.<sup>58</sup> Although the opinion is somewhat imprecise, a reasonable reading of the case is that foreclosure of competitors from equal access to 15% of the relevant market violates the Clayton Act. Since prior opinions by the Court under the Sherman Act in the 1920 *Reading*<sup>59</sup> case and the 1948 *Columbia Steel*<sup>60</sup> case suggest foreclosure in the 13-16% area would be illegal, the duPont decision came as no surprise on this issue. However, the courts have gone much further when there was evidence of intent to foreclose competitors from a market and when the markets involved were concentrated or tending towards concentration. In *Brown Shoe*,<sup>61</sup> Brown's acquisition of Kinney was held illegal on vertical grounds, although Kinney had only 1.5% of the total shoe market involved. This decision was based in part on the Court's findings as to Brown's intent

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56. *Allis-Chalmers Mfg. Co. v. White Consol. Indus., Inc.*, 294 F. Supp. 1263 (D. Del. 1969), *rev'd* 414 F.2d 506 (3d Cir. 1969), *cert. denied*, 90 S. Ct. 567 (1970).

57. See cases cited in text p. 87-89 *infra*.

58. *United States v. E.I. duPont de Nemours & Co.*, 366 U.S. 316 (1961).

59. *United States v. Reading Co.*, 253 U.S. 26 (1920).

60. *United States v. Columbia Steel Co.* 334 U.S. 495 (1948).

61. *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962).

to force its shoes into Kinney and as to the trend toward concentration and integration in the industry. In *Standard Oil*,<sup>62</sup> the acquisition was held illegal on vertical grounds although Jersey's requirements of potash were around 1% of the market. The District Court regarded the potash industry as highly concentrated and as having high barriers to entry; although there were already ten producers of potash and five additional companies had already announced firm plans to enter the market. *Kennecott-Okonite*<sup>63</sup> and *Kimberly Clark*<sup>64</sup> are two additional cases wherein district courts have held vertical mergers illegal despite the fact that the shares of the markets involved were only 1-2%. In the former, the market was already concentrated, and in the latter, the market was becoming more and more concentrated as a result of numerous acquisitions.

Here, as with horizontal mergers, there are two reasons why the strict legal doctrine available may not be sufficient to stem the conglomerate merger parade. On the one hand, some conglomerate mergers may not have vertical aspects, or they may have vertical aspects in which the shares of the markets involved are substantially less than 1%, or are somewhat larger than 1% but which involve markets that are not concentrated and are not tending towards concentration. On the other hand, many conglomerate mergers may involve substantial foreclosures in a few lines of commerce and the companies involved may voluntarily, or under court order, divest themselves of the lines of commerce involved. The government, and ultimately the courts, may conclude that such partial divestiture satisfies the requirements of the antitrust law. The discussion of these issues in the horizontal area is applicable here as well.<sup>65</sup>

#### IV. POTENTIAL COMPETITION

Conglomerate mergers may be illegal if they involve the elimination of potential competition. In the pending *Goodrich-Northwest*<sup>66</sup> litigation, for example, the government alleges that Northwest is an active participant in a number of chemical markets which Goodrich has considered entering; that Goodrich is a major manufacturer of PVC and uses it to make PVC pipe, a product Northwest has recently considered manufacturing; and that Goodrich and Northwest are potential competitors in numerous other markets. In the *Ling-Tempco-Vought—Jones & Laughlin* complaint, the government alleged that "LTV was a potential competitor in various product lines in which J. & L. Steel was and is a substantial factor."<sup>67</sup> Furthermore, the government alleged that "J. & L. Steel was

62. *United States v. Standard Oil Co.*, 253 F. Supp. 196 (D.N.J. 1966).

63. *United States v. Kennecott Copper Corp.*, 231 F. Supp. 95 (S.D.N.Y. 1964); *aff'd*, 381 U.S. 414 (1965); *consent decree*, 249 F. Supp. 154 (S.D.N.Y. 1965).

64. *United States v. Kimberly-Clark Corp.*, 264 F. Supp. 439 (N.D. Cal. 1967).

65. See p. 65 *supra*; see also *United States v. Mead Corp.*, 5 TRADE REG. REP. (1970 Trade Cas.) ¶ 73,227 at 88, 457 (S.D. Ohio 1970).

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

67. *United States v. Ling-Tempco-Vought, Inc.*, 5 TRADE REG. REP. (1970 Trade Cas.) ¶ 73,227 at 88,863 (W.D. Pa. 1970).

a potential competitor in various product lines in which LTV was and is engaged," and that "each . . . was a potential competitor in various industries" in which neither had ever been engaged—for example, primary aluminum and gypsum.<sup>68</sup> Both the Northwest and the LTV complaints also allege that the mergers attacked therein have caused an increase in overall industrial concentration and will create further additional overall industrial concentration, thereby "reducing the number of firms capable of entering concentrated markets"<sup>69</sup> and "reducing the number of firms with the capability and incentive for competitive innovation."<sup>70</sup> The *ITT-Hartford* complaint,<sup>71</sup> the *Wilson-Nissen*<sup>72</sup> complaint, and the *White Consolidated—Allis Chalmers*<sup>73</sup> complaint all involve allegations of elimination of potential competition, either in markets in which only one of the two companies was presently engaged, or in markets in which neither was engaged.

