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Antitrust policy versus economic power

Aarts, Jacobus Wilhelmus Leonardus Theodorus

Publication date:
1975

Document Version
Publisher's PDF, also known as Version of record

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Citation for published version (APA):
Aarts, J. W. L. T. (1975). *Antitrust policy versus economic power*. [Doctoral Thesis, Tilburg University]. Stenfert Kroese.

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ANTITRUST POLICY VERSUS ECONOMIC POWER

JACK W. AARTS

ANTITRUST POLICY VERSUS ECONOMIC POWER

Antitrust Policy versus Economic Power

PROEFSCHRIFT

TER VERKRIJGING VAN DE GRAAD VAN DOCTOR IN DE ECONOMISCHE
WETENSCHAPPEN AAN DE KATHOLIEKE HOGESCHOOL TE TILBURG,
OP GEZAG VAN DE RECTOR MAGNIFICUS IN HET OPENBAAR TE
VERDEDIGEN TEN OVERSTAAN VAN EEN DOOR HET COLLEGE VAN
DEKANEN AANGEWEEZEN COMMISSIE IN DE AULA VAN DE HOGESCHOOL
OP DONDERDAG 10 APRIL 1975 DES NAMIDDAGS TE 16.00 UUR

DOOR

JACOBUS WILHELMUS LEONARDUS THEODORUS AARTS

geboren te 's-Hertogenbosch

1975

H. E. STENFERT KROESE BV LEIDEN

PROMOTOR: PROF. MR. W. L. SNIJDERS

ISBN 90.207.0472.9

The publication of this book was made possible by financial support from the Netherlands Organization for the Advancement of Pure Research (ZWO)

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Printed in the Netherlands.

PREFACE

The gradual economic integration of Western Europe is bringing about far-reaching changes in the countries taking part in the venture. One of the features of this process – and a prominent feature – is making itself felt in the field of industrial organization through a profound change in the structure of a large number of markets. In taking advantage of the larger market created by the elimination of national frontiers as barriers to trade, large firms play a leading role – firms from within the European Community and from outside. The merger device has been a major vehicle of expansion, and in several sectors of manufacturing industry this has already led to an increase in the relative importance of a few firms.

Over the years, public opinion has become increasingly aware of the concentration of industrial power and of its attendant problems. Merger law and control of the operations of large corporations are current topics of discussion. More especially, merger statutes have recently been enacted in Britain and Germany, and the matter is coming to be one of the chief pre-occupations of the European Commission.

The study offered here is intended to answer a practical need for criteria upon which to judge the effectiveness or workability of competition, which we feel should play a crucial role in the formulation of competition policy. We have to be able to determine whether concentration is the product of competitive pressures, a means of attaining superior performance, or whether it is a device for avoiding competition. The study also examines the capabilities and limitations of competition policy in dealing with the problems that arise from industrial concentration. Because of the vast experience with legislation on concentration that has been built up in the United States, a good deal of space is given over to American antitrust. There are two reasons why this is relevant to the situation in Europe today. First, much can be learned by policymakers in the Commission and in the member states of the Community from a careful study of the American case law on monopolies and mergers – not because any great part of American law can simply be transposed to fit European circumstances, but because examination of the criteria used in antitrust decisions and of the solutions the Americans have found to the

problem of restoring competition to markets where concentration has had undesirable effects will be useful to Europeans when they come to adopt appropriate measures. There may also be a need in the future for some degree of interaction between American and European antitrust policies.

The manuscript was completed, except for revision, early in 1973. Since then there have been a number of noteworthy additions to the literature on industrial organization and on merger law in particular, not all of which could be covered adequately during rewriting. My apologies for any shortcomings this has entailed.

I have received a wealth of pertinent comment from a number of European and American friends. Among them, I want particularly to mention Professors A. H. M. Albregts and W. L. Snijders for their guidance throughout the preparation and completion of the book, and Professors P. Hennipman and P. VerLoren van Themaat, the late Professor Heinrich Kronstein, Professor Corwin D. Edwards and Mr. A. A. van Ameringen for their observations on different parts of the manuscript. I have had invaluable assistance from Mr. Leonard Scott, who ably translated the sections of the book which were originally written in Dutch, edited those parts which were drafted in English, and prepared the bibliography, table of cases and indexes. Finally, a word of great warmth and indebtedness to my wife and children, who sustained with their understanding a husband and father part of whose scarce free time had to be sacrificed to this study for so many years.

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INTRODUCTION

CHAPTER I

INDUSTRIAL CONCENTRATION AND ECONOMIC POWER

Corporate growth can be considered either in terms of absolute size – where a firm, seen in isolation, increases its assets, income or output – or in terms of relative size – where a firm grows more quickly than other firms. It is the latter phenomenon, where growth is not distributed proportionately, that induces concentration, which, in Joe S. Bain's definition, refers to '(1) control of a large proportion of some aggregate of economic resources or activity *by a small proportion* of the units which control the aggregate; or (2) control of a large proportion of such an aggregate *by a small absolute number* of these units.'¹

Concentration merits due attention because, if carried sufficiently far, it may engender or reinforce economic power. Economic power implies one form or another of real control over the supply of economically scarce goods, services or financial resources, enabling its possessor to assert his own will, economically speaking, within certain limits, the firms with which he does business being unable to oppose him effectively.² For the purposes of this study, this distinguishes the concept sufficiently from such other manifestations of power as political power or military power. The means employed by possessors of these forms of power are not economic, though their objectives may of course be economic, just as economic power can be used to attain noneconomic objectives.

Economic power may make itself felt on a single market (through 'market' or 'industry' concentration) or in the broader context of the economy as a whole (through what is generally termed 'overall' concentration). A firm or group of firms has market power if it can bring so much influence to bear

¹ *Industrial Organization* 78 (New York: Wiley, 2d ed. 1968).

² A similar definition is given by A. H. M. Albregts, *De leer der maatschappelijk-economische organisatievormen* 24-25, 316-17 (Amsterdam: Elsevier, 1949). See also W. L. Snijders, *Mededinging en mededingingsrecht* (Alphen a/d Rijn: Samsom, 1964).

on other market participants as to enable it substantially to affect or even to eliminate the working of the market mechanism.³ 'Market dominance' and 'monopoly power' are notions indicating degrees of market power, the latter implying absolute control of a market. Economic power is not only a factor in what has traditionally been called the 'monopoly problem': it may also make itself felt in a much wider context. Where firms account for a substantial proportion of the national product, they can influence the rate of economic growth and the industries into which it is channeled, the level of employment or the distribution of income (both primary and secondary) – to mention but a few of the economic issues that may arise. And we should not forget the political and cultural influence that can derive from economic power. These phenomena can be observed not only on a national scale: they are increasingly being felt internationally through the influence multinational companies exert. There is no direct link between market power and economic power in its wider sense, but a strong market position may well be conducive to economic power.

It is not at all simple to determine where we should set the limits beyond which market power – and even more so economic power in the wider sense – can be said to exist, chiefly because the extent to which the possessor of economic power can exert his influence depends on a variety of circumstances – ranging from the influence wielded by competitors or potential competitors in related industries (interindustry competition) to constraints of a non-economic nature on decisions in the economic sphere. To give some idea of where economic power may be sought, statistical indicators have been developed over the years that try to measure the degree of industry or overall concentration. However, care has to be taken to put such statistics in their proper context. First, we do not regard them as indicators of economic power for reasons inherent in competition theory which are set out elsewhere in this book (in Chapter 3). Second, there are also constraints of a statistical nature that oblige us to look at concentration statistics with a critical eye.

The first of the problems encountered in measuring concentration is what dimension should be selected for measurement – the industry or the product.⁴ Industry classification is wider than product classification, so that product concentration figures are generally higher, but there are objections to both approaches. If the product categories are defined too narrowly, i.e. if a single category does not include products which serve the same function and most of which are regularly substituted for each other, then the degree of concentration will be overstated and hence economically irrelevant. The reverse is true, of course, if too much substitutability – more than is observed in

reality – is presumed. Similar problems also emerge where the industry is taken as the basis of measurement, though here the danger is more often that industries are given too broad a definition – so that they include goods that are not competitive substitutes.⁵ Finally, substantial distortion arises from the classification of multiproduct companies in the product group that accounts for most of their output.

Another difficulty concerns the selection of the concentration index. The possibilities include employment, total assets and net capital assets, income, value added by manufacture, and value of shipments. The main objection against the first of these indexes is that it tends to understate concentration since big firms are often more capital-intensive than small businesses. Assets generally give a correct picture of the productive resources and financial strength of a corporation; the other advantages and the disadvantages of this measure have been thoroughly discussed in the literature.⁶ Value-of-shipments data are generally readily available and for that reason widely used in the

³ Carl Kaysen and Donald F. Turner, *Antitrust Policy* (Cambridge, Mass.: Harvard UP, 1959), define market power in § 2 of their draft antitrust statute (at 266) as 'the persistent ability of a person, or of a group of persons whether or not acting pursuant to agreement or conspiracy, to restrict output or determine prices without losing a substantial share of the market, or without losing substantial profits or incurring heavier losses, because of the increased output or lower prices of rivals.' See also Commission de la Communauté économique européenne, *Le problème de la concentration dans le marché commun* 25 (Brussels, 1966).

⁴ See Gideon Rosenbluth, 'Measures of Concentration', in Universities-National Bureau Committee for Economic Research, *Business Concentration and Price Policy* 57, 87–88 (Princeton, NJ: Princeton UP, 1955); Maxwell R. Conklin and Harold T. Goldstein, 'Census Principles of Industry and Product Classification, Manufacturing Industries', in *id.* at 15; Edward H. Chamberlin, 'Measuring the Degree of Monopoly and Competition', in Chamberlin (ed.), *Monopoly and Competition and Their Regulation* 262 (London: Macmillan, 1954); Clair Wilcox, 'On the Alleged Ubiquity of Oligopoly', 40 *Am. Econ. Rev.* 67 (1950); M. A. Adelman, 'The Measurement of Industrial Concentration', 33 *Rev. of Economics and Statistics* 269 (1951); Eugene Singer, 'The Structure of Industrial Concentration Indexes', 10 *Antitrust Bull.* 75 (1965). Detailed discussion is also to be found in Jacques Houssiaux, *Le pouvoir de monopole* 98–135 (Paris: Sirey, 1958); Christian Marfels, 'A Guide to the Literature on the Measurement of Industrial Concentration in the Postwar Period', 31 *Zeitschrift für Nationalökonomie* 483 (1971); H. W. de Jong, *Dynamische concentratietheorie* 22–62 (Leiden: Stenfert Kroese, 1972).

⁵ In the United States, for instance, the Census of Manufactures carried out by the Bureau of the Census is used for a variety of purposes, so these points cannot always be taken into account in its compilation. Statistical notes on the Census figures have been made by Eugene Singer, 'Census Concentration Data: A Critical Analysis', 10 *Antitrust Bull.* 851 (1965).

⁶ See, e.g., Adelman, *supra* note 4, at 272–73, and John M. Blair, 'The Measurement of Industrial Concentration: A Reply', 34 *Rev. of Economics and Statistics* 343 (1952).

statistics. The main objection to the use of this variable, however, is that it does not take account of transactions within a vertically integrated company, which are important in the measurement of overall concentration.⁷ There are no such objections to value added.⁸ However, statistical measurement of the index may be difficult when more than a single good is produced by a single production process. Only where there is a quantifiable technical link between volume of production and utilization of raw material for each good can value added by manufacture be assigned to individual goods. This is why value added is not yet widely used as an index. The difficulty may be less troublesome in a country whose turnover-tax system is based on gross value added, but then there is the likelihood of inaccurate figures being supplied for reasons of tax avoidance or evasion. Figures based on profits obviate this difficulty, but there is the major additional drawback that profit data are only published for a corporation as a whole; consequently, broad industry groupings must be used if misstatement is to be avoided in the case of diversified (conglomerate) companies.⁹ A second major distortion may arise where a firm belongs to a multinational group whose internal pricing is designed to ensure that group profits are taxed in countries where taxation is low.

A third problem relates to the fact that national concentration figures are not reliable where they do not include imports (particularly distorting for countries with a high rate of imports). Furthermore, the geographic market for some products may either extend beyond the national frontiers or be smaller than the national territory.

The fourth and last problem to which we must draw attention is the selection of the measure of concentration. In the United States the 'concentration ratio' is generally used, which gives the percentage of the selected variable accounted for by a specified number (normally four, eight, twenty) of the biggest firms. The drawback to this method is that it does not show the size distribution within each group of companies. And it makes a great deal of difference whether the leading firms in an industry are very unequal in size or the size distribution is fairly symmetrical: any given sales figure for the biggest firms can cover a number of completely different competitive situations. There are considerable disadvantages attaching to other statistical measures too – the Lorenz curve and the Gini coefficient, for instance; but discussion of this would be going outside our province.¹⁰ However, we should not be excessively concerned about these technical difficulties in examining figures on industrial concentration as long as we exercise sufficient caution. Most of the statistical problems involved in measuring concentration arise in the interpretation of the trend of concentration figures over time; we shall be coming back to this in Chapter 6.

The unmistakable impression is that corporate concentration is anything but a rare phenomenon. This is especially true of industry in the United States, for which both historical series and an abundance of fairly recent statistical material are to hand. The first great combination movement in the United States ran its course as long ago as the end of the nineteenth century, and there have been several others since. This has had an impact on both industry and overall concentration. About one fourth of all manufacturing in 1970 was carried on in what can be termed highly concentrated industries, i.e. in which the four largest companies accounted for more than 50 percent of the value of shipments. These industries rank among the most vital of the American economy. In 33 of the 125 industries belonging to this group, which supply just under 9 percent of total manufacturing output, the four-firm concentration ratio was as high as 75 percent or more.¹¹ For earlier years, comparable conclusions can be drawn from other statistical sources, though the figures may be different depending on the concentration index used.¹² One noteworthy structural feature of a number of these highly concentrated manufac-

⁷ Adelman, *supra* note 4, at 272. See also Tibor Scitovsky, 'Economic Theory and the Measurement of Concentration', in Universities-National Bureau Committee for Economic Research, *op. cit. supra* note 4, at 101, 110-11; Betty Bock and Jack Farkas, 'Comparing Shipments and Employment Concentration Ratios', *The Conference Board Record*, Oct. 1964, p. 19.

⁸ Value added has, however, the additional difficulty that it incorporates wage increases, and this may disturb the statistical comparison if there is a long time span between the two sets of concentration figures being compared.