A merger which eliminates potential competition may violate the antitrust laws. The Supreme Court recognized that principle in the *United Shoe Machinery*<sup>74</sup> case over 50 years ago and reaffirmed it in the 1948 *Columbia Steel*<sup>75</sup> case, both of which were brought under the Sherman Act. In recent years, the Court has repeatedly applied the potential competition doctrine under the Clayton Act. In *United States v. El Paso Natural Gas*,<sup>76</sup> the Court held El Paso's acquisition of Pacific Northwest illegal because El Paso had 50% of the natural gas market in California and Pacific Northwest was one of the few natural gas pipelines in a position to compete for the California market. In *Penn-Olin*,<sup>77</sup> the Court held that Pennsalt and Olin violated the Clayton Act when they set up Penn-Olin as a joint venture for the production and sale of sodium chlorate in the Southwest if, absent the joint venture, either Pennsalt or Olin would have entered that market, and the other company would have remained a potential competitor on the edge of the market. Another example is *Procter & Gamble*,<sup>78</sup> wherein the Court held illegal Procter & Gamble's acquisition of Clorox, in part because the acquisition eliminated Procter & Gamble as a potential entrant into the chlorine bleach market.

The principal problem in this area is how far the courts will go in deciding how much potential competition must be eliminated before a

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68. *Id.*

69. See cases cited notes 66 & 67 *supra*.

70. See cases cited notes 66 & 67 *supra*.

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

72. *United States v. Wilson Sporting Goods Co.*, 288 F. Supp. 543 (N.D. Ill. 1968), *consent decree entered*, 1968 Trade Cas. ¶ 72,585 (N.D. Ill. 1968).

73. *Allis-Chalmers Mfg. Co. v. White Consol. Indus., Inc.*, 294 F. Supp. 1263 (D. Del. 1969), *rev'd*, 414 F.2d 506 (3d Cir. 1969), *cert. denied*, 90 S. Ct. 567 (1970).

74. *United States v. United Shoe Mach. Co.*, 247 U.S. 32 (1918).

75. *United States v. Columbia Steel Co.*, 334 U.S. 495 (1948).

76. 376 U.S. 651 (1964).

77. *United States v. Penn-Olin Chem. Co.*, 378 U.S. 158 (1964).

78. *Federal Trade Comm'n v. Procter & Gamble Co.*, 386 U.S. 568 (1967).

merger "may . . . *substantially* lessen competition." The courts and economists have traditionally pointed to two ways in which potential competition may be important. First, there is the so-called "edge effect," which occurs even if no potential competitor ever actually enters the market. Firms in a concentrated industry may compete more vigorously than otherwise if they know that there are companies outside the market interested in entering their market. Second, if potential competitors eventually enter a concentrated market, they thereby increase the number of competitors in the market and generally, the vigor of competition as well. Note, however, that the substantiality of both of these effects depends in part on the degree of concentration in the markets involved. In a market in which there are already fifty competitors, the competitors in the market will already be affected so directly by the actual and possible efforts of their actual competitors that they would probably not be affected substantially, if at all, by the possibility that additional companies might also enter the market. Similarly, if there are already fifty companies in the market, the vigor of the competition is not likely to be affected by the addition of one or two companies who change their status from potential to actual competitors. An additional factor is also important in measuring the substantiality of the effect of eliminating a potential competitor: the number of similarly capable potential competitors. If there is only one potential competitor, its elimination may have a very substantial effect on a concentrated market; however, if there are fifty companies equally interested in, and capable of, entering a particular concentrated market, elimination of one of those fifty companies will probably have no effect on the market, since there are forty-nine other companies remaining who might have an edge effect on the market and who may enter and deconcentrate the market.

In the Clayton Act cases, referred to above, there was evidence of substantiality within traditional terms. In *El Paso Natural Gas*,<sup>79</sup> the natural gas market was highly concentrated; El Paso alone had 50% of the market; Pacific Northwest was in terms of its financial resources, managerial resources, location of its reserves, location of its pipeline, and its prior efforts to enter the California market, probably the most likely potential entrant or at least one of a very few potential entrants into that market. The evidence showed an actual edge effect due to Pacific Northwest's prior efforts to sell gas to Edison, the largest industrial user of gas in Southern California. El Paso had to give Edison a firm, as opposed to an interruptible, supply of gas and had to cut prices to Edison from 40 cents per mcf to 30 cents per mcf. Indeed, in view of Pacific Northwest's prior efforts to sell gas to California buyers and the nature of the natural gas pipeline business, *El Paso Natural Gas*<sup>80</sup> appears to be really an actual rather than a potential competition case. In *Penn-Olin*, there were only two manufacturers and sellers of sodium chlorate in the Southeast.

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79. *United States v. El Paso Natural Gas Co.*, 376 U.S. 651 (1964).

80. *Id.*

Pennsalt and Olin were in terms of manufacturing know-how, marketing systems, related chemical operations, prior planning, and interest, two of the four most likely entrants into the area.<sup>81</sup> In *Proctor & Gamble*, six companies had 80% of total national sales. Clorox alone had almost 50% of national sales and much higher shares of several important regional markets. In terms of Proctor & Gamble's diversification program, its complementary products sold to the same users through the same distribution outlets and merchandised in the same manner as bleach, its financial resources, its technical know-how, and its advertising advantages, Proctor was the most likely potential entrant into the chlorine bleach market.<sup>82</sup> Thus, none of these recent Supreme Court cases tell us how the Court will react to the elimination of a potential competitor from a relatively unconcentrated market or to the elimination of one of ten or twenty equally effective potential competitors.