⁹ See the Statement of John M. Blair, Chief Economist, Subcommittee on Antitrust and Monopoly, in Hearings before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary, 89th Cong., 1st Sess., *Economic Concentration* Pt. 4: 'Concentration and Efficiency', at 1551 (1965) [hereinafter cited as *Economic Concentration*].

¹⁰ For detailed discussion see Houssiaux, *op. cit. supra* note 4, at 148-77, and the literature cited therein. The concentration curve and related measurement techniques are also explained in detail in John M. Blair, 'Statistical Measures of Concentration in Business', 8 *Bull. of the Oxford Institute of Statistics* 351 (1956).

¹¹ Bureau of the Census, *Annual Survey of Manufactures, 1970: Value-of-Shipments Concentration Ratios, M70(AS)-9* Table 4 (Washington, DC: Government Printing Office, 1972).

¹² David R. Kamerschen, 'Changes in Concentration in American Manufacturing Industries', 127 *Zeitschrift für die gesamte Staatswissenschaft* 621, Table 5, at 632 (1971), calculates that the proportion of manufacturing value added originating in industries with four-firm concentration ratios of 50% or higher was 33.1% in 1963 but 28.6% in 1966. See also *id.* Tables 10 and 11, at 636. However, care should be taken in drawing conclusions on the trend of industry concentration in manufacturing in the United States. See Chapter 6 *infra* for fuller information and discussion of this point. See also the Statement of Willard F. Mueller, Director, Bureau of Economics, Federal Trade Commission, in *Economic Concentration*, 88th Cong., 2d Sess., Pt. 1: 'Overall and Conglomerate Aspects', at 112-23 (1964).

turing industries is the presence of one firm that is much bigger than its competitors; in a large number of moderately concentrated industries no such sharp asymmetry is found.¹³ The level of overall concentration is fairly high too. The share of the two hundred largest American manufacturing corporations in total manufacturing assets was 58.7 percent in 1967.¹⁴ Taken by size of assets, the 272 corporations with assets of \$250 million or more held 64 percent of the total assets of manufacturing corporations in the first quarter of 1968 and 69 percent of all manufacturing corporation profits. But 28 percent of these corporations, with assets of \$1 000 million and over, representing 67 percent of the total assets of the 272 corporations, earned 71 percent of their profits.¹⁵ A similar picture is obtained from value-added figures published by the Census Bureau, which show that in 1970 the fifty largest manufacturing companies accounted for 24 percent of total value added by manufacture, the hundred largest companies for 33 percent and the two hundred largest for 43 percent.¹⁶

Although large firms were not unknown in Europe in the past, and a considerable number of big companies have grown up in modern times, industrial concentration in European, as opposed to American, industry has been very modest for many years. It is not our task here to explore the reasons for this, but the American economist Bain may well be right in seeing in widespread cartelization a major contributing factor toward what he considered, a number of years ago, to be the existence of many plants of suboptimal scale.¹⁷ Particularly since 1966, however, industrial concentration in Europe has accelerated considerably. The concentration movement that we have been witnessing over the past few years has now reached sizable proportions, even by American standards, so that Bain's observations probably no longer apply. The main reason for this recent increase in concentration has been anticipation of and reaction to the creation of a common market for goods and services among the member countries of the European Economic Community, which has influenced the trend in European countries outside the Community as well. Increasing competition from large American and Japanese corporations is another factor causing European firms to broaden their financial base in order to keep up in the field of research and development. Although the initial reaction of firms in some lines of business to the establishment of this common market was reflected in something of a trend toward restrictive agreements, these were no more than tentative means of adapting to the structural exigencies of a growing market. For one thing, agreements already concluded in EEC countries have lost much of their effect now that frontiers are being opened up. And then the ban on restrictive agreements incorporated in the treaties setting up the European Communities is also likely to help convince

businessmen that such agreements are not very reliable devices for shielding their markets.

Unfortunately, for most European countries either reliable statistical data are not available at all or such statistics as *are* available leave large segments of the economy uncovered.¹³ The results of the industrial census published by the Statistical Office of the European Communities provide the only comparative figures we have on industry concentration in the six original EEC

¹³ See Federal Trade Commission, *Report on the Concentration of Productive Facilities, 1947* Table 3, at 21 (Washington, DC: Government Printing Office, 1949), and *Industrial Concentration and Product Diversification in the 1000 Largest Manufacturing Companies, 1950* (Washington, DC: Government Printing Office, 1957).

¹⁴ Cabinet Committee on Price Stability, *Staff Studies*, Study Paper No. 2: 'Industrial Structure and Competition Policy', App. Table 1, at 92 (Washington, DC: Government Printing Office, 1969).

¹⁵ *Id.* App. Table 2, at 92.

¹⁶ Bureau of the Census, *op. cit. supra* note 11, Table 1. More information on this subject is given in Chapter 6 *infra*.

¹⁷ Bain shares the standard American view of cartelization, which is not always so very wide of the mark, suggesting that in most of the countries he studied it might be 'performing its historically typical function of controlling or dividing markets in such a way as to create havens for inefficiently small or technologically lagging plants....' Joe S. Bain, *International Differences in Industrial Structure* 146-47 (New Haven, Conn.: Yale UP, 1966). See also Frederic L. Pryor, 'An International Comparison of Concentration Ratios', 54 *Rev. of Economics and Statistics* 130 (1972).

¹⁸ For France, see the Statement of Prof. Jacques Houssiaux in *Economic Concentration*, 90th Cong., 2d Sess., Pt. 7: 'Concentration outside the United States', at 3583, 3590 (1968), and Annexes thereto in Pt. 7A: 'A Compendium of Supplementary Material'. Concentration data up to 1954 are to be found in Houssiaux, *op. cit. supra* note 4, at 336-92. For Germany, see Deutscher Bundestag (ed.), *Bericht über das Ergebnis einer Untersuchung der Konzentration in der Wirtschaft*, Bundesdrucksache IV/2320 (Bonn, 1964), and the Statements of Dr. Eberhard Günther, President, Bundeskartellamt, Berlin, and Prof. Helmut Arndt, Full Professor of Economics, Director of the Institute for Research on Concentration, Free University of Berlin, in *Economic Concentration* Pt. 7, at 3468 and 3486 respectively. For Italy, see the Statement of Prof. Giorgio Bernini, School of Political Science, University of Padua, in *Economic Concentration* Pt. 7, at 3552, and Milena Boni and G. M. Gros-Pietro, *La concentrazione industriale in Italia* (Turin: Angeli, 1967). For the Netherlands in particular and the Common Market in general, see the Statement of Associate Prof. H. W. de Jong, Europa Instituut, University of Leiden, in *Economic Concentration* Pt. 7, at 3608. See also de Jong's remarks on concentration movements in European industry in *Ondernemingsconcentratie* (Leiden: Stenfert Kroese, 1971). For Britain, see Richard Evelyn and I. M. D. Little, *Concentration in British Industry* (Cambridge: Cambridge UP, 1960); P. E. Hart and S. J. Prais, 'The Analysis of Business Concentration: A Statistical Approach', 119 *J. of the Royal Statistical Soc'y* 150 (1956); William G. Shepherd, 'A Comparison of Industrial Concentration in the United States and Britain', 43 *Rev. of Economics and Statistics* 70 (1961). Useful information can also be found in the lists of leading firms, modeled on *The Fortune Directory*, published annually by *Entreprise* in France and *The Times* in Britain.

countries, and they cover 1963 only.¹⁹ On overall concentration, the explanatory memorandum to the European Commission's recent merger-control proposal states that the share of the hundred largest industrial firms in total sales by manufacturing industry rose from 26 percent in 1953 to 50 percent in 1970 in the United Kingdom and from 34 percent in 1954 to 50 percent in 1969 in Germany. The degree of concentration is said to be lower in France and lowest of all in Italy.²⁰

No doubt owing to the impressive increase in concentration in recent years and to the more penetrating glare of publicity and the consequently heightened awareness of the issues involved, there has recently been considerable discussion in Europe – as there has for decades in the United States – about the concentration phenomenon. This is a fact of economic life on which there is much diversity of opinion, and it is regularly discussed from the most disparate viewpoints. Concentration is generally observed with mixed feelings, especially when discussion turns to the big firm and the influence it inherently exerts. Depending on the views of the observer, aversion or admiration may be aroused by the various facets of corporate size; hardly any other economic subject has given rise to so much controversy.

Because it is undoubtedly the most common form of economic power, and because it is the easiest to define in concrete terms, market power is the aspect of the phenomenon which attracts most attention. Discussion is generally limited to manufacturing and banking, mainly because the statistical information available relates for the most part to these sectors – both in the United States and in Europe.

One aspect of market power that is currently under discussion is its relation to the quality of market performance (the microeconomic benefits accruing from competition). Among the different opinions that are held on this point, let us take the two extremes. On the one hand there are those economists who see maximum freedom of action of all market participants as essential to a properly operating competitive system, as a basis on which the market mechanism can do its job. They point out that where one firm or a group of firms collectively can exert a substantial influence on the market, the corollary is that the other participants in that market will not have the freedom required to keep the former in check. This will have an adverse effect on market performance, reflected in excessive profits, hesitancy in introducing new products or production processes that will cut down costs, or other features of noncompetitive behavior. Even where a firm's performance is good, this may not last if there are insufficient corrective market forces in the event of the firm deciding to reduce its exertions.²¹ Other economists, however, stress the dynamic role that can be played by the big firm which has sufficient

resources to build up a fine research department and can afford to develop new products. They consider some degree of market power constitutes a healthy environment for economic growth, for unrestrained competition (price wars and the like) absorbs too much of the market participants' energy wastefully and limits the prospects for above-normal profits when developing new products.²²

Then there is the discussion on the consequences of economic power for attainment of economic-policy targets. Big firms are one of the major growth factors in the modern economy, but their decisions may substantially interfere with other economic-policy goals of the government, as in the fields of prices and incomes, monetary policy, employment and taxation. Closely allied to this is the fact that since the way in which the government handles its policy instruments in order to attain these targets may conflict with firms' interests, disturbance of the working of the market mechanism by private economic power may considerably interfere with the aims the government pursues in using its policy instruments. This implies that government must either co-operate with business on a voluntary basis or take steps that have a direct impact on the freedom of transactors.

Finally, the influence of economic power on the international scene is becoming more and more a topic of discussion, not only as a result of a number of instances of political interference but also because of its economic impact. The economic repercussions of decisions by multinational companies to invest in foreign countries are increasingly felt all over the world; they have notably led in the United States to protests from labor unions about the employment effects and the export of technology and capital that they engender. The reactions in the receiving countries are mixed – generally positive as far as

¹⁹ Office Statistique des Communautés européennes, 'Résultats définitifs de l'enquête industrielle de 1963', *Etudes et enquêtes statistiques 1969-2* (Brussels and Luxembourg, 1969).

²⁰ Commission document COM(73)1210 final, mimeographed (Brussels, 18 July 1973). For further and fuller details of the situation in the Community we shall have to wait for the publication of studies on a number of industries recently put in hand by the Commission. See Commission of the European Communities, *Reports on Competition Policy* Pt 3 (Brussels and Luxembourg, 1972-74) and *Rapport sur la capacité concurrentielle de la Communauté européenne* Pt. 2 (Brussels, 1971).

²¹ See, e.g., Wilhelm Röpke, *Jenseits von Angebot und Nachfrage* (Erlenbach-Zürich and Stuttgart: Rentsch, 1958); Walter Eucken, *Grundsätze der Wirtschaftspolitik* (Tübingen: Mohr, 2d ed. 1955).

²² See, e.g., Joseph A. Schumpeter, *Capitalism, Socialism and Democracy* (New York: Harper, 3d ed. 1942); J. K. Galbraith, *American Capitalism* (Boston: Houghton Mifflin, rev. ed. 1956) and *The Affluent Society* (Boston: Houghton Mifflin, 1958).

the economic impact of foreign direct investment is concerned, but negative as soon as aspects of foreign domination of the national economy come into play. Much less generally discussed are the harmful effects on the terms of trade of primary-producing countries if the buyers of raw materials possess so much market power that their actions can have an appreciable influence on the price level of raw materials and hence on the income of these countries. Since both production and manufacture are often in the hands of integrated firms, this makes them to a large extent immune when prices of raw materials fall because the prices of processed products will not fall as far. On the other hand, the prices of the industrial goods that the primary-producing countries consume may be determined by these manufacturers.

Economic power can also affect the function of competition within the context of the organization of society. Advocates of freedom of competition hold that the principle of equal opportunity must be considered an expression of democratic freedom in the economic field as well. In their view, economic power that hinders anybody from taking part in the economic process is liable even to imperil the rule of law and democratic freedoms.²³

In view of the diversity of these problems, no comprehensive judgment of the issue is possible. This has its repercussions on policy in the difficulties that arise when it comes to making recommendations as to what policies should be followed: nothing meaningful can be put forward if each separate aspect has not been properly investigated. The present study is confined to the influence of concentration on the competitive system; it is premised on the view that, but for a few exceptions, the optimum degree of competition attainable (depending on the market context) provides the best guarantee not only of microeconomic benefits but also of the attainment of macroeconomic targets and that exclusion or distortion of competition by public or private action must be checked. The importance that the governments of most private-enterprise countries attach to the protection of competition when called upon to act against the concentration of economic power also underlines the significance of the competition aspect. Most of the measures taken come under the head of rules regarding market conduct or competition policy proper (what is known as antitrust policy in the United States), for competition law does enable direct and selective action to be taken on the market. Indirect action on the market mechanism – competition policy in the wider sense – is much less frequent; this category includes policies aimed at narrowing the gap between small and big business or directly curbing the growth of large firms.

This book has two main purposes. The first is to formulate a series of criteria whereby actual competitive situations can be judged. This will be done

on the basis of insights drawn from economic theory and of practical experience obtained in the enforcement of competition laws. We refrain from developing a new theory of entrepreneurial behavior in concentrated market circumstances, preferring to take from existing theory those elements which we find to be usable in practice. Our second purpose is to examine the capabilities and limitations of antitrust policy in respect of the regulation of economic power. In so doing we limit ourselves in two respects. First, no serious attempt can be made to elaborate theoretical policy norms since not only economic but also legal, sociological and even psychological considerations need to be taken into account: antitrust policy should be seen from all these angles. Second, it will often be necessary to steer a middle course between the wish for simpler tests frequently voiced by the enforcement agencies and the need to make a full economic analysis (though analysis should not be taken to extremes since an effective competition policy must obviously allow for some margin of uncertainty).