Although several highly knowledgeable experts in the area are somewhat pessimistic about how far the courts will go in developing the doctrine of potential competition, the judicial authority on the subject is inconclusive. In the early *United Shoe Machinery* case,<sup>83</sup> the four justice majority was skeptical not of the doctrine of potential competition, but of its effective application. The potential competition, the government, and subsequent economists relied upon, appeared to the majority either to be nonexistent or so ephemeral or impossible to measure that it was insubstantial on the one hand, or so potentially powerful, on the other hand, that United Shoe Machinery was warranted in buying Goddu out in self defense. In *Columbia Steel*, the majority found that the potential competition in shipbuilding was insubstantial in view of Consolidated's lack of financial resources, plant capacity, and the numerous other more substantial potential competitors. Potential competition in steel plates on the West Coast was insubstantial because the record was insufficient as to the production and demand for plates in the West and the number of producers in the market, and also because of the freight disadvantage U.S. Steel would face competing in the area from the East.<sup>84</sup> The majority did not explain why U.S. Steel would not have become a substantial competitor in the West by building a fabricating plant there. This was an apparent possibility since the evidence showed that U.S. Steel planned to build fabricating plants in the West before the acquisition became available, its nationwide market position on fabricated products was 20%, and it had established customers on the West coast as a result of prior dealings in other products. But these are Sherman Act, not Clayton Act, cases. They were narrowly decided cases (one 5-4<sup>85</sup> and the other 4-3<sup>86</sup>)

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81. *United States v. Penn-Olin Chem. Co.*, 378 U.S. 158 (1964).

82. *Federal Trade Comm'n v. Proctor & Gamble Co.*, 386 U.S. 568 (1967).

83. *United States v. United Shoe Mach. Co.*, 247 U.S. 32 (1918).

84. *United States v. Columbia Steel Co.*, 334 U.S. 495 (1948).

85. *Id.*

86. *United States v. United Shoe Mach. Co.*, 247 U.S. 32 (1918).



and *Columbia Steel*<sup>87</sup> is one of the cases under the Sherman Act that led Congress, in reaction, to amend Section 7 of the Clayton Act to apply a stricter standard to corporate acquisitions.<sup>88</sup>

The two significant potential competition cases under the Clayton Act, other than the Supreme Court cases referred to above, point in opposite directions. In *Wilson-Nissen*, Judge Marovitz took a conservative position as to potential competition although he held the merger illegal on other grounds.<sup>89</sup> The court decided that there was insufficient proof Wilson would have actually entered the gymnastic equipment industry by internal expansion, therefore there was no deconcentrating effect eliminated. The court then found that the evidence showed that firms in the industry regarded Wilson as one of a small group of potential entrants into the market, therefore there was an "edge effect" present. However, the court said that if this were "the only factor, it would not be sufficient."<sup>90</sup> The only explanation<sup>91</sup> the court gave for this conclusion was a citation to a leading article in the field by Professor, subsequently Assistant Attorney General, Turner.<sup>92</sup> Professor Turner stated that if one of two or three of the most likely entrants into a concentrated market acquires one of the two to four dominant sellers in an industry, the effect is substantial enough to violate the Clayton Act, but that if a larger number of likely entrants exist, the effect is not substantial enough to violate the statute.<sup>93</sup> In *Wilson*, there were five potential entrants available, rather than the three Professor Turner used as his maximum. It is apparently for that reason that Judge Marovitz felt the potential competition effect was an insufficient basis to hold the merger illegal. That is a very fine line to draw. Professor Turner himself concedes the matter is a close one, depending on one's judgment, based in part on the values the Act is designed to serve and in part on matters on which economists are not wholly in accord and for which there is scanty empirical data.<sup>94</sup> The fineness of the line drawn by Professor Turner in this area is indicated by the fact that while in his 1965 article he concluded it would not be illegal for a potential entrant to acquire one of the four dominant sellers in an industry, unless the potential entrant was one of the two or three most likely entrants into the industry,<sup>95</sup> in 1968, as Assistant Attorney General, he issued the Merger Guidelines, which concluded that just such a merger would be illegal as long as the acquirer was one of the most likely entrants, without limiting the number of most likely entrants to

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87. *United States v. Columbia Steel Co.*, 334 U.S. 495 (1948).

88. See H. R. REP. No. 1191, 81st Cong., 1st Sess. II (1949).

89. *United States v. Wilson Sporting Goods Co.*, 288 F. Supp. 543 (N.D. Ill. 1968), *consent decree entered*, 1968 Trade Cas. ¶ 72,585 (N.D. Ill. 1968).

90. *United States v. Wilson Sporting Goods Co.*, 288 F. Supp. 543, 557 (N.D. Ill. 1968).

91. *Id.* at 567.

92. Turner, *Conglomerate Mergers and Section 7 of the Clayton Act*, 78 HARV. L. REV. 1313 (1965).

93. *Id.*

94. *Id.* at 1320-322.

95. *Id.*

three.<sup>96</sup> In *Standard Oil*, Judge Shaw took a more liberal view of potential competition and held the acquisition illegal in an industry in which there were already ten actual competitors and five additional companies had already announced they were entering the industry and had taken steps which would put them in operation by 1970. According to the district court, if the acquisition were enjoined, "Jersey will probably remain a potential competitor in the potash industry in the United States market, likely to enter on a 'grass roots' basis just as soon as continued exploration for a good potash ore body develops the opportunity."<sup>97</sup> At this point it should be noted that the potash industry is already less concentrated than many in America containing at least ten to fifteen large sellers, depending upon whether you add the five the court found were coming in by 1970. Furthermore, the court did not find that Jersey was the most likely entrant. It would have been difficult for the court to so characterize Jersey, since Jersey had been studying entry for over five years, a period during which others not only studied entry but, as already indicated, had already begun their entry. In addition, the same reasons that made Jersey a potential entrant—financial resources, profitable opportunity, and desire for a raw material source for its fertilizer operations—would appear to make most of the major oil companies in the country potential entrants into the potash business. Indeed, the court itself pointed out that Cities Service, Continental, Mobil, and Gulf had entered the fertilizer business since World War II. However, the court listed none of them as being engaged in the potash business as of the date of the opinion.<sup>98</sup> In short, Judge Shaw's approach appears to be that in a relatively concentrated market, no potential competitor of the size of Jersey can be eliminated without the effect being substantial enough to warrant condemnation under a statute designed to deal with probabilities, not certainties.