Competition policy proper varies considerably from one country to the next, but one of the earliest and most comprehensive attempts to legislate in this field was made in the United States. Here, the problem of industrial concentration has been given a central position in the antitrust laws, which are extremely broad in scope. First of all, they contain rules concerning market power; in essence, the laws are designed more to prevent the creation, extension or protection of market power than to combat abuse. The prohibition of 'monopolization' under Section 2 of the Sherman Act is in some ways akin to legislation against abuse, but the concept of monopolization is much wider, and dissolution may be ordered where a firm is held to have infringed the Act. In the second place, the provisions outlawing certain business practices (such as price discrimination and exclusive dealing) whose effect may be 'substantially to lessen competition' (Sections 2 and 3 of the Clayton Act) are frequently directed against firms with market power because their conduct

²³ See, e.g., F. A. Hayek, *The Road to Serfdom* (Chicago: University of Chicago Press, 1944); Franz Böhm, *Wettbewerb und Monopolkampf* (Berlin: Heymann, 1933), *Wirtschaftsordnung und Staatsverfassung* (Tübingen: Mohr, 1950) and 'Demokratie und ökonomische Macht' (published with Eng. transl. 'Democracy and economic power'), in International Conference on Restraints of Competition (Frankfurt on Main, June 1960), *Cartel and Monopoly in Modern Law* 3-24 (Karlsruhe: Müller, 1961); Corwin D. Edwards, *Maintaining Competition* (New York: McGraw-Hill, 1949); Edward S. Mason, in Dexter M. Keezer (ed.), 'The Effectiveness of the Federal Antitrust Laws: A Symposium', 39 *Am. Econ. Rev.* 689, 712-13 (1949). Similar views are expressed in Hans von der Groeben, *Competition Policy as Part of Economic Policy in the Common Market: Address to the European Parliament on 16 June 1965* (Brussels: EEC Commission, 1965).

is more likely to have the proscribed effect. A third and currently the most important aspect of the antitrust laws is concerned directly with the number of market participants and their relative sizes. Section 7 of the Clayton Act prohibits mergers and other forms of combination leading to a substantial lessening of competition. In this field, the United States has more statutory facilities than other countries for controlling or preventing mergers from which anticompetitive effects are deemed to flow. As we read in a recent OECD report, 'the threshold where mergers are considered to be illegal or against the public interest is in all cases substantially higher than in the United States.'²⁴

The antitrust laws of other countries dealing with market power are generally more modest in scope than those of the United States. Apart from that, they are of much more recent date and there has been relatively little practical experience of enforcement.²⁵

Given the vast experience that the Americans have acquired in the field of competition policy in respect of concentration, this study deals at length with the American antitrust experience in regulating economic power. In the case of a book directed, as this one is, mainly to the European reader, it may be objected that the American approach is based on legal principles that differ in some degree from those generally accepted in European countries and that the usefulness to Europeans of a study of American antitrust policy is sharply reduced by the differences in the extent of concentration and in economic structure between the two continents. But we do not believe that too much weight should be attached to these objections. The main purpose of examining American antitrust policy is to facilitate recognition of the practical problems inherent in regulating industrial concentration and diagnosis of potential remedies. Another point is to consider how far European legislation in this field should draw upon American antitrust experience. We are not of the opinion, often heard in business and governmental circles in Europe, that the differences between the economic and legal systems of the United States and Europe are far too great for this to be relevant.

Finally, it must be borne in mind that because of the growing influence of multinational corporations – and this is unlikely to diminish in the years ahead – there will be an increased need for the European Community and the United States to learn from each other's experience and to adapt their policies accordingly.

The organization of this study follows the pattern suggested above. In Part 1 we examine the phenomenon of concentration and attempt to formulate a judgment from the economist's standpoint. Part 2 is given over to an exposition and appraisal of American antitrust law in relation to concentration.

And in Part 3 we take the conclusions arrived at in Parts 1 and 2 as the starting point for a wider discussion of our basic theme – the capabilities and limitations of policy concerning concentration in the United States and Europe.

²⁴ Organization for Economic Cooperation and Development, *Market Power and the Law* 94 (Paris, 1970).

²⁵ A detailed survey of the relevant statutes and case law in OECD member countries is contained in the report cited *supra* note 24.

PART 1

INDUSTRIAL CONCENTRATION AND COMPETITION: AN APPRAISAL

In the first part of this study we shall discuss the basic implications of the process of industrial concentration for competition and the economy as a whole and try to formulate criteria on which to essay an appraisal. First of all, in Chapter 2 we shall give our attention to the major factors determining concentration. We shall then go on in Chapter 3 to analyze and assess the impact of concentration on competition.

CHAPTER 2

FACTORS DETERMINING CONCENTRATION

2.1 INTRODUCTION

At the outset, some comment should be made on the forms of corporate growth. When a firm's expansion is effected through investment of its own or borrowed capital, we speak of internal growth. External growth is the term used to describe expansion through a permanent link with one or more other firms, their previously separate facilities being brought under single management. External growth can take a variety of legal forms, the three best known being consolidation, merger (acquisition, takeover) and the joint venture. In a consolidation, the firms involved are absorbed in a new corporate unit and lose their former legal identities. In the various forms of merger, one of the firms survives and the other or others involved lose their corporate existence. In a joint venture, two or more parent companies set up a joint subsidiary, each of them normally owning an equal share of the subsidiary's stock and remaining an independent entity. What is important for an appraisal of concentration is not so much the legal form of combination chosen as the subsequent behavior of the firms involved toward each other once they are under single management – whether there is still any degree of competition between the constituent firms or whether they act as a unit. Although merger, technically, is only one of the forms of combination, the term is regularly used to cover all types of external growth other than the joint venture, and it is in this sense that we shall generally be employing it.

Various motives may weigh in favor of growth by the merger route. In the first place, the business community usually claims that merger is a peculiarly suitable means of adjusting to changes in market circumstances. This type of motive seems to be particularly predominant in the current merger movement in Europe in that mergers are being used to adapt firm size to an increase in the geographical extent of markets or to provide better defense against competition from foreign firms. A number of considerations come into play here. To begin with, merger enables a company to avoid part of the uncertainty inherent in any extension of business activities and therefore

to reduce investment risks. Especially when a company wishes to expand into new production fields, merger has the important initial advantage that an operating organization that has already proved itself is acquired. Secondly, merger may save time in the expansion of a firm's production facilities, and this can be important when expansion has to be carried through quickly – though it should not be overlooked that the effective integration of the acquired firm into the operation of the acquiring company may take a long time as well. A third and probably the most important competitive advantage that may cause a firm to prefer an external form of growth is the desire to obtain better access to nonfinancial productive resources and the economies accruing from all sorts of financial benefits that are linked with the merger. Acquiring suitable workers, managerial talent, well-developed production and marketing facilities, names or techniques may be a considerable incentive to a merging firm. Apart from this, there may be pecuniary advantages in the form of cheaper access to certain inputs. However, the financing advantages that may accrue from merger are generally considered the most important. Merger may give a firm access to funds on easier terms and so help it to engage in expensive capital projects. This argument for merger is frequently advanced in European industry, usually with reference to the expansion of research facilities.¹ And the sharp rise in the price of capital since 1945 has made it attractive to acquire firms with liquefiable assets. As certain of the factors that are adduced here can also be ascribed to the advantages that may fall to a firm because of its size, we will go into this in more detail in section 2 below.

Another motive may be the fact that restrictive agreements between competitors are prohibited, so that firms seeking to restrain trade between themselves have to resort to merger. But evidence is very scarce. Only in the United States, where Supreme Court rulings in cases involving agreements among competitors left no room for doubt that restrictive agreements were *per se* in conflict with the Sherman Act,² is there evidence that this motive obtained.³ But even before the Sherman Act was passed, agreements in restraint of trade had been void at common law. Thus restrictive agreements have never played a part in the American economy comparable with that they have played in a number of European countries, with the exception perhaps of trade restraints between the owners of small firms of only local importance.

A further point is that the creation of new production capacity may invite competitive bidding for additional sales as well, possibly resulting in price reductions and lower profits to all, whereas the purchase of additional market shares, as far as it leaves supply intact, reduces this risk.

Again, if economic power is a firm's objective, it can be attained much more

efficiently by external growth than by internal growth. One way of checking the accuracy of the assertion that the incentive of making monopoly profits should be regarded as one of the major causes of combination is to examine the impact of corporate combination on market structure. In an article published in 1935 Shaw Livermore calculated that out of a total of 339 major corporate combinations organized between 1890 and 1904 in the United States, about 155 possessed considerable market power.⁴ An approximately equal number, however, were doomed rapidly to disappear. For the period of intensive merger activity between 1897 and 1903, Stigler reckons that out of the 257 combinations formed, 78 controlled 50 percent or more of the output of their respective industries, 57 controlled 60 percent and over, and 26 had as much as an 80-percent market share. Nelson comes to similar conclusions.⁵ From the relatively large number of combinations which originally produced dominant firms but often were headed for failure within a few years – quite apart from those that enjoyed continued success – we may conclude that the urge to acquire a monopoly position was an important element in the formation of many combinations in the period we are considering. Many of the large companies that grew out of combinations between 1887 and 1904 – including Standard Oil, American Tobacco, US Steel, du Pont, International Harvester, American Can, Corn Products Refining, United Shoe Machinery – still occupy a leading position in their industries. Although the size of these corporations – with the exception of the first two, of course, which in 1911 were split up into a number of firms – has increased many times over since 1900, their present standing in the American economy is a result of the combination movement at the turn of the century.

In this particular period until 1904, corporation law seems to have played

¹ The proprietors of family-owned businesses, however, particularly if they are unincorporated, will frequently prefer not to make room for people outside the family in the management of the company. Very often they allow considerations of this kind to weigh more heavily than the economic advantages that can accrue from external growth, even when they are substantial.

² *US v. Trans-Missouri Freight Ass'n*, 166 US 290 (1897); *US v. Joint Traffic Ass'n*, 171 US 505 (1898); *US v. Addyston Pipe & Steel Co.*, 175 US 211 (1899).

³ See Hans B. Thorelli, *The Federal Antitrust Policy* 258–59 (Baltimore: Johns Hopkins; London: Allen & Unwin; Stockholm: Norstedt, 1954). The question is not discussed in the literature on concentration around 1900.

⁴ 'The Success of Industrial Mergers', 50 *QJ Econ.* 68 (1935).

⁵ George J. Stigler, 'Monopoly and Oligopoly by Merger', 40 *Am. Econ. Rev.* 23 (1950, Proceedings). Ralph L. Nelson, *Merger Movements in American Industry, 1895–1956*, at 102 (Princeton, NJ: Princeton UP, 1959), notes: '... it might not be too misleading to place the actual share of disappearances into market-leading firms as high as two thirds of all merger disappearances, and the share of such firms' capitalizations as high as three fourths or four fifths of all merger capitalizations.'

a role as well by allowing corporations to acquire stock. For the formation of trusts and holding companies may offer considerable advantages over merger proper, either because it can be effected more quickly and simply, or because less capital is needed to acquire control over the decision-making process of another corporation than would be the case with a takeover. Thus trusts and holding companies became the ideal means of attempting to gain control of the market. When the Supreme Court ruled in *Northern Securities* in 1904 (discussed in Chapter 4) that combinations of this kind were illegal, this was one reason why that particular stage in the development of corporate combination came to an end. In this case there seems to have been a clear link between the use of a specific form of combination and the proportions of the combination movement, but this need not be universally so.

The sharp increase in corporate income tax since 1945 has been a major stimulus for mergers, particularly conglomerate ones, since they enable low profits or losses to be set off against high profits in order to cut down tax liability.

Although nothing (to our knowledge) has been published on this aspect, purely personal motives were undoubtedly instrumental in many mergers both before and after 1945, especially where small firms were involved. Predominant among the motives of owners of small businesses when they sell their companies to big corporations – in addition to the avoidance of estate taxes – are the lack of suitable successors and the steadily growing complexity of running a business. Apart from those proprietors of small businesses who solve their management problems by merger, there are countless others who feel no need to expand because they do not think they could take on a more complicated task. Both of these factors lead directly or indirectly to a reinforcement of the position of big business in the economy.

Finally, external growth may be preferred because it provides a vehicle for obtaining incidental financial benefits. Profits from speculation, made possible by an active and booming stock market, were a major ingredient in the merger movements in American industry, first during the years 1887 to 1904 and a second time from 1921 to 1929. One of the basic reasons for this was the high level of business activity, which could be evidence of a positive relationship between the business cycle and merger activity.⁶ The absence of mergers between 1904 and 1921, for instance, was largely due to the fact that low stock prices discouraged speculation. Another factor, instrumental to the first, was the leading role of promoters, who were often prominent bankers, in the organization of corporate combinations. Apart from taking their promotion fee, the banks often issued stock in the new corporations for their own account. So that these issues might succeed, it was essential that market conditions

should be stabilized beforehand in order that large profits could be promised to stockholders. And if the combinations proved to be a success, these bankers could reap part of the monopoly profits themselves. The stock issued was often well in excess of the tangible assets of the corporations; gross overcapitalization, causing a 'watering' of the stock of the combined undertaking, was a feature of the formation of US Steel by J. P. Morgan and his associates in 1902, for instance.⁷

In view of these advantages of external growth over internal growth for the individuals and firms involved, it seems likely that the expansion of a great number of corporations would have been much slower and more modest if there had been no opportunity for external growth.⁸ This is shown, for instance, by the rather important part that merger and other forms of external growth have played and do play in the formation and growth of most of the big American and European corporations.

Much more has been written and published about corporate combination in the United States than in Europe. This is partly because of the vast interest in the subject that has been shown by the press and public opinion in the United States, as well as by the specialists, since the first great wave of combination swept across American industry at the close of the nineteenth century. The literature has grown to considerable proportions particularly since anti-

⁶ J. Fred Weston, *The Role of Mergers in the Growth of Large Firms* 75-81 (Berkeley and Los Angeles: University of California Press, 1953), tried to work out a merger cycle and succeeded in showing a satisfactory correlation between the number of mergers and the business trend for the period 1919-47. Nelson, *op. cit. supra* note 5, at 110-11, also found a relationship between the turning points of merger cycles and business cycles. For the dairy industry, see the Statement of Willard F. Mueller, Director, Bureau of Economics, Federal Trade Commission, in *Economic Concentration*, 89th Cong., 1st Sess., Pt. 2: 'Mergers and Other Factors Affecting Industry Concentration', at 506 (1965). See also the more recent Staff Report of the Federal Trade Commission, *Economic Report on Corporate Mergers* 71-85, published as Pt. 8A of *Economic Concentration*, 91st Cong., 1st Sess. (1969); H. W. de Jong, *Dynamische concentratietheorie* 252-70 (Leiden: Stenfert Kroese, 1972).