Although the Supreme Court has not yet spoken in this area, it appears likely that it will follow and develop Judge Shaw's approach rather than Judge Marovitz', at least if the right case reaches it during a continuance of the present conglomerate merger parade. If Section 7 was designed to preserve an economic way of life, as Chief Justice Warren pointed out in *Brown Shoe*,<sup>99</sup> and to prevent economic dominance by large companies, which have grown through merger, as Justice Harlan stated in *Proctor & Gamble*,<sup>100</sup> then it appears reasonable to say that no company with, for example, over 250 million dollars of assets, which is a potential competitor in any market where less than twenty companies have, or appear likely to have around 80% of the total sales, can acquire

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96. DEPT. OF JUSTICE, REPORT ON MERGER GUIDELINES, 1 TRADE REG. REP. ¶ 4430 (May 30, 1968).

97. *United States v. Standard Oil Co.*, 253 F. Supp. 196, 227 (D.N.J. 1966).

98. *Id.* at 212.

99. *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962).

100. *Federal Trade Comm'n v. Proctor & Gamble Co.*, 386 U.S. 568 (1967).

any company with over 1% of the market, without the elimination of the acquiring company as a potential competitor. This would be regarded as sufficiently significant, in terms of long term probabilities, to be considered substantial and therefore illegal under the Clayton Act. There are simply too many concentrated or concentrating markets to enter for any single company to enter a significant share of the total in any decade, particularly since many companies will be reluctant to enter markets without some familiarity with the raw materials, production or marketing techniques or customers involved in the new market.

Furthermore, there are simply too few companies around with over 250 million dollars of assets for us to be unconcerned about the elimination of any of them as potential competitors in any concentrated or concentrating markets. This is true, at least during the merger parade in which the size and number of acquisitions by such companies is growing at the pace encountered in the last few years. Indeed, at the rate at which the top two hundred largest industrial corporations in the country have been increasing their share of total manufacturing assets in the country, it would not be unreasonable for the courts to hold that any acquisition by any of the top two hundred or so corporations of any medium size company, *e.g.*, a company with over \$10 million in assets, is a violation of the antitrust laws absent unusual circumstances, such as a failing company situation. For the crucial issue under the Clayton Act, as the Supreme Court pointed out in *Brown Shoe*, is not the impact of a particular acquisition in particular markets, but the impact of a particular acquisition as part of a trend of acquisitions and other industrial developments.<sup>101</sup> At the time of the *Brown* decision, there were still 852 shoe manufacturers in the country. The 24 top manufacturers had only 35% of total sales, a highly unconcentrated market in the opinion of most, if not all economists.<sup>102</sup> The acquisition affected only 1.5% of the retail market and gave Brown only 5% of the retail market in many areas.<sup>103</sup> The Court struck down the merger, not because its impact was substantial, but because the Court felt it was part of a trend of concentration and vertical integration in the industry. This trend, if not halted, would eventually lead to the very concentrated markets of which Congress disapproved. Similarly, any substantial acquisition by the top two hundred companies in the country should be evaluated not only as to its impact on specific markets, but also as to its tendency to cause overall industrial concentration to a degree disapproved by Congress.

There is another effect the current merger wave may have, unless it is checked, which appears to fall within the specific terms of Section 7. It may give rise to an understanding among the two hundred largest companies in the country that they should not compete too vigorously

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101. *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962).

102. *Id.* at 300.

103. *Id.* at 343.

against each other in any particular line of commerce or geographical area. Such an understanding would not be too difficult to reach among giants who were oligopolists in many specific markets and who had thereby learned the advantages of a live-and-let-live philosophy. The overall effect of such an understanding would be a serious decline in the vigor of competition throughout the country, not only because of compliance with the understanding by the giants, but also because of the deterrent effect upon small to medium sized corporations.

The counter arguments, however, are powerful enough so that the outcome of the issue is in doubt. True, Congress was concerned with gross industrial concentration, but it did not pass a statute prohibiting all acquisitions, or all acquisitions *by* companies over a given size, or all acquisitions *of* companies over a given size. Instead, it passed a statute which only prohibits acquisitions with a probable substantial impact on competition.<sup>104</sup> Moreover, such a decision was sound as a matter of public welfare since it provides a more objective standard than someone's gut reaction as to how big is too big; it ties the law to competitive markets which is in the public interest in the long run; and it enables us to benefit from the efficiencies and increased competition which many huge conglomerate mergers create. As for the threat of overall concentration, merger waves come and go. This one has not yet reached threatening levels. It will be time enough to deal with the threats in this area when it is clear that the present wave is not self-correcting in the market place. If we do have to deal with the problem, let us do so directly and by specific legislation, precisely designed to balance all the values involved rather than by gross judicial legislation under the guise of interpreting the antitrust laws. As for the hypothetical understanding among corporate giants, none has yet developed, and the contention that one will develop is pure surmise. It is hardly a substantial enough threat at this stage to warrant sacrificing the benefits conglomerates make possible.<sup>105</sup>

#### V. RECIPROCITY

Conglomerate mergers often if not usually lead to reciprocity, *i.e.*, the use of purchasing power to induce others to purchase one's products or services. In fact all the recent conglomerate complaints contain allegations of reciprocity. In the pending *Goodrich-Northwest* complaint, the government alleges that Goodrich's substantial purchasing power will benefit Northwest in seeking railroad business and that Northwest's substantial purchases of railroad equipment and petroleum products will help Goodrich sell tires and industrial products.<sup>106</sup> ITT's purchasing power, the government alleges, will help Hartford to sell insurance,

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104. Clayton Act § 7 (1964).