⁷ Eliot Jones, *The Trust Problem in the United States* 269 (New York: Macmillan, 1921), finds evidence in cases of overcapitalization for his thesis that the promoters anticipated monopoly gains. See also Jeremiah W. Jenks and Walter E. Clark, *The Trust Problem* (Garden City, NY: Doubleday, Doran, 1917; Henry R. Seager and Charles A. Gulick, *Trust and Corporation Problems* (New York: Harper, 1929). For more recent discussion, see Thorelli, *op. cit. supra* note 3, at 68-72; Jesse W. Markham, 'Survey of the Evidence and Findings on Mergers', in Universities-National Bureau Committee for Economic Research, *Business Concentration and Price Policy* 141 (Princeton, NJ: Princeton UP, 1955); Stigler, *supra* note 5, at 23; Nelson, *op. cit. supra* note 5; Donald L. Kemmerer and C. Clyde Jones, *American Economic History* 313-15 (New York: McGraw-Hill, 1959); Chester W. Wright, *Economic History of the United States* (New York: McGraw-Hill, 2d ed. 1949).

⁸ See J. Fred Weston and Stanley I. Ornstein (eds.), *The Impact of Large Firms on the US Economy* Ch. 1 (Lexington, Mass.: Heath, Lexington Books, 1973),

trust laws were first enacted. Another reason is that the combination movement set in a good deal sooner in the United States than in Europe. Economic historians generally distinguish three periods during which combinations were particularly numerous in the United States: from 1887 to 1904 (with a peak between 1897 and 1904), from 1919 to 1930, and since the closing years of World War II. In this last period, two phases can be distinguished: one from 1943 to 1947 and one starting in the early 1950s and becoming particularly intensive, in terms both of the number of mergers and of aggregate assets acquired, since 1965. In this last phase, the total number of manufacturing and mining mergers increased from 219 in 1950 to 835 in 1959, a level at which it remained until 1964; it passed the 1 000 benchmark in 1965 and went as high as 2 407 in 1968. Since then, the number of recorded mergers has fallen (appreciably since 1970) and seems to be under 1 000 again at the time of writing. The country's largest industrial corporations have been particularly active as acquirers during these years. A large proportion of the acquired companies were relatively small firms; but acquisitions of medium-sized and large firms, though much smaller in number, represented by far the greater part of all acquired assets.⁹

Mergers between competitors were predominant during the first wave, stimulated as they were by financial considerations such as the desire for monopoly profits and supported by institutional factors such as a well-developed capital market and the promoters. In the second period, and more so even in the third, the urge to dominate markets was relegated to a position of secondary importance, chiefly because firms came to realize that it requires a great deal of effort to maintain a dominant position, but also because of the influence of public opinion and antitrust policy. The first phase and the beginning of the second phase of the third merger period were characterized by horizontal mergers between small companies in already concentrated markets and between firms in industries where concentration was relatively low, such as textiles and food manufacturing. There were a few vertical mergers, but a growing number of combinations were of the conglomerate type. In the course of the 1960s conglomerate mergers advanced in importance. The decline in the number of horizontal and vertical mergers was rather spectacular, and their combined share in total assets acquired may well have fallen below 10 percent recently. The number of conglomerate mergers accordingly increased in this period. Before 1960 the predominant type of conglomerate merger was the product- and market-extension merger. Product-extension mergers involve companies that are functionally related in production and/or distribution but sell products which are not direct competitors; market-extension mergers link companies that manufacture the same products but sell

them in different geographic markets. After 1960 'pure' conglomerate acquisitions, involving essentially unrelated firms, rapidly increased and came to represent the majority of all mergers. To illustrate this growth in diversification, particularly among the largest firms, a recent staff report of the Federal Trade Commission states that 44.5 percent of the two hundred largest manufacturing firms in 1950 were in ten or more different four-digit industries; by 1968 the figure had gone up to 73 percent, and at that time 19.5 percent were classified in thirty or more separate industries.¹⁰ This marked conglomerate growth has not so much been concentrated on long-established large firms but has enabled relatively new and unknown firms to join the ranks of the hundred largest manufacturers in the United States.

The American sources available – particularly those relating to recent years – hardly provide enough material on which to base a proper judgment of the extent to which mergers have been successful. We mentioned earlier the failure of many combinations formed during the first merger wave, a result which is not surprising as the prevailing motive at that time was market dominance, without reference to the basic rules of good management. But there was no guarantee of a combination's success at a slightly later period either: a study of mergers formed between 1900 and 1934 concludes that, in the United States at any rate, only 48.4 percent were a success. In Canada the figure was 41.5 percent.¹¹ Of course, mergers proper will normally be assured of success when they are effected for financial reasons (enhancement of a waning profit margin) which can be thoroughly examined beforehand. On the other hand, the success of consolidations, which are generally found in the small-business sector, may be torpedoed because production facilities are not properly adjusted or because of subjective factors such as the failure of the different managements to get along with each other. While mergers based predominantly on economic considerations came to the fore in the United States after 1950, consolidations seem to have declined in importance. If studies were available for this period, a more positive assessment of the success of combinations could probably be given.

⁹ For details, see Federal Trade Commission, *Conglomerate Merger Performance* 14–18 (Nov. 1972). See also the earlier FTC studies *Current Trends in Merger Activity*, 1971 (May 1972) and *Economic Report on Corporate Mergers*, *op. cit. supra* note 6. For further information on the scope and background of the current merger movement, see Weston, *op. cit. supra* note 6; Weston and Ornstein, *op. cit. supra* note 8; George D. McCarthy, *Acquisitions and Mergers* (New York: Ronald, 1963); Michael Gort, *Diversification and Integration in American Industry* (Princeton, NJ: Princeton UP, 1962).

¹⁰ *Conglomerate Merger Performance* 88–93 (Nov. 1972).

¹¹ L. A. Skeoch, 'Anticombiners Legislation: Does it Prevent Rationalization?', in National Industrial Conference Board, *Problems and Policies in Canadian Manufacturing – A Symposium* 44 (Montreal, 1964).

A number of typical differences distinguish European industry from its American counterpart, particularly as regards the scale of plants and firms, which on the whole is still well below the American level. However, in Europe we are now witnessing a process of reorganizing and consolidating production in bigger plants and firms – mainly to benefit from economies of scale. As was observed in Chapter 1, this process has assumed major proportions in recent years. In the European Community there has been a growing number – in both absolute and relative terms – of intra-Community mergers. And companies from outside the Common Market, especially from the United States and Japan, have been involved in a large number of takeovers and joint ventures. However, as the concentration movement in Europe has not yet had such a penetrating influence on industrial structure as that in the United States, a number of factors which are of particular consequence in the merger waves in that country – quite apart from the typically American aspects involved – have not yet become significant in Europe.

The motives we have discussed so far give us no idea whether or not there are limits of a technical or economic nature to combination. We thus have to ascertain whether economies of scale need to be associated with high to very high concentration levels before the firm or plant can reach minimum optimal size, i.e. the point at which average total costs (the production and selling costs needed to bring the goods to the market) are as low as possible under normal operation and beyond which no further economies of any significance are likely to be obtained. The question is an important one in that if corporate expansion did need to go to this extreme, there would be a fundamental conflict between competition and the requirements of efficient business organization.

2.2 ECONOMIC DETERMINANTS OF CORPORATE GROWTH

In analyzing the reasons behind the growth of a firm, we may usefully distinguish between factors determining the size of the plant or production unit and factors determining the size of the firm.

2.2.1 Factors Determining Plant Size

Both technical and economic factors determine plant size. Production techniques have grown less important in a large number of industries than they were in the past. For instance, the purchase of a steam engine was a costly undertaking, but investment costs became less of a constraint with the introduction of the electric motor and the diesel engine, which no longer necessi-

tated large production units. In other industries, however, production techniques still play a more or less decisive role. Prominent among them are the production of steel, cement, paper and certain chemicals. On the other hand, modern control techniques make it possible to link up a sizable number of large or small production units, so the scale of the plant has no technical limitations.¹²

Among the essential economic factors that determine plant size are the size of the market, infrastructure and the price and availability of factors of production. A firm's market may be confined within natural or artificial boundaries, so the benefits of mass production may be effectively barred. In such circumstances a firm must produce on a smaller scale than is technically optimal. Particularly in industries manufacturing goods for which considerable cost savings can be obtained where the scale of production is large, we may expect the creation of a common market in goods and services in Western Europe to entail an increase of plant size. The scale of a plant may also be influenced by infrastructure factors. This is important in the case of tankers, for example: substantial cost savings appear to be achieved by shipping oil in tankers with a capacity of 200 000 tons and over, but there are only a limited number of ports that will accommodate these vessels. And finally, the price and availability of the factors of production determine substantially different optima under different circumstances.¹³

The determination of the minimum optimal scale of plant encounters a number of specific difficulties as well. Most plants manufacture not a single product but several products, so that the problem of allocation of overheads needs to be solved. And in the case of an assembly plant, the production of the separate parts may be based on different cost curves. One example of this is the automobile industry, where the optimal scale of production seems to be very large for engineering and the pressing of vehicle bodies but relatively

¹² John M. Blair, 'Technology and Size', 38 *Am. Econ. Rev.* 121 (1948, Proceedings), and 'On the Causes of Concentration', in Helmut Arndt (ed.), *Die Konzentration in der Wirtschaft* Vol. 2 (Berlin: Duncker & Humblot, 1960). In his Statement in *Economic Concentration*, 89th Cong., 1st Sess., Pt. 4: 'Concentration and Efficiency', at 1550 (1965), Blair speaks of a 'general tendency . . . for plant concentration to decline'. See also Blair, *Economic Concentration* Chs. 5 & 6 (New York: Harcourt Brace Jovanovich, 1972). For developments in the steel industry, see Walter Adams and Joel B. Dirlam, 'Big Steel, Invention and Innovation', 80 *QJ Econ.* 167 (1966).

¹³ See Joseph Steindl, *Small and Big Business* (Oxford: Blackwell, 1946); Hans Otto Lenel, *Ursachen der Konzentration unter besonderer Berücksichtigung der deutschen Verhältnisse* 82-83 (Tübingen: Mohr, 2d ed. 1968).

small for the manufacture of upholstery and assembly work.¹⁴ The optimal scale of production of automobiles is consequently the larger of these two, unless exceeding the lower optimum entails serious diseconomies.

There are only a few studies which attempt to quantify the importance of economies of scale as a factor determining the actual size of the plant. One of the better known is by Joe S. Bain, whose investigations ranged over twenty, mostly large, American manufacturing industries. The industries selected ranged in seller concentration from 'very high' to 'low-moderate', though most of them had 'very high' to 'high-moderate' concentration. The results of Bain's survey show that the importance of plant-scale economies varies widely from one industry to another. The economies, expressed as the percentage of national capacity provided by one integrated plant complex of minimum optimal scale, with allowance made for the shape of the average cost curve for the plant, were unimportant (considerably under 5 percent of total market capacity) in nine industries, 'moderately important' (between 4 and 6 percent) in five industries and 'very important' (over 10 percent) in only two of the twenty industries – automobile manufacturing and typewriter production. Bain observes that the 'market' on which he bases his calculations may be the entire national market or the largest geographic or product submarket, depending on competitive circumstances in each industry. This point must be taken into consideration in any comparison with the situation in Europe.¹⁵

Bain's inquiries led him to conclusions about the shape of the average cost curve on both sides of the minimum point which coincide approximately with what is always assumed in the literature. In a number of industries Bain found that serious diseconomies of suboptimal scale arose only where the scale of production was one fifth or less of the optimum (for soap, petroleum refining, cigarettes, tires and tubes, and liquor distilling, for instance). On the other hand, production costs for automobiles, fountain pens, cement and rayon fiber went up sharply even where plants were only slightly below the minimum optimal scale. With production above the optimum, Bain found no diseconomies, but neither did he find that costs declined to any significant extent. These findings on what happens beyond the optimum point are in line with the conclusions of theory that the average total production cost curve eventually flattens out until it is virtually horizontal. However, it will generally not be profitable for an entrepreneur to try to reap all possible cost benefits, not only because of the risk involved in a substantial increase in fixed costs but also because increased output can often be sold only at ever-decreasing prices – at least if competitors, unwilling to lose their market shares, expand their capacities too. So if a plant expands its technical capacity, it has to make the choice between lower unit costs and taking the risk that it may

not be able to sell its increased production at a profit. The English economist Andrews has added that the curve may rise and fall in waves since economies obtained cause average costs to decline, until the trend is reversed by running in excess of capacity and the variable costs (especially labor costs) go up. With the introduction of a new production technique the average cost curve can then continue its downward movement.¹⁶ And in some industries such as shoe manufacture the curve may be stepped because there are suitable combinations of machines that can be utilized for different scales of production.

Bain's data can of course be criticized for being partly drawn from subjective impressions rather than a truly empirical survey. What is more, his observations date from several years ago. There are now a number of industries in which it seems that the requirement of efficient plant scale leaves room for no more than a few companies. In the industries covered by Bain, technical and economic factors may have raised or lowered the optimum plant size since his study was published. If the results of such studies, then, are to be used as arguments by those who consider the present degree of concentration in manufacturing industry too high, the information must be updated so as to provide thorough knowledge of the extent of plant- and firm-scale economies.

2.2.2 Factors Determining Firm Size

The growth of a firm may be a result of the combination of several plants in one organization or of vertical or conglomerate expansion. A firm that grows

¹⁴ See Caleb A. Smith, 'Survey of the Empirical Evidence on Economies of Scale', in Universities-National Bureau Committee for Economic Research, *op. cit. supra* note 7, at 213, 217. The UK motor industry is instanced by D. Swann and D. L. McLachlan, *Concentration or Competition: A European Dilemma?* 14 (London: Chatham House/PEP, 1967).