105. See Turner, *supra* note 92; See also *United States v. I.T.T.*, 5 TRADE REG. REP. ¶ 73,424 (D. Conn. 1970).

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

Grinnell to sell automatic sprinkler systems and related products, and Container to sell vending and in-plant feeding services.<sup>107</sup> Jones & Laughlin and LTV will allegedly benefit in the sale of their products by reason of the increased and wider scope of the purchasing power resulting from LTV's acquisition of J & L stock.<sup>108</sup> And the FTC has alleged that Allis Chalmer's purchases of steel mill products will help White sell rolling mill equipment to steel companies.<sup>109</sup>

In *Consolidated Foods*, the Supreme Court clearly established that a merger creating a probability of substantial reciprocity is illegal under the Clayton Act.<sup>110</sup> The key question is the meaning of "substantiality." In *Consolidated Foods*, the acquiring company owned a network of wholesale and retail outlets and was a substantial purchaser of food processor's products. The food processor bought dehydrated onion and garlic for use in preparing and packaging their food; Gentree, the acquired company, was a manufacturer of dehydrated onion and garlic.<sup>111</sup> The Court held that since food processors who sold or wanted to sell to Consolidated would give Gentree their garlic and onion business if it could meet competitive price and quality terms, the merger had the requisite probable effect on competition in the dehydrated garlic and onion lines of commerce.<sup>112</sup> Note, however, that the markets affected were very highly concentrated. The two leading manufacturers of dehydrated garlic and onion had 90% of the total sales, and Gentree alone had 32% of the market.<sup>113</sup> Thus, the case could readily be disposed of in terms of the oligopoly theory developed in horizontal competition cases. The markets involved were highly concentrated, so that every unnecessary limitation on the ability of the smaller competitors within the market to compete and every limitation on the ability of potential competitors to enter the market should be eliminated. Reciprocity is an arbitrary limitation which is inherently anticompetitive; therefore, a merger which creates the probability of substantial reciprocity is illegal. But what about mergers which create the probability of substantial reciprocity in unconcentrated markets or in moderately concentrated markets in favor of, for example, the sixth largest competitor in the market? Also, what about mergers which create the possibility but not the probability of reciprocity where the companies involved, while large in absolute terms, have such a small share of the purchases involved that any attempt at overt reciprocity would probably have a negative reaction on most sellers in the market?

Here, as in the case with potential competition, several knowledgeable

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

108. *United States v. Ling-Temco-Vought, Inc.*, 5 TRADE REG. REP. (1970 Trade Cas.) ¶ 73,227 at 88,863 (W.D. Pa. 1970).

109. *See Allis-Chalmers Mfg. Co. v. White Consol. Indus., Inc.*, 414 F.2d 506, 522-25 (3d Cir. 1969).

110. *Federal Trade Comm'n v. Consol. Food Corp.*, 380 U.S. 592 (1965).

111. *Id.*

112. *Id.*

113. *Id.* at 595.

experts are pessimistic about the scope of the doctrine and its applicability to most conglomerate mergers. They feel that unless the markets involved are highly concentrated and the share of the market affected is substantial, there is an insufficient basis in economics to conclude that a merger may substantially lessen competition. The guidelines issued by the Antitrust Division under Professor Turner, for example, condemn mergers on reciprocity grounds only when at least 15% of the purchases in a market in which one of the merging firms sells are accounted for by firms which make substantial sales in markets where the other merging firm is both a substantial buyer and buys substantially more than most of its competitors.<sup>114</sup>

The scant judicial authority in the area, however, points the other way. Although *Consolidated Foods* involved a very highly concentrated market, there was little proof that Consolidated had substantial purchasing power in economic terms. Readily available sources would have shown Consolidated's total purchases of food products were less than 2% of total sales.<sup>115</sup> Moreover, while Justice Douglas' majority opinion held that all mergers which create a reasonable probability of substantial reciprocity were not illegal under the Clayton Act, the only exception specifically noted was a merger involving *de minimus* reciprocity,<sup>116</sup> hardly an important exception for a Court which has already held that tie-in sales of \$50,000 were not *de minimus*.<sup>117</sup> Recently, the Third Circuit directed entry of a preliminary injunction in the Allis Chalmers—White Consolidated suit. The court relied on the probability that the merger would give rise to substantial reciprocity in the sale of rolling mills to steel companies as sufficient ground for concluding that the merger was probably illegal under the Clayton Act.<sup>118</sup> Judge Stahl clearly stated that where reciprocity was involved, the merging parties' share of the total purchases in the market involved was not the crucial figure. The significant figures were the merging parties' total purchases compared to their competitors' purchases.<sup>119</sup> Since White's and Allis' total purchases of steel from steel companies were greater than purchases of steel by any other manufacturer of rolling mills, the court concluded that steel companies would favor White-Allis in their purchases of rolling mills. That effect was sufficient to warrant a conclusion of illegality.

The approach of the court in *White-Allis Chalmers* appears more

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114. DEPT. OF JUSTICE, REPORT ON MERGER GUIDELINES, 1 TRADE REG. REP. ¶ 4430 (May 30, 1968).

115. *Consolidated Foods Corp. v. Federal Trade Comm'n*, 329 F.2d 623, 625 (7th Cir. 1964).

116. *Id.* at 600.

117. *United States v. Loew's Inc.*, 371 U.S. 38 (1962).

118. *Allis-Chalmers Mfg. Co. v. White Consol. Indus., Inc.*, 414 F.2d 506 (3d Cir. 1969), *cert. denied*, 90 S. Ct. 567 (1970).

119. *Allis-Chalmers Mfg. Co. v. White Consol. Indus., Inc.*, 414 F.2d 506 (7th Cir. 1964). *United States v. White Consol. Indus.*, 5 TRADE REG. REP. ¶ 73,487 (N. D. Ohio 1971).

consistent with Congressional intent than the approach of the commentators and is probably more likely to prevail in the long run. If Congress was concerned with rising corporate concentration as well as with the protection of smaller corporations from the adverse consequences of a trend of acquisitions by large corporations, it would appear reasonable to carry out Congress' intent by holding that any acquisition by a large company which creates a market situation in which the large company is favored at the expense of most of its smaller competitors is illegal. Furthermore, since every acquisition by a large company thereby substantially enlarges the scope and size of the purchases available to the acquired company, and since we are witnessing a merger wave, the long-run overall impact of this trend on the ability of independent smaller and medium-size companies to compete equally for business on the basis of price, quality, and service will be substantial. Therefore, it would be reasonable to hold on "reciprocity effect" grounds alone that any acquisition of a company with assets of over ten million dollars by a company with assets of over 250 million dollars is illegal under the Clayton Act absent exceptional circumstances.

It has been argued that even if the probability of substantial reciprocity may be a sufficient ground to condemn a merger, the proper remedy is an injunction against the merged company engaging in reciprocal trading agreements with its suppliers, rather than ordering divestiture of the acquired company. This contention is related to the position discussed above, that the proper relief in the case of a conglomerate merger with horizontal effects is divestiture of the overlapping assets, rather than total divestiture.<sup>120</sup> But there is a further weakness in this position in the reciprocity area. All an injunction can do is prohibit overt attempts at reciprocity and eliminate the detailed accounting and personnel machinery required to make a reciprocity program fully effective. It cannot eliminate the tendency of suppliers to favor their customers with purchases in the hope that their customers will thereby favor them in return or give them a chance to maintain or increase sales. Furthermore, as more huge conglomerates are formed, each having tremendous purchasing power, a wide variety of products and services required for their operation, and a wide variety of products and services available for sale, it becomes apparent that no injunction can prohibit a community of interest developing among the huge conglomerates. Price, quality, terms, and conditions of sale being substantially similar, it pays to buy from someone within the group of huge conglomerates. Those purchases insure the greatest possibility of maintaining and increasing one's overall sales.<sup>121</sup> The simplest and surest way of preventing such a community of interest from arising as a result of a series of acquisitions by very large companies is to prohibit these

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120. See notes 47-50 *supra* and corresponding text.

121. See generally note 119 *supra*; and Davidow, *Conglomerate Concentration and Section Seven: The Limitations of the Anti-Merger Act*, 68 COLUM. L. REV. 1231 (1967).

acquisitions rather than allowing the acquisitions to occur subject to numerous detailed but ineffective injunctions.

## VI. COMPETITIVE ADVANTAGES

Conglomerate mergers may be illegal under the Clayton Act if they create competitive advantages for the merging companies which deter competitors within the merged company's markets from competing vigorously with the merged company or which deter potential competitors from entering the merged company's markets. In the *ITT—Hartford* case, for example, the government alleged that "the competitive advantages which will accrue to the defendants which are leading firms in several industries, as a result of this merger, will raise barriers to entry and discourage smaller firms from competing in these industries."<sup>122</sup> Similar allegations appear in the *ITT—Grinnell*<sup>123</sup> and the *Allis Chalmers—White*<sup>124</sup> complaints and also in the *Wilson—Nissen*<sup>125</sup> litigation.

The leading Supreme Court decision dealing with competitive advantage as an indicator of a Clayton Act violation is *Procter & Gamble*, where the Court held Procter's acquisition of Clorox illegal. Two of the reasons for the Court's finding of illegality were as follows: First: "smaller firms would become more cautious in competing due to their fear of retaliation by Procter"<sup>126</sup> and second, "a new entrant would be more reluctant to face the giant Procter than it would have been to face the smaller Clorox."<sup>127</sup> Of course, *Procter & Gamble* can be read narrowly. In fact, Justice Harlan demonstrated in his concurring opinion how the majority's position could be rationalized in terms of traditional conservative oligopoly theory. The bleach industry was highly concentrated thus all unnecessary restrictions on the vigor of competition and entry by potential competitors should be eliminated. The addition of Procter & Gamble's resources to Clorox's probably restricted competitive vigor in the industry and deterred new entry. Potential entrants would be discouraged by Procter & Gamble's huge financial resources, huge advertising budget, the advertising discounts available to Procter but not to Clorox, and Procter & Gamble's tenacity in reacting to competitive entry into a particular geographical market.<sup>128</sup> However, Justice Douglas' opinion for the majority is not as limited as Justice Harlan's concurrence. Justice Douglas asserts that "there is every reason to assume" that smaller companies would become more cautious in competing with Procter & Gamble than Clorox and that Procter & Gamble would probably become

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

124. *Allis-Chalmers Mfg. Co. v. White Consol. Indus., Inc.*, 294 F. Supp. 1263 (D. Del. 1969), *rev'd*, 414 F.2d 506 (3d Cir. 1969), *cert. denied*, 90 S. Ct. 567 (1970).

125. *United States v. Wilson Sporting Goods Co.*, 288 F. Supp. 543 (N.D. Ill. 1968), *consent decree entered*, 1968 Trade Cas. ¶ 72,585 (N.D. Ill. 1968).

126. *Federal Trade Comm'n v. Procter & Gamble Co.*, 386 U.S. 568, 575 (1967).

127. *Id.*

128. *Id.* at 581 (concurring opinion).



a price leader.<sup>129</sup> If he was relying on the fact that Proctor & Gamble was much larger than Clorox—it had assets of over five hundred million and sales of over one billion in 1957, while Clorox had assets of only twelve million and sales of forty million<sup>130</sup>—then the acquisition of Clorox by any of the 300 largest industrial corporations in the country with over 250 million dollars of assets would appear to be similarly illegal.