¹⁵ Joe S. Bain, *Industrial Organization* 189-97 (New York: Wiley, 2d ed. 1968). See also his 'Economies of Scale, Concentration and the Condition of Entry in Twenty Manufacturing Industries', 44 *Am. Econ. Rev.* 15 (1954), and *Barriers to New Competition* (Cambridge, Mass.: Harvard UP, 1956). Bain's information derived from Census reports, direct industry sources and 'extensive questioning of executives in various firms' in the twenty industries selected. Similar inquiries, though on a smaller scale, yielding comparable results, include Federal Trade Commission, *Relative Efficiency of Large, Medium-sized and Small Business* (Washington, DC: Government Printing Office, 1941); John M. Blair, 'Technology and Size', 38 *Am. Econ. Rev.* 121 (1948, Proceedings), and 'Relation between Size and Efficiency in Business', 24 *Rev. of Economics and Statistics* 125, 135 (1942); Herbert A. Simon and Charles P. Bonini, 'The Size Distribution of Business Firms', 48 *Am. Econ. Rev.* 607 (1958).

¹⁶ Smith, *supra* note 14; Steindl, *op. cit. supra* note 13; Blair, *supra* note 12; J. Viner, 'Cost Curves and Supply Curves', 3 *Zeitschrift für Nationalökonomie* 23 (1931); P. W. S. Andrews, 'A Reconsideration of the Theory of Individual Business', 1 *Oxford Economic Papers* 54 (1949), and *Manufacturing Business* Chs. 3 & 4 (London: Macmillan, 1949).

in either of these ways may do so for reasons of efficiency or for reasons of market strategy or for both. The two are closely interdependent: expansion must be economically justified, because otherwise the firm will sooner or later go out of business (unless, that is, it attains a monopoly position in good time). Seen from the angle of market strategy, the main motive behind expansion is often the urge to exercise a strong influence, if not dominance, not only on a single market but throughout the national economy and even beyond national frontiers. In view of our judgment of corporate growth from the antitrust standpoint in the following chapter, we should investigate what efficiencies there are in the combination of plants. A subsidiary question is whether this process of growth is also subject to technical or economic limits. It is useful to distinguish between the consequences of horizontal combination on the one hand and those of vertical and conglomerate expansion on the other.

The economic advantages of horizontal combination (the multiplant firm) will be seen mainly in the organization of production and in sales. As regards the first of these, complete production units can be specialized in the multiplant firm, each unit being of optimal scale. And any temporary idling of production facilities in one plant can be offset by switching to production of any of the firm's other products that are in need of extra capacity. There may be sales advantages in offering a broader range of products because this generally reduces costs per unit sold and because customers may prefer to buy all they need from a single firm. Furthermore, a bigger sales budget may be made available if shipments are increased – and this in turn will mean more and better sales points and purchasers generally paying greater attention to the product. There may also be managerial economies in multiplant operation in that more efficient management techniques can be selected, though the introduction of cost-saving management techniques cannot go on indefinitely.

However, a number of writers have found that a steady increase in output will not cause average total costs to fall, even if technical production costs per unit of output continue to drop.¹⁷ This would seem to indicate, then, that the economies of the multiplant firm are not very substantial – a conclusion endorsed by writers such as Bain, Blair, Stigler, Edwards, Adams, Schneider and Eucken, who have elaborated on the subject.¹⁸ Hardly any arguments to the contrary are to be found in Sargent Florence, Steindl or Lilienthal, writers who extol the economic advantages of the large-scale firm.¹⁹ There is some empirical support for these observations, such as the reports of the Temporary National Economic Committee and the studies of Blair, Bain and Saving, but the evidence is old. Bain has the merit of having undertaken an investigation on the magnitude of the economies attributable to

multiple-plant operation in twenty American manufacturing industries, excluding advantages of large-scale sales promotion. His conclusion is that only in six of the twenty (cement, steel, gypsum products, shoes, soap and cigarettes) could real economies be attributed to the multiplant firm. In the first three instances they were mainly in the organization of production, in the last three mainly in distribution. In the other fourteen industries, they were either nonexistent or insignificant.²⁰ An attempt by Bain to establish a link between profit margin and the scale of the firm in a number of American industries revealed no significant positive correlation for most industries, though a correlation could be established between industry concentration and the profit margin, a point that will be elucidated in more detail in Chapter 3.²¹ On the other hand, Hall and Weiss found a significant positive correlation between firm size and profitability during the years 1956 to 1962.²² Empirical findings on scale economies, however, may be difficult to compare if the observations are made during different periods.

Even if the introduction of new marketing or management techniques does not give rise to substantial cost savings, other aspects of firm size may give decisive advantages. One of the most important economies that a larger firm may reap is in raising capital. First, the technical costs of obtaining a loan

¹⁷ See Andrews, *supra* note 16, at 75, and *op. cit. supra* note 16; Edith T. Penrose, *The Theory of the Growth of the Firm* 92-95, 261 (Oxford: Blackwell, 1959). Note also the discussion on the 'empty economic boxes' in England between 1922 and 1930.

¹⁸ Bain, *Barriers to New Competition*, *op. cit. supra* note 15; Blair, 'Technology and Size', 38 *Am. Econ. Rev.* 121 (1948, Proceedings); Stigler, *supra* note 5; Corwin D. Edwards, *Maintaining Competition* 113-20 (New York: McGraw-Hill, 1949); Walter Adams, Statement in Hearings before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary, 84th Cong., 1st Sess., *A Study of the Antitrust Laws* 335 (1955); J. M. Clark, *Studies in the Economics of Overhead Costs* (Chicago: University of Chicago Press, 1923); Erich Schneider, 'Real Economies of Integration and Large-scale Production versus Advantages of Domination', in Edward H. Chamberlin (ed.), *Monopoly and Competition and Their Regulation* (London: Macmillan, 1954); Walter Eucken, *Grundsätze der Wirtschaftspolitik* (Tübingen: Mohr, 2d ed. 1955).

¹⁹ Philip Sargant Florence, *Investment, Location and Size of Plant* (Cambridge: Cambridge UP, 1948); Steindl, *op. cit. supra* note 13; David E. Lilienthal, *Big Business: A New Era* (New York: Harper, 1953).

²⁰ *Industrial Organization*, *op. cit. supra* note 15, at 195-97; 'Economies of Scale, Concentration and the Condition of Entry in Twenty Manufacturing Industries', *supra* note 15, at 38-39; *Barriers to New Competition*, *op. cit. supra* note 15, at 89.

²¹ Data for 1936-40 are to be found in 'Relation of Profit Rate to Industry Concentration: American Manufacturing, 1936-40', 65 *QJ Econ.* 293, 322-23 (1951), and for 1947-51 in *Barriers to New Competition*, *op. cit. supra* note 15, at 255. In more recent investigations, other students have found no correlation.

²² Marshall Hall and Leonard W. Weiss, 'Firm Size and Profitability', 49 *Rev. of Economics and Statistics* 319 (1967). For a survey of the literature, see F. M. Scherer, *Industrial Market Structure and Economic Performance* 80-82 (Chicago: Rand McNally, 1970).

or floating a stock or bond issue are more or less fixed, so that they diminish proportionately with the size of the loan or issue. Second, the cost of capital (the rate of interest) may vary sharply with the size of the company: large and well-capitalized firms may obtain large loans at much lower interest rates than would be possible for smaller firms (which in fact may even find it impossible to raise sufficient capital at all). Numerous examples in the history of modern industrial growth show that lack of the funds needed for developing successful discoveries has kept small firms small while their financially powerful competitors grew stronger yet.

The 'survivor technique' has occasionally been used to determine optimal plant or firm size empirically: the size of firms and plants which survive or which manage to increase their share of their industry's output may be considered optimal, whereas a declining share may indicate suboptimal scale.²³ Applying this test, Saving found only negligible economies at plant level in a majority of the industry sample for which he made estimates (in 64 out of 91 industries for the years 1947-54). And only in four industries had minimum optimal plant size to be higher than 5 percent of total industry output.²⁴ Advocates of this measurement technique have therefore suggested that since small and large firms coexist in various industries, neither the plant optimum nor the firm optimum can be very high. This line of thinking may well make sense as regards the scale of the plant, since modern production methods, as we have seen, have reduced the technical optimum in a number of industries. But it seems less accurate for differences found in the scale of firms. For in an oligopolistic setting small firms may survive for quite a long time by means of product differentiation, gaining a share of the market and thus stepping up their profitability to some extent once again without this proving that they are efficient.²⁵

Integration can produce cost savings in different ways. They may derive from more efficient production planning and more economical stockholding and handling of goods between the integrated stages. Typical examples of this can be seen in the integration of a blast furnace with a steel mill or of an oil-producing company with a refining company or of a sawmill with a paper mill.²⁶ A broader form of integration is where a firm begins to work its own raw-material deposits or sets up its own distribution network with retail outlets and so on. Generally, a firm will do this for cost considerations only beyond the point at which specialized firms supply these goods or services at a higher price than it would cost the integrating firm to provide them itself. Economies in the use of resources may result from the fact that integration brings a firm closer to the market needs of its customers. Reasons of security can also induce a firm to integrate – for instance, in order to safeguard its

supplies of raw materials from interference by competitors, or to escape from dependence on a distribution network controlled by competitors.²⁷

Finally, corporate expansion may present neither strictly horizontal nor vertical features because it takes place in markets other than the one in which the company has hitherto been operating. Here, a distinction should be made between the efficiencies underlying acquisitions of firms that either produce related or complementary products or are active in geographic markets not yet supplied by the acquiring firm and acquisitions of firms in wholly unrelated fields of activity. Whereas the first two kinds of expansion (product-extension and market-extension mergers) are forms of diversification whose motivation is clearly related to those of horizontal mergers, the latter is the pure conglomerate variety. The motives of many of the newly established conglomerate firms are the desire to spread risks, to give stockholders the impression of alert management, and to realize instantaneous merger profits, which raise the price of the acquiring firm's shares on the stock market.

The basic motive underlying most conglomerate expansion is the fact that a better return on capital can be obtained in industries other than the firm's traditional fields of interest, growth opportunities on its own market being no longer satisfactory.²⁸ Conglomerates may be able to improve the operation of the firms they acquire in many different ways, depending on the availability and size of excess resources. As a firm stops making new investments, financial resources will be the first to become available for new opportunities. Apart from resources that the acquiring firm can put directly at the disposal of the acquired firm, conglomerate expansion may help to improve the ac-

²³ Survival as the test of the ability of firms of a given size to cope derives from Stigler, *supra* note 5, at 26. See also Stigler, 'The Economies of Scale', 1 *J. of Law and Economics* 54 (1958).

²⁴ T. R. Saving, 'Estimation of Optimum Size of Plant by the Survivor Technique', 75 *QJ Econ.* 569, 580-85 (1961). See also L. W. Weiss, 'The Survival Technique and the Extent of Suboptimal Capacity', 72 *J. Pol. Econ.* 246 (1964).

²⁵ For a full discussion of this topic, see Stephen Hymer and Peter Pashigian, 'Firm Size and Rate of Growth', 70 *J. Pol. Econ.* 556 (1962); William G. Shepherd, 'What Does the Survivor Technique Show About Economies of Scale?', 34 *Southern Economic J.* 113 (1967).

²⁶ John G. McLean and Robert W. Haigh, *The Growth of Integrated Oil Companies* 663 (Boston: Division of Research, Graduate School of Business Administration, Harvard University, 1954); Melvin G. de Chazeau and Alfred E. Kahn, *Integration and Competition in the Petroleum Industry* (New Haven, Conn.: Yale UP, 1959); Lenel, *op. cit. supra* note 13.

²⁷ For a discussion of the possible disadvantages of vertical integration as regards costs, see Lenel, *id.* at 147-83.

²⁸ We have de Jong to thank, *op. cit. supra* note 6, at 206-18, for introducing the life-cycle theory as a means of elucidating the concentration phenomenon and bringing out more clearly the essential reasons why a firm expands into other fields (chiefly stagnation in sales of its products).

quired firm's access to the capital market and lead to more rational capital-budgeting techniques. If excess resources are available in such areas as production capacity, sales organization and transportation facilities, firms can be expected to expand for preference into industries which produce related products or the same products in geographically different markets. Better utilization of sales-promotion facilities may play a particularly important role in decisions to expand. Diversification may give rise to appreciable promotional economies if sales of a large number of products can be promoted by pushing one brand name and thus reducing advertising costs per unit of output.²⁹ Availability of excess management capacity may be beneficial to expansion in hitherto wholly unrelated fields of activity as well. The history of a number of American conglomerates shows the extremely important role that absorption of excess management capacity in particular plays in the organization and growth of conglomerates.³⁰ The same may be true of research facilities as well. These advantages are highly conjectural, however, as hardly any information is available on what happens after a firm has been acquired by a conglomerate.³¹

These economies may give firms seeking diversification or conglomerate activities decisive advantages over companies in the markets they enter, specifically if those companies are smaller in absolute terms, so that the expanding firms also have the financial edge over them. It is especially then that strategic (market-power) motives come to the fore. For conglomerate expansion allows a big firm to pursue a flexible production and price policy (market strategy) and hence to exert more influence on individual markets than its share of them would otherwise allow. Conglomerate firms have more opportunity for saving on taxes since losses in one part of the business can be set off against profits made elsewhere. And then there are the specific benefits of sheer size – better relations with government procurement agencies for government contracts and a greater influence on political decisions that might affect them. As both types of advantage add to the firm's opportunities for market strategy and therefore to market power, and the purely economic advantages could also be obtained by merger with small firms in new markets, it may not be without justification to remark that in the case of conglomerate expansion the bigger the constituent companies the more important strategic motives become.³²

One last aspect that we should touch upon in this review of the economic advantages and disadvantages of firm size is its role in research and development. After the theory of perfect competition fell into decline, Schumpeter's views on this point gained a great deal of support. For Schumpeter, a certain degree of monopoly power was needed to provide a fertile soil for the intro-

duction of new products: the cost of introducing them could be paid for out of accumulated monopoly profits, and monopoly power had to be maintained in order to make the new products a paying proposition.³³ Many economists since Schumpeter have also held that the pacemakers in innovation are the big firms, because they can raise the funds that are essential to research and are also in a better position to apply the results of their research and to make them yield a profit.³⁴

Without closer inquiry it is debatable whether the big firm can be considered the sole breeding ground for innovational effort. If we consider the results of R & D, we find that a large number of major inventions have either

²⁹ It should be remembered here that Bain in his study of twenty American industries found that economies of large-scale sales promotion are of the same order of magnitude as economies resulting from large-scale production and distribution. *Barriers to New Competition*, *op. cit. supra* note 15, at 142-43, 216. As will be elaborated in Chapter 3 *infra*, advertising and, for consumer durables in particular, the possession of a large number of outlets can give a firm a considerable lead over its competitors.