Justice Douglas may have relied in part on the advertising discounts available to Proctor and not to Clorox, but the logic inherent in his statement indicates the advertising discounts were not crucial. For if the key to the situation is the smaller firms' "fear of retaliation by Proctor," it would seem reasonable to "assume" a "fear of retaliation" if they competed too vigorously against any merged company with assets of over 250 million dollars. Moreover, if "fear of retaliation" is the key to the decision, it also appears that the oligopoly situation in the bleach industry and Clorox's dominant position in that market also appear to be relevant but not decisive facts. This follows since acquisition by a corporate giant of the sixth largest firm, for example, in a relatively unconcentrated medium-size industry would probably lead the remaining companies to fear retaliation from the corporate giant.

Justice Harlan attempted to tie the *Clorox* decision to the case's facts, but he inadequately explained how to determine when the effects present in *Clorox* would be sufficiently significant to be substantial within the meaning of the Clayton Act.<sup>131</sup> For example, he regarded the bleach industry as oligopolistic in terms of pricing decisions, but he said that if the evidence showed that the smaller companies' pricing decisions were cost-determined and set an effective ceiling on Clorox's prices through the mechanism of an acceptable differential, the merger would not be illegal.<sup>132</sup> But most prices are cost determined to some extent, and most unbranded or locally branded prices set ceilings on branded prices through some differential. How does one know how high cost-determined prices must be or how much of a margin is acceptable before Justice Harlan will allow a giant corporation to buy a medium-size corporation in a concentrated industry? Moreover, once a market is sufficiently oligopolistic in its pricing mechanism to concern Justice Harlan, how do we know when there is a sufficient deterrent to vigorous competition or to entry so as to warrant condemnation. For example, while Proctor & Gamble was much larger than Clorox, Clorox was already much larger than most of the companies in the bleach industry. Clorox had \$12 million in assets, whereas there were only eight companies which had over a million dollars in assets, and very few had assets over \$75,000.<sup>133</sup> Additionally, although Proctor & Gamble could easily increase the dollars spent advertising

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129. *Id.* at 579.

130. *Id.* at 572.

131. *Id.* at 581-604.

132. *Id.* at 595.

133. *Id.* at 571.

Clorox bleach, what evidence was there that Clorox was not already spending as much on advertising as was profitable?

The competitive advantage theory is similar to the vertical foreclosure and reciprocity theories discussed above. Indeed, those theories may be regarded as merely specific examples of competitive advantages resulting from mergers—preferred access to supplies or customers in the one case and the reciprocity effect in the other. Therefore, most of the discussion above is relevant here. A few additional comments are appropriate here which were also relevant to the foreclosure and reciprocity issues. First, so called competitive advantages often simply do not exist; *e.g.*, a merger of two large companies may appear to give the resulting firm a competitive advantage based on increased size, but the additional assets may actually be a detriment rather than a benefit if the assets are invested in unprofitable operations or burdened with excessive debt obligations. Second, even if a competitive advantage may be theoretically available on paper, it may not be realizable in practice. For example, a merger between firms with manufacturing operations in California and a retail operation in the same industry in New England may not result in any foreclosure of competitors from either a source of supply or retail outlets. It may be that the costs of shipping goods from California to New England will be prohibitive, or that the quality of the product may deteriorate during long shipments, or that speed of delivery may be an important aspect of service in the industry. Third, even if a competitive advantage exists and is realizable in practice, it may not be profitable for a company to attempt to realize the advantage. A company with substantially more resources than all the other companies in the industry combined could engage in below cost price wars or other predatory behavior to eliminate half the competitors in the industry, but the long run profits from increasing its share of market might not be sufficient to cover the short run costs of the predatory behavior. Once the predatory behavior ceased, either voluntarily or under court order, new competitors might reenter the industry in substantial numbers and dissipate the company's short run increase in market position. Fourth, even assuming a realizable competitive advantage would be utilized, it may not have a substantial impact on competitive conditions or an unfair impact on competitors. The impact may be quite small in view of the power involved and the numerous other factors affecting market position. Whatever other effects the *LTV-Jones & Laughlin* merger may have, for example, it is quite unlikely that the increase in assets of the J & L Steel Company will deter vigorous competition in the steel industry through fear of retaliation. Fifth, the impact may actually result in an increase in the vigor of competition in the industry. Assume, for example, that a multi-billion dollar diversified company has 80% of total sales of an important piece of equipment to the railroad industry; that there are only two other manufacturers of the product involved, both small single line companies; and that those two

smaller companies were acquired by multi-market billion dollar companies whose total annual railroad shipments were such that they could be and were used to increase the sales of the smaller companies. Under these circumstances, competition in the sale of the product involved would appear to have been increased. Of course, the merger may have raised barriers to entry into the industry, but those barriers may have already been so high that no entry was reasonably probable except by those who would not be deterred by the mergers anyway. Finally, and this is one of the most troublesome issues in the area, some competitive advantages achieved through merger are based on increased efficiency. In the railroad equipment example given above, assume that the smaller companies' increased sales enables the companies involved to achieve economies of scale which reduce unit-costs substantially. A conglomerate merger may make computer services, cost control techniques, and other advanced managerial techniques available to a theretofore family-run operation, thus substantially increasing the efficiency of the business. It may also make production or marketing technology available from a related field, or it may introduce aggressive management into a rigid stultifying old-line industry which will seek out new ways to satisfy consumer needs in the area. One of the main reasons a competitive economy is preferred is that a competitive economy is efficient in allocating resources to their most productive position in the economy thus producing newer and better goods and service at lower prices.<sup>134</sup> Therefore, it is somewhat incongruous to condemn a merger for creating efficiencies under a statute whose test of legality speaks in terms of maximizing competition which, in turn, is desired because it promotes efficiency.