³⁰ See John C. Narver, *Conglomerate Mergers and Market Competition* 63-65 (Berkeley and Los Angeles: University of California Press, 1967). However, as is pointed out in the FTC report mentioned above, 'top management of an extremely diversified conglomerate will have to rely heavily on the judgment of subordinates within the various divisions when making routine operating decisions. In making investment decisions, even though top management can follow rational capital allocation procedures, it will again have to rely upon the technical judgment of subordinates in estimating future payoffs from specific investments. The more diversified a conglomerate, the less capability top management will have to challenge subordinate decisions on technical details.' *Conglomerate Merger Performance* 10 (Nov. 1972).

³¹ *Id.* at 11. And the FTC report itself has done little to improve matters: it concludes that 'the most valuable contribution of this study is that it points out how little is known about the operations of conglomerate firms. There is a serious "information gap" between the information available to managers of conglomerates and that available to the public.' *Id.* at 13.

³² See, e.g., Corwin D. Edwards in *Economic Concentration*, 88th Cong., 2d Sess., Pt. 1: 'Overall and Conglomerate Aspects' (1964); John M. Blair in *id.* Pt. 1, at 77-109, 203-19, and *id.*, 89th Cong., 1st Sess., Pt. 2: 'Mergers and Other Factors Affecting Industry Concentration', at 651-73 (1965). See also James S. Campbell and William G. Shepherd, 'Leading-firm Conglomerate Mergers', 13 *Antitrust Bull.* 1361, 1367-72 (1968); Narver, *op. cit. supra* note 30. But see Weston and Ornstein, *op. cit. supra* note 8, Ch. 14.

³³ Joseph A. Schumpeter, *Capitalism, Socialism and Democracy* 89, 95 (New York: Harper, 3d ed. 1942); Edward S. Mason, *Economic Concentration and the Monopoly Problem* Ch. 5: 'Schumpeter on Monopoly and the Large Firm' (Cambridge, Mass.: Harvard UP, 1959).

³⁴ J. K. Galbraith, *American Capitalism* 86 (Boston: Houghton Mifflin, rev. ed. 1956); Lilienthal, *op. cit. supra* note 19, at 69; A. D. H. Kaplan, *Big Enterprise in a Competitive System* (Washington, DC: Brookings Institution, 1954). See also P. Hennipman, 'Monopoly: Impediment or Stimulus to Economic Progress?', in Chamberlin (ed.), *op. cit. supra* note 18; Hans Otto Lenel, *Die Bedeutung der grossen Unternehmen für den technischen Fortschritt* (Tübingen: Mohr, 1968).

been the work of inventors who were not directly associated with or financed by business firms or emerged from the laboratories of comparatively small firms.³⁵ Studies of R & D achievements in certain industries in the United States have also come to the virtually unanimous conclusion that many innovations are in fact introduced by the smaller firms.³⁶ Examples of this are also to be found in European industry. And even where large firms do produce basic inventions, they are often unwilling to market them because they are reluctant to write off past investments which the inventions make obsolete. Finally, the government plays the major part in the R & D activity of big firms by awarding them contracts in this field, especially basic research. In the United States the government pays for more than fifty percent of industry's R & D; the percentage is somewhat lower in certain Community countries where more public funds go to government-owned undertakings.³⁷

These findings, however, should not be seen as evidence that the innovational efforts of big business are slighter than those of its smaller competitors. For discovering applications for inventions is often what requires the heaviest expenditure, and money spent in this activity should also be counted part of the innovational effort. In order to establish what link there might be between R & D expenditure and market structure, a number of empirical studies have been made, some of them using regression analysis. Some of the investigators have found a positive correlation between firm size (expressed in sales or employment) and expenditure on R & D.³⁸ Others conclude that the very biggest firms in a number of the industries examined spend a relatively smaller proportion of sales on R & D than somewhat smaller firms but a larger proportion than still smaller ones.³⁹

Given the dependence of these statistical findings on the type of variable used and on how typical the variables are, we are perhaps justified in drawing the cautious conclusion that, admitting that there is a financial threshold below which serious research is not possible, the intensity of research effort does not necessarily increase as a firm gets bigger. This would also imply that a high degree of concentration in advanced-technology industries is not necessarily a prerequisite for rapid technological advance. Diversification does seem to stimulate research, however, and this should not surprise us if we remember that the greater stability of a conglomerate firm guarantees that it will be able to persevere with major research projects once embarked upon.⁴⁰ Those firms that cannot raise the necessary funds to cross the financial threshold, then, will have to be satisfied with R & D in the less complex areas of industrial technology; the only way they can get round this drawback is to set up joint research centers. We shall not go into the management and other difficulties that this may raise.

Corporate growth is no longer hindered by technical or economic barriers, so that more often than not reasons of market strategy may be predominant in pushing growth still further. This should give no cause for pessimism: big firms are often models of dynamism. They may, however, constitute something of a threat to the operation of the market, and this may not only have an injurious impact on market performance: since the big firms' be-

³⁵ See, e.g., John Jewkes, David Sawers and Richard Stillerman, *The Sources of Invention* (London: Macmillan, 1958); Jacob Schmookler, 'Bigness, Fewness and Research', 67 *J. Pol. Econ.* 628 (1959); Daniel Hamberg, 'Invention in the Industrial Research Laboratory', 71 *J. Pol. Econ.* 95, 96 (1963); *Economic Concentration*, 89th Cong., 1st Sess., Pt. 3: 'Concentration, Invention and Innovation' (1965).

³⁶ For the steel industry, see Walter Adams and Joel B. Dirlam, *supra* note 12; for the aluminum, petroleum and chemical industries, see Universities-National Bureau Committee for Economic Research, *The Rate and Direction of Inventive Activity: Economic and Social Factors* (Princeton, NJ: Princeton UP, 1962). See also *Economic Concentration* Pt. 3.

³⁷ See Organization for Economic Cooperation and Development, *The Overall Level and Structure of R & D Efforts in OECD Member Countries* Tables IV & V, at 60-61 (Paris, 1967); Lucie R. Blau, 'R & D: Still a Growth Industry', *The Conference Board Record*, May 1970, p. 38.

³⁸ J. D. Worley, 'Industrial Research and the New Competition', 69 *J. Pol. Econ.* 183, 185 (1961); Daniel Hamberg, 'Size of Firm, Oligopoly and Research: The Evidence', 30 *Can. J. of Economics and Political Science* 62 (1964).

³⁹ Edwin A. Mansfield, 'Size of Firm, Market Structure and Innovation', 71 *J. Pol. Econ.* 556 (1963). 'The Speed of Response of Firms to New Techniques', 77 *QJ Econ.* 290 (1963), and 'Industrial Research and Development Expenditures: Determinants, Prospects and Relation to Size of Firm and Inventive Output', 72 *J. Pol. Econ.* 319, 337-38 (1964); F. M. Scherer, 'Size of Firm, Oligopoly and Research: A Comment', 31 *Can. J. of Economics and Political Science* 256 (1965), commenting on Hamberg, *supra* note 38. In a study of the relation between the number of patents granted to major firms as an indicator of innovational effort and concentration variables - 'Firm Size, Market Structure, Opportunity and the Output of Patented Inventions', 55 *Am. Econ. Rev.* 1097, 1121 (1965) - Scherer reaches conclusions corresponding to those in his article cited *supra*. See also William S. Comanor, 'Market Structure, Product Differentiation and Industrial Research', 81 *QJ Econ.* 639 (1967). Louis Philips, 'Concentration, dimension et recherche dans l'industrie manufacturière belge', 35 *Recherches économiques de Louvain* 15 (1969), and *Effects of Industrial Concentration* 136-37 (Amsterdam: North Holland, 1971), using Scherer's methods, arrives at similar results for Belgium. A critical analysis of the statistical measurement of these relationships is to be found in Jesse W. Markham, 'Market Structure, Business Conduct and Innovation', 55 *Am. Econ. Rev.* 323 (1965, Proceedings). Yale Brozen, 'Significance of Profit Data for Antitrust Policy', 14 *Antitrust Bull.* 119, 126 n.18 (1969), finds that smaller firms which engaged in research were more research intensive than larger firms prior to World War II but that the position was reversed in the 1950s. Finally, Comanor, 'Research and Technical Change in the Pharmaceutical Industry', 47 *Rev. of Economics and Statistics* 182, 190 (1965), has discovered substantial diseconomies of scale associated with large firm size in the drug industry in the United States. For an extensive review of this and other literature on the subject, see also Scherer, *op. cit. supra* note 22, at 363-78.

⁴⁰ Jesse W. Markham, Statement in *Economic Concentration* Pt. 3, at 1273. See also Scherer, *op. cit. supra* note 22, at 362-63, for a review of studies on the influence of diversification on inventiveness.

havior is not dictated by social and economic considerations, growth can go far beyond what may be deemed to be desirable from the standpoint of economic policy. This is the problem we must now tackle.

CHAPTER 3

AN ASSESSMENT OF CONCENTRATION

3.1 INTRODUCTION

In this chapter we shall analyze the influence of concentration on the market mechanism and on economic-policy targets and work out economic standards from which practical policy conclusions can be drawn. Our analysis of concentration will be from the standpoint of competition policy, i.e. concerned with the influence of concentration on relations between firms, rather than from the point of view of the individual firm. There may be considerable differences in our judgment or assessment of a given phenomenon (profit margins, for instance), depending on whether we approach it from the one angle or the other, as will be made clear in the course of our discussion.

We shall be concerned first and foremost with concentrated markets because it is through them that the effect of industrial concentration on competition can best be shown. Where corporate growth is not concentrated on a specific market, as in cases of conglomerate expansion, it is much more difficult to draw conclusions about its effects on competition because no direct link can be established with the working of the market mechanism. It is no doubt for this reason and because conglomerate expansion is a fairly recent development that the attention of theorists and policymakers has been turned almost exclusively toward the problems of concentration on individual markets – even in the United States, where conglomerate expansion has taken on considerable proportions. We shall attempt to cover the conglomerate aspect of concentration in this chapter as well. In considering existing concentration levels we disregard the means by which they have been reached (whether by internal or by external growth), though later in the chapter we shall be examining in detail the specific problems arising from combination.

In discussing the implications of concentration and the degree of market power held by firms on concentrated markets we shall confine ourselves as a rule to the sellers' side of the economy, i.e. manufacturing, banking, etc. Apart from the arguments mentioned in Chapter 1 – lack of statistical evidence and the general impression that the level of concentration in the retailing

sector is relatively low – such theory as has been developed for the buyers' side is rather unconvincing. For it is in no way proved that the countervailing power of monopsony or oligopsony produces favorable effects on performance.¹

Although economic theorists have always regarded the analysis of supply and demand situations as one of their major tasks, competition on markets with a limited number of sellers has not been discussed in the literature until fairly recently. For many years economists used the model of 'pure and perfect' competition as a basis on which to refine their analysis of the pricing process without considering the consequences of a change in the equilibrium conditions of the model. In conditions of 'pure' competition there are a large number of sellers, none of whom alone has any significant influence on the market. All sellers receive the same price, which means that their supply curve is horizontal. 'Perfect' competition implies a smooth movement toward an equilibrium situation that has been disturbed by either external or internal factors (e.g. overproduction resulting in underselling by a number of suppliers). The major conditions for pure and perfect competition are homogeneous products (i.e. no buyer preferences), full knowledge of market conditions so that at any given moment buyers know the sellers' prices and vice versa, and perfect communications between buyers and sellers. Marshall's *Principles* is the established textbook for a description of pricing on markets of this kind.²

It was not until 1922, with Clapham, that economists began to investigate how far the hypotheses underlying the operation of the classical model accorded with conditions obtaining in the real world.³ We shall not be dealing with the discussion that arose at this point, especially after Sraffa's paper on the shape of the average total cost curve.⁴ The first real step toward an analysis of competitive conditions on imperfect markets was the introduction of the concept of product differentiation and its associated problems into the analysis of competition by Chamberlin, Robinson and von Stackelberg.⁵ None of these writers, however, considered the problem of circular competitive relationships inherent in markets with a limited number of sellers. More recent theoretical developments have not only provided considerable insight into the factors determining the firm's pricing and production policies but have also furnished criteria for judging performance in such markets. Before coming to this, however, we should make some observations on the criteria for market delimitation, since a proper knowledge of the place of firms in the economy must be the starting point of any investigation into the effects of concentration on competition. In section 3 of this chapter we shall then elaborate on these recent developments in competition theory as a point of departure for judging the position of a firm or group of firms on the market. In section 4 we shall examine the consequences of increasing concentration resulting from mergers and other forms of combination.

3.2 CRITERIA FOR MARKET DETERMINATION

In order to establish what markets a firm is operating in, we have to consider four different market dimensions. First, we must determine what products constitute the market. A multiproduct firm whose size as such is the object of inquiry may be active in several markets, depending on the characteristics of the product it offers. Where we are concerned with only one facet of corporate conduct, such as the assessment of resale-price maintenance in respect of only certain items of a firm's output, the search for markets may be less wide-ranging. Second, the geographic boundaries of these markets have to be drawn. The other two dimensions are time and function.⁶ Products available at different times are generally not economically substitutable and therefore cannot be considered part of one and the same market. Where there is price differentiation between two or more classes of customers for the same product – e.g. functional discounts – we speak of the functional dimension of the market. In practice, however, the first two market dimensions are by far the most important, and we shall therefore consider them in some detail.

3.2.1 The Product Dimension

In the literature, the definition of the product market has undergone a number of changes over the years. For his price theory, Marshall took firms producing physically identical products. With the arrival of the theory of monopolistic competition, considerations of substitutability entered into the market definition, this being based on the criterion of substitution between groups of products with common characteristics. In fact, however, if we take the idea of product differentiation a little further, there are only a few *real* substitutes

¹ Galbraith has dealt most extensively with the influence of buyer concentration on performance, but it is on this point that the theory is open to basic criticism. J. K. Galbraith, *American Capitalism* (Boston: Houghton Mifflin, rev. ed. 1956).

² Alfred Marshall, *Principles of Economics* (London: Macmillan, 1890, 9th ed. 1961). See also Edward H. Chamberlin, *The Theory of Monopolistic Competition* 6–7 (Cambridge, Mass.: Harvard UP, 1931, 7th ed. 1962).