The dilemma is real and inescapable. It is not unique in this area of antitrust. Two basic issues are involved: social versus private economies and the basic purposes of antitrust. There are activities which result in a company's saving money but which do not result in society saving resources. This is so either because the saving to the company is simply a shift of cost from one firm to another (*e.g.*, numerous discriminatory price situations) or because the company is using society's resources without paying for them (*e.g.*, numerous pollution situations). These activities are examples of private economies which society has no reason to encourage as opposed to social economies which increase society's wealth and which society does have reason to promote. Although the general concept of social or private economies is widely accepted, there is difficulty in determining whether a particular form of activity involves social or merely private economies. The most common illustration of the problem in the merger area arises in connection with advertising economies. Some experts feel that since advertising is often used to create irrational brand preferences which distort competition by creating pockets of market power for

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134. See *United States Steel Corp. v. Federal Trade Comm'n*, 5 TRADE REG. REP. (1970 Trade Cas.) ¶ 73,167 at 88,596 (6th Cir. 1970).

branded items, it then becomes plausible to believe that mergers which create advertising economies and increase product differentiation are therefor not the kind of activity society should encourage by allowing the mergers that create them.<sup>135</sup> Others contend that it is almost impossible to draw a line between advertising which creates "irrational" consumer demand and advertising which educates consumers and creates sufficient consumer demand to realize economies of scale of production and distribution. Since it is rational for consumers to rely on brands for psychological values deemed desirable by consumers and for assurances as to quality, consumers should be allowed to decide what is rational and what is irrational advertising by exercising their purchasing power in the market place, rather than have government officials make those decisions for them.

There is a similar split of authority on the efficiency issue. Some experts argue that the basic purpose of antitrust is to maximize the community's wealth by maximizing efficiency in the allocation and use of its resources. They argue that no merger which creates efficiencies should be condemned and that the competitive advantage theory should be eliminated, at least to the extent that the competitive advantage involved is based on any efficiency created by a merger. Other experts reach a similar result by contending that, while efficiency is not the sole goal of antitrust, it is so important that no merger should be condemned solely on the ground that it creates efficiencies. There are two difficulties with this position. First, competition is usually the most efficient way to organize and operate an economy only as a long run process. Therefore, it is eventually more efficient to prohibit activities which maximize efficiency in the short run but which also lead to noncompetitive market structures which are inefficient in the long run. This has been the general approach of the courts toward efficiency under the antitrust laws; *i.e.*, efficiencies are generally desirable but not at the expense of destroying competitively structured markets. Second, as already indicated, Congress has repeatedly indicated in enacting antitrust legislation, and the courts have repeatedly held in applying the antitrust laws, that efficiency was not the sole or most important value to be promoted. The reports and debates which led to amendment of the Clayton Act did not indicate any concern about efficiency or the effect that a strict merger law would have on efficiency. The legislators were concerned with the impact of the merger movement on individual opportunity, the ability of small businessmen to survive, local control of business, and control of numerous markets by a few corporations. The greatest concern was with the large share of the country's total manufacturing assets that were falling into the hands of fewer and fewer corporate hands and the threat that such increasing absolute concentration would eventually cause the nation to become socialist, communist, or fascist, which was the European experience. Congressman Celler's statement that

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135. See, e.g., Davidow, *Conglomerate Concentration and Section Seven: The Limitations of the Anti-Merger Act*, 68 COLUM. L. REV. 1231, 1258-264 (1968).

"mergers are usually the forerunners of collectivism and socialism and therein lies the danger"<sup>136</sup> was typical of the statements in both the House and the Senate when the Clayton Act was amended. With that background judicially recognized by the Supreme Court in *Brown*<sup>137</sup> and *Proctor & Gamble*,<sup>138</sup> it seems reasonable to contend that at least during a merger wave of the dimensions occurring in recent years, any merger involving one of the top 200 to 300 companies in the country which may substantially lessen competition is illegal, even where the probable effect on competition is due to efficiencies created by the merger. This is so because the economic way of life threatened by the merger wave is more important than the efficiencies sacrificed by such an approach. The issue is a close one when efficiency is created by mergers involving only medium-size corporations. However, where acquisitions by very large corporations are involved, those who contend that efficiency should never be the basis for declaring a merger illegal are in effect substituting their value judgments for that of Congress.

## VII. CONCLUSION

Conglomerate mergers, like most forms of business activity, may increase efficiency or competition and thereby increase the community's wealth. On the other hand they may have neutral or adverse effects on either or both efficiency or competition. Since conglomerate mergers are simply one form of business activity and mergers in toto are simply one form of a market, (part of the market for capital assets) those who rely on free market behavior to organize and operate the economy are and should be reluctant to interfere with conglomerate merger activity. However, since mergers so often directly change market structure, and since market structure normally conditions market behavior, some way of delineating those mergers which change market structure by reducing the workability of competition therein and those mergers which either increase or have a slight effect on competition must be identified. Furthermore, since mergers affect the degree of overall industrial concentration, and thus may affect important political and social values as well as competition in specific markets, the effect of mergers on these goals cannot be ignored. The purpose of this discussion has been to describe as specifically as possible those elements which the courts have considered in drawing the line between legal and illegal mergers; to point out some of the problem areas involved; to consider the arguments pro and con on certain issues; and to suggest that an important, if not overriding, factor the courts should and probably will take into account in their evaluation of acquisitions by the top 200 to 300 industrial corporations in the country is that

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136. 95 CONG. REC. 11486 (1949).

137. *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962).

138. *Federal Trade Comm'n v. Proctor & Gamble Co.*, 386 U.S. 568 (1967).

the overall impact of an unchecked merger wave by these corporations would so increase overall industrial concentration that the economic way of life Congress sought to preserve in amending the Clayton Act in 1950 may be destroyed.