³ J. H. Clapham, 'Of Empty Economic Boxes', 32 *Economic J.* 305 (1922).

⁴ Piero Sraffa, 'The Laws of Returns under Competitive Conditions', 36 *Economic J.* 535 (1926).

⁵ Chamberlin, *op. cit. supra* note 2; Joan Robinson, *The Economics of Imperfect Competition* (London: Macmillan, 1933, 2nd ed. 1969); H. von Stackelberg, *Marktform und Gleichgewicht* (Berlin: Springer, 1934).

⁶ These factors are mentioned by, e.g., Eberhard Günther, *Relevanter Markt im Recht der Wettbewerbsbeschränkungen* 19 (Karlsruhe: Müller, 1960). See also Hans-Heinrich Barnikel, 'Die Abgrenzung des relevanten Marktes', 11 *Wirtschaft und Wettbewerb* 246, 250 (1961).

for each product, so these groups ought to be split up into subgroups with a limited number of sellers. This is the basis of the theory of classification of market organization, first developed by Robert Triffin in 1940.⁷ Not only can certain aspects of market classification constitute a valuable tool for determination of the relevant market: the system also gives an idea of the possible number of market structures. It should not be forgotten, however, that market classification was not designed as a guide to public policy.⁸

On the substitutability criterion used in the theory of monopolistic competition, products are considered to be competing with each other if in the eyes of the buyer they satisfy a need to the same extent. This may imply that technically identical products need not be substitutes because, say, the buyer prefers a particular seller for personal reasons or because he is not familiar with certain products or with the place where they are on sale (this last point encroaches on the geographic dimension, to which we shall turn later).⁹ However, if too much stress is laid on this sort of substitutability, it can lead us to the conclusion that each individual brand or product offered by a specific supplier constitutes a market of its own, and this for all practical purposes would reduce the concept of the relevant market to a point at which it is rendered meaningless. Apart from this, the criterion is not realistic for it would imply that the customer selects on the basis of purely external features alone, and generally this is not the case.¹⁰ On the other hand, of course, the ordinary consumer does have much less information about available supplies than the industrial buyer – which is not surprising in view of the variety of products on the market – and for that reason attaches more importance to brands or price differentials. Nor is a criterion based exclusively on product differentiation realistic in the case of the many markets that form the links in the chain of production, particularly those near the end. The main considerations influencing a businessman when he buys machinery, raw materials or finished products are the continuity and the profitability of his business. This implies that besides differences in price and other terms between the various sellers he will give considerable weight to factors such as technical identity of certain products, relations with his traditional suppliers and the like. What is more, manufacturers are often able, by making slight changes in their production programs, to improve the substitutability of their products (production flexibility), so that it will be very difficult to draw clear-cut boundaries. These considerations have led writers, not without reason, to accept the concept of the industry (a group of firms producing similar goods) as the guideline for market definition.¹¹ In practice, however, industry notions used in Census statistics or other statistical sources cannot easily be taken over because their classification is made according to

criteria other than those that would be appropriate for an economically satisfactory market definition. And as technology advances and more and more uses are found for an increasing number of products, even the boundaries between industries are blurred: there are already many cases of interindustry competition.

In practice, however, it is not possible to give anything like quantitative rules that can be used in forthcoming cases. Though cross-elasticity coefficients are familiar as a theoretical means of ascertaining where the boundaries of substitutability lie, they are only of very limited use for determining these boundaries. One of the two coefficients of cross elasticity of demand that Triffin used to identify the market forms of isolated selling, heterogeneous and homogeneous competition – that which defines price – can be of some use as an indicator.¹² This coefficient measures the degree in which a small price change by one firm causes its sales to be transferred to its competitors, assuming that all other prices remain unchanged. If buyers regard the products of this firm and its competitors as completely interchangeable, then the coefficient is infinity. This will not normally be the case because of product differentiation, and the coefficient will be something between zero and infinity. A serious limitation on the practicality of Triffin's coefficient appears if we bear in mind the possibility that sellers may not be able to take full advantage of shifts in demand resulting from price changes. For example, a firm may market a cheaper or better product than that of its big competitors, only to find – assuming that its competitors do not follow suit – that it cannot satisfy the sudden increase in demand because it lacks spare production capacity. The same kind of thing may affect its competitors if the firm increases its prices, but of course to a less extent if it has more than one competitor since then the effect will be dispersed over a number of firms. Here again, the price cross-elasticity coefficient is much less than infinity, corresponding to that part

⁷ *Monopolistic Competition and General Equilibrium Theory* (Cambridge, Mass.: Harvard UP, 1940, 4th ed. 1949).

⁸ As C. E. Ferguson, *A Macroeconomic Theory of Workable Competition* 42 (Durham, NC: Duke UP, 1964), rightly points out.

⁹ See Barnikel, *supra* note 6, at 247; Frank J. Kottke, 'The Role of an Economist in Delineating the Relevant Market', 6 *Antitrust Bull.* 143 (1961).

¹⁰ Although buyers may often show a conspicuous preference for a certain brand of cigarettes or whiskey, for instance.

¹¹ See Triffin, *op. cit. supra* note 7.

¹² *Id.* Ch. 3. Triffin's other coefficient, the quantity cross-elasticity coefficient, measures the consequences of a change in the quantity sold by one firm on another firm's prices. While this is of great importance in the classification of market relationships, it can be passed over in the present context.

of the firm's demand curve where its production capacity is big enough for it to deliver the quantities demanded within a reasonable space of time. This could imply that the coefficient is higher in the case of an oligopoly (firms having greater productive resources) than in an atomistic market structure. As it is further conceivable that especially with nonhomogeneous products a small supplier must make more concessions in order to attract a large number of new customers than would be necessary for a large firm (quite apart from the question of retaliatory action on the part of its big competitors), this might also account for differences in price cross-elasticity coefficients.

To avoid the difficulties inherent in Triffin's coefficient, Papandreou suggested that there was a need for a new tool – the coefficient of penetration, which 'measures the capacity of the firm to cut into the volume of another firm's sales by reducing price.'¹³ This offers no practical solution either, however. A first difficulty that is equally applicable to this index is that it first has to be established at what point there is still substitutability. Before we can assess its value as a policy instrument, however, we must have experience with it in a number of actual market situations. But then we come up against a second difficulty which also sharply reduces the value of the coefficient of penetration in the most common market form – circular heteropoly. As we shall show in more detail below, in this type of market a price cut by one of the sellers will in practice never go unanswered for long enough to enable us to study the quantity relations in a vacuum. Moreover, for reasons we shall go into later, price will not normally be used as a means of increasing market share in those oligopolistic market situations that interest us most from a policy viewpoint: quality, advertising, and so on, will be employed more often. The most important contribution of the penetration coefficient for policy purposes, then, is that it may indicate what firms are in a position to undertake aggressive price policies.¹⁴ For the rest, these tools make no decisive contribution to a solution of the difficult practical problems of market definition.

3.2.2 The Geographic Dimension

The bigger, geographically, the territory on which the firm's product (or products) is (or are) sold, the more likely it is that the firm will have new competitors to reckon with in some parts of its market and that its total market share will decline. Many products manufactured by large firms are sold in several countries or even in more than one continent, but market definition would cease altogether to be meaningful if we had regard to a geographic expanse of such proportions. Determination of the geographic boundaries of the market should properly be based on the area where under normal con-

ditions *most* of the product in question is sold. Two points here need to be explained more fully.

The first is that the area may be large (e.g. the entire territory of a country) and may consist of a number of local or regional markets (submarkets) each of which accounts for a not insignificant part of the firm's total sales. In the case of products like cement or steel, where freight charges are very high in relation to production costs, the sales of a plant are usually concentrated in the surrounding area, the outer boundary of which is at the points of delivery where total production and freight costs are the same as those of competitors. Big firms in industries such as these, however, will usually operate more than one plant, so that they can extend their sales to other areas too. In that case, all the areas served by the firm may constitute a geographically relevant larger area, usually marked off by national frontiers or physical barriers. Although in the case of these multiplant firms the larger market may be appropriate for investigation, to assess the market position of the firm accurately it is also essential to examine the situation on the submarkets, since a multiplant firm will have to meet competition there not only from other firms that have several plants too but also from small firms of only local importance. In the case of products for which freight costs are not very high, the situation is different. Big firms in these industries generally sell their products in a large territory, and this should normally be regarded as the market. However, there may be relevant submarkets as well. Buyers' habits, for instance, or the concentration of retailers may be significant factors in the constitution of submarkets. Distribution arrangements such as mail-order sales can of course break down the isolation of such local markets to some extent.

In determining economically relevant geographic markets, some general quantitative indications may be given that represent a kind of 'rule of thumb'. It has recently been advocated¹⁵ that a geographic area that absorbs much the greater part (75 percent or over) of the sales of the firm under investiga-

¹³ A. G. Papandreou, 'Market Structure and Monopoly Power', 39 *Am. Econ. Rev.* 883, 890 (1949). See also Edward H. Chamberlin, 'Measuring the Degree of Monopoly and Competition', in Chamberlin (ed.), *Monopoly and Competition and Their Regulation* 267 (London: Macmillan, 1954); Ferguson, *op. cit. supra* note 8, at 32-43; J. E. Andriessen, *De ontwikkeling van de moderne prijsentheorie* Ch. 4 (Leiden: Stenfert Kroese, 3d ed. 1965); Herbert Jacob, *Preispolitik* 27-32 (Wiesbaden: Gabler, 1963); H. W. Lambers, 'Marktstrategie en mededinging', 98 *De Economist* 810 (1950); F. J. de Jong, *Het systeem van de marktvormen* (Leiden: Stenfert Kroese, 1951).

¹⁴ Ferguson, *op. cit. supra* note 8, at 37.

¹⁵ Kenneth G. Elzinga and Thomas F. Hogarty, 'The Problem of Geographic Market Delineation in Antimerger Suits', 17 *Antitrust Bull.* 45, 73-75 (1972).

tion can be considered relevant when at least the same percentage of the total sales of the relevant product is shipped from plants located in the area and at least 75 percent of the shipments by the firms within the area are to customers within that area. Another quantitative guideline is to consider markets of a local or regional compass as economically relevant in all those cases where firms operating on them are able to raise their prices more than, say, 10 percent above the price level existing in neighboring local or regional markets for comparable products.

A second point to be made more clearly relates to the fact that political frontiers will often mark the farthest boundary of the market. This is especially relevant in Europe, with its relatively small national markets. Here, differences in tax incidence, differences in forms of taxation, export barriers resulting from differences in technical regulations, differences in statutory provisions, traditional preferences for home produce, language difficulties, and so on, make manufacturers in many industries prefer their traditional markets. However, with the growing competition from firms operating on several markets in different parts of the world at the same time, and with the rapid removal of the political, legal and technical barriers to trade between European countries (at least between those making up the European Economic Community), more firms will extend their operations outside their home country, and the territory of a number of countries will sometimes constitute the relevant geographic market. Here again, the two criteria for distinguishing economically relevant submarkets mentioned above should be taken as the guideline.

3.2.3 Summary and Conclusions

An economically meaningful definition of the markets on which a firm sells its products (or supplies its services) is an essential basis on which to assess the firm's influence on competition. However, it is impossible to formulate relatively simple guidelines to cover practical circumstances. On the one hand, more and more substitutes for existing goods are being put on the market as a result of rapid technical advance, so that the boundaries of existing markets are extended. On the other hand, the development of new market strategies is designed among other things to ensure optimum protection of markets. Triffin's price cross-elasticity coefficient and Papandreou's coefficient of penetration have the major drawback that they are not very suitable for an analysis of the most common cases (heterogeneous oligopoly) because the reactions of competitors are different and more complicated on such markets than on homogeneous ones. In many cases, therefore, the industry will be a useful guide, though it should be refined if need be by an analysis of the

market conduct of the firm under investigation in order to establish which are its most important competitors. Geographically, increasing integration between countries will result in a bigger market, though in a number of cases smaller areas may be regarded as sufficiently distinct to be used in an analysis of competitive impact if most of the firm's sales are transacted there.

3.3 METHODS OF DETECTING MARKET POWER

3.3.1 Introduction

Criteria for determining when the changes in market circumstances brought about by corporate concentration have overstepped acceptable limits have to be distilled from standards for assessing how the market is operating. These standards are to be found in the literature or underlying the policy systems in current use. Two major sets of such standards can be discerned. The first relates to the element of freedom in relations between competitors: everybody must have the opportunity to act as he thinks fit. The second is the economic norm of performance – market performance in the context of competition. By 'market performance' we mean the extent to which the functioning of the market leads to the satisfaction of material needs in the circumstances given (with due regard for future needs and the cost of satisfying them) or, to put it another way, the extent to which it contributes to social welfare. Market performance has both a microeconomic and a macroeconomic dimension. Microeconomic targets include productive and allocative efficiency and progressiveness, whereas macroeconomic targets are generally derived from national economic aims. Clearly, the two sets of standards are not always compatible with each other, and government will sometimes have to make a political choice before reaching a decision in a given situation. More than the welfare norm, the concept of freedom has engendered highly divergent opinions among both writers and policymakers. This scarcely comes within the province of economic theory, and as this study is basically concerned with the economic problems of concentration theoretical discussions on the compatibility of the two complexes of norms need not detain us.

The classical reference to a general equilibrium model in which optimum performance is attained is the Pareto theorem in traditional welfare economics. The static conditions of the classical model, however, limit the usefulness of the insights obtained for solving practical policy problems under dynamic, constantly changing circumstances. For to keep to these static conditions in a changing world would leave no room for technical innovation and other growth factors. Moreover, government too has an effect, both direct and in-

direct, on market performance. Under these modified assumptions, then, Pareto's conditions cannot be considered normative – a point extensively developed in the newer welfare economics.¹⁶

The problem then arises what attitude should be taken if some of the conditions for the Pareto optimum cannot be fulfilled. In order to take these real-world circumstances into consideration, economists have made various attempts to formulate policy standards for imperfect markets. The first development was an article by J. M. Clark, published in 1940, stating that lapses from the conditions of perfect competition encountered in daily life may give rise to countervailing imperfections which make this imperfect competition workable.¹⁷ This implies that where there are countervailing imperfections the welfare attained may be greater than where only one of the conditions of the perfect competition model is absent and all the others are present. But Clark still seeks maximum conformity with the classical model, regarding workable competition as second best to perfect competition.¹⁸ This can also be seen from his definition of workable competition:

rivalry in selling goods in which each selling unit normally seeks maximum net revenue, under conditions such that the price or prices each seller can charge are effectively limited by the free option of the buyer to buy from a rival seller or sellers of what we think of as 'the same' product, necessitating an effort by each seller to equal or exceed the attractiveness of the others' offerings to a sufficient number of buyers to accomplish the end in view.¹⁹

A number of writers, most of them American, who have followed Clark in reflecting upon imperfectly competitive markets²⁰ also regard, implicitly or explicitly, the performance standard of the classical model, or a variant that resembles it as closely as possible, as a desirable outcome of competition. In the conditions they lay down for workable competition they try to approximate to the competitive model by emphasizing a number of minimum structural requirements to which the markets should conform. Although each writer formulates his structural standards somewhat differently, they all basically come down to this: a large number of sellers for each group of only slightly differentiated products in each geographically relevant market, no collusive behavior, no market participant in a position to exercise a substantial influence on the market and, lastly, no barriers to entry.²¹ A comparable view of the competition problem in modern circumstances is seen in the concept of *Leistungswettbewerb* advanced by members of the German neoliberal school. For Lutz, Hayek and Röpke, the essence of competition is that the seller must always be on the alert to win new customers by cutting his price, by improving quality, by advertising and so on.²² Although this introduces the

idea of active rivalry into competition – something unknown in this form in the classical theory – attachment to the competitive model is still evident in the requirement that competition should lead as far as possible to optimum output.

This group of workable-competition theorists, then, introduces new conditions into the competition model only where the original conditions no longer correspond to the real world, leaving the rest of them unaltered. But this is a faulty approach, for a change in certain of the conditions necessitates

¹⁶ Vilfredo Pareto, *Manuel d'économie politique* 354–65, 617–31, 639–57, 666–71 (Paris: Giard, 2d ed. 1927). For a criticism of the traditional welfare economics based on Pareto, see, e.g., I. M. D. Little, *A Critique of Welfare Economics* (London: Oxford UP, 2d ed. 1957), and the survey in Ferguson, *op. cit. supra* note 8, at 5–64.

¹⁷ 'Toward a Concept of Workable Competition', 30 *Am. Econ. Rev.* 241 (1940).

¹⁸ Ferguson, *op. cit. supra* note 8, at 50.

¹⁹ *Supra* note 17, at 243.

²⁰ The reason why so many American economists take an interest in these problems is that criteria for judging market power, mergers, exclusive dealing etc. are needed for the enforcement of the antitrust laws.

²¹ See, e.g., Corwin D. Edwards, *Maintaining Competition* 9–10 (New York: McGraw-Hill, 1949), and 'Public Policy and Business Size', 24 *J. Bus. U. Chi.* 280 (1951); M. A. Adelman, 'Business Size and Public Policy', 24 *J. Bus. U. Chi.* 269, 272 (1951), and 'Effective Competition and the Antitrust Laws', 62 *Harv. L. Rev.* 1289 (1948); Joel B. Dirlam and Alfred E. Kahn, *Fair Competition* (Ithaca, NY: Cornell UP, 1954); Carl Kaysen and Donald F. Turner, *Antitrust Policy* (Cambridge, Mass.: Harvard UP, 1959); *Report of the White House Task Force on Antitrust Policy* (5 July 1968) [hereinafter cited as *Neal Report*]; William G. Shepherd, *Market Power and Economic Welfare: An Introduction* (New York: Random House, 1970); John M. Blair, *Economic Concentration* (New York: Harcourt Brace Jovanovich, 1972). In the German literature the concept of *optimale Wettbewerbsintensität* has been developed alongside or instead of workable competition. See Erhard Kantzenbach, *Die Funktionsfähigkeit des Wettbewerbs* (Göttingen: Vandenhoeck & Ruprecht, 1966), and the discussion by Erich Hoppmann, 'Das Konzept der optimalen Wettbewerbsintensität', 179 *Jahrbücher für Nationalökonomie und Statistik* 286 (1966).

²² See Friedrich A. Lutz, 'Bemerkungen zum Monopolproblem', in *Ordo: Jahrbuch für die Ordnung von Wirtschaft und Gesellschaft* Vol. 8 (Düsseldorf and Munich: Küpper, 1956); F. A. Hayek, *Individualism and Economic Order* (Chicago: University of Chicago Press, 1948); Wilhelm Röpke, 'Wettbewerb: (II) Ideengeschichte und ordnungspolitische Stellung', in 12 *Handwörterbuch der Sozialwissenschaften* 29 (Stuttgart: Fischer, 1965). There is closer affinity to classical ideas in Walter Eucken, *Grundlagen der Nationalökonomie* 96 (Berlin: Springer, 6th ed. 1950); Erich Schneider, *Einführung in die Wirtschaftstheorie* Vol. 2, at 63 (Tübingen: Mohr, 5th ed. 1958). See also Eberhard Günther, 'Wandlung des Wettbewerbs?' in Günther (ed.) *Freie Gesellschaft und freie Marktwirtschaft* 10–24 (Ludwigsburg: Hoch, 1966); Klaus Stegemann, 'Workable Competition nach zwanzig Jahren', 9 *Hamburger Jahrbuch für Wirtschafts- und Gesellschaftspolitik* 237 (1964). An allied concept found in some commentators is that of 'open competition', which is meant to indicate active competition reflected chiefly in regular entry to or exit from the market. See P. W. S. Andrews, *On Competition in Economic Theory* 15 (London: Macmillan, 1964).

changes in the others too. Consequently, the performance standard which they apply cannot simply be accepted as a policy norm whereby competition is to be appraised under present-day circumstances. First, the content of the notion of efficiency undergoes considerable changes when we move away from the static model conditions. Second, in the traditional welfare economics competition performs its economic function in a situation of partial and general equilibrium. But equilibrium is never attained on most markets, not only because the Pareto conditions are not fulfilled on the vast majority of them but also because of the constantly changing conditions in which firms operate. However, abandoning Pareto's conditions for the optimum implies that there will then be no *a priori* way of analyzing situations. In order to find out how equilibrium conditions can be restored, we need to have, among other things, sufficient information on cost and demand relations (which is generally not available) or on interpersonal utility comparisons (but information on the shape of the indifference curves is lacking). For these reasons, the theory of second best, which was developed to provide an answer based upon the circumstances peculiar to each case, cannot constitute a reliable guide for policy decisions either.²³ As abandoning the model conditions implies that a microeconomic optimum will not necessarily help target attainment in a wider context, the only practicable approach is to assess the operation of markets in the light of macroeconomic targets as well as microeconomic goals, at least in those industries whose contribution to the formation and composition of the national product is other than marginal.²⁴ The influence of the firms in those industries on the attainment of both macroeconomic and microeconomic targets should therefore be examined as part of an antitrust investigation.

Another implication of the disappearance of the model conditions as a starting point for judging actual market situations is that the direct link that the classical writers assumed between the structure of a market, the behavior of the firms belonging to it and the resulting performance is lost. Those who adopt the structural approach advocate, for instance, a large number of sellers, but there is no guarantee that market performance will always be better in such a setting than in a highly concentrated oligopoly. This depends, among other things, on how active the firms are as innovators and how eager they are to increase productivity. And competition among a large number may lead to ruinous pricing, just as competition among a few may entail excessive selling outlays. It is only in the theoretical model of perfect competition that concentration necessarily lessens competition. Outside the model conditions, the only practicable general rule is that concentration is unobjectionable until it becomes so substantial that it confers market power, i.e. until a situation

arises in which a firm or group of firms on a given market can exercise such decisive influence on the behavior of the other participants in that market as to prevent them from pursuing a strategy of their own and hence to preclude competition from functioning properly. The crucial question when formulating guidelines for competition policy is under what circumstances a firm or group of firms attains or exercises market power.

Some economists have come to the conclusion that under today's circumstances monopolistic market structures may be more conducive to the attainment of micro- and macroeconomic policy targets than where market power is absent. They point out that it is the very big firms that have the resources enabling them to make new discoveries and render them marketable, and like Schumpeter they consider partial monopoly a fruitful soil for technological progress. Zimmerman is following much the same line of argument when he says that in industries where the pattern of demand or supply is such that intensive price competition can easily arise, a monopoly structure can contribute more to welfare.²⁵ We concede that the absence of market power does not necessarily guarantee maximum deployment of competition. There are several other factors that can impede competition: the firms on the market may be of suboptimal scale or may lack competitive spirit, they may be engaged in cutthroat competition or be inadequately informed of market conditions. Consequently, it is not sufficient for theorists or policymakers to prescribe market dominance as a means of attaining effectively competitive conditions. Moreover, there may be circumstances in which dominant positions are economically justified, i.e. where competition could not have led to satisfactory performance, but these are relatively rare situations, to which we shall return in more detail in the course of this chapter. However, though complete or partial monopolies on the sellers' side may be under constraint to

²³ For details, see R. G. Lipsey and Kelvin Lancaster, 'The General Theory of Second Best', 24 *Rev. of Economic Studies* 11 (1956-57); for interpretation and criticism, F. M. Scherer, *Industrial Market Structure and Economic Performance* 22-27 (Chicago: Rand McNally, 1970), and the references given by Scherer at 25 n.30.

²⁴ See on this Ferguson, *op. cit. supra* note 8, at 80; Jesse W. Markham, 'An Alternative Approach to the Concept of Workable Competition', 40 *Am. Econ. Rev.* 349, 361 (1950); J. M. Clark, 'The Orientation of Antitrust Policy', 40 *Am. Econ. Rev.* 93, 95, 98 (1950, Proceedings).

²⁵ Joseph A. Schumpeter, *Capitalism, Socialism and Democracy* 84 (New York: Harper, 3d ed. 1942); François Perroux, *Le progrès économique* (Paris: Presses Universitaires de France, 1967); Donald Dewey, *The Theory of Imperfect Competition: A Radical Reconstruction* (New York: Columbia UP, 1969); John S. McGee, *In Defense of Industrial Concentration* (New York: Praeger, 1971). See also L. J. Zimmerman, *The Propensity to Monopolize* (Amsterdam: North Holland, 1952); Notes, 68 *Yale LJ* 1627 (1959).

exchange the fruits of efficiency and progressiveness with buyers' monopolies, the latter would be under no constraint to do so with unorganized groups such as the consumers. The ultimate consequence of wholly or partially monopolized or monopsonized structures would then be that government would have to step in on behalf of the unorganized consuming part of the nation by imposing rigorous price controls which eventually would have to lead to stringent supervision of the production process as a whole. We believe, therefore, that fostering as much competition as is consistent with the technical and economic conditions for an efficient and progressive production and distribution apparatus is the best position to be taken. Government policy may thus appropriately be directed against economically unjustifiable positions of market power, provided that it takes account of the uniqueness of each case and the evolution of the market situation over a number of years.

In order to establish what influence a firm exerts in a given case, either alone or by restraining competition in conjunction with others – by overt agreement or by tacit collusion – we must have intimate knowledge of the 'competitive environment' on the various markets on which the firm operates. By 'competitive environment' (or 'market structure') we mean all those characteristics of the market on which the nature of competition depends – its degree of perfection, the number of market participants and their relative size, opportunities for entry and whether demand is expanding or stagnating. Knowledge of the structural relationships on the market generally yields no more than presumptions as to the existence or absence of market power, so it may be necessary to assess all the firm's acts on the market – those directly or indirectly affecting competitors and potential competitors and those affecting customers, suppliers and the ultimate consumer. This introduces a normative element into the matter in that evidence of market power has to be derived from the impact of the firm's conduct on these categories of market participants. The structural development of demand may provide certain pointers to the existence of market power as well. In industries where demand is stagnating completely or rising mainly because of population growth, market power may easily assert itself. Where demand is expanding, industries generally have to face competition from inside and outside and monopoly positions seldom arise.²⁶

Now the structure of a market and the behavior of the firms belonging to it are not independent of one another. For one thing, structure can set certain limits to behavior. A firm's freedom of action will generally be affected, for instance, by the number of competitors in the market. If they are numerous and there are no important differences in size among them – a type of structure on which the model of perfect competition is based – none of the sellers can

change, say, his price: there is no point in lowering it because the quantities offered can be sold at the higher market price. In oligopolistic markets, on the other hand, a great deal of latitude is left for market behavior. So changes in structure as a result of corporate combination may bring about more or less radical changes in the behavior of all market participants, depending on the influence that can be exerted by the firm or firms emerging from the combination. Conversely, a firm's behavior can affect the structural element of the competitive environment. For example, a seller may try to shift the demand curve for his products to the right by advertising or sales techniques; this may alter the degree of perfection of the market and, depending on how successful he is, the number of sellers and the conditions of entry. Another instance of certain elements in market structure being changed is where small competitors are forced out of the market by a big competitor's behavior.

The remaining part of this section will be devoted to the problems associated with detecting single-firm or jointly held market power. In subsection 2 we shall deal with those aspects of the competitive environment which may be relevant to this. In subsection 3 we shall fill out the picture with a discussion of the strategies toward the various groups of market participants that may be employed by firms with market power.

3.3.2 Indicia of Market Power: The Competitive Environment

One of the major structural indicia of market power is market share, generally expressed as the percentage of total sales in a given market. Now one possible guide might be to regard as dominant a firm which accounts for more than half the market's output and has succeeded in keeping this share for a number of years. The critical percentage may well have to be higher

²⁸ H. W. de Jong, *Dynamische concentratietheorie* (Leiden: Stenfert Kroese, 1972), has developed in detail the influence of the stage of market development of a product on market structure and competitive processes. He sees a deconcentration phase where the product passes from an introductory to an expansionary stage (a situation reminiscent of that of the imitators of Schumpeter's innovator), whereas concentration appears when the expansion stage of a product passes into a maturity or stagnation stage, characterized by diminishing growth in demand and concomitant overcapacities. At the beginning of the concentration phase price competition still predominates. It is only in the period of what de Jong terms 'market stagnation,' in which the demand for a product rises mainly because of population growth, that typical interdependent behavior in an oligopoly appears. Interesting as de Jong's theory is, it should be borne in mind that the large majority of markets for consumer goods are in a maturity stage, with technical developments mainly concentrated in capital goods and raw-materials processing. His observations underline the necessity, observed above, that an examination of market behavior should be the core of any investigation into the existence and extent of market power.

where a competitor has a substantial share of the market, but if competitors are small and insignificant a lower market share may be enough to signify dominance. A number of American writers have defined 'highly concentrated' industries – i.e. industries in which it can be assumed that there will be signs of joint dominance – as those in which the four largest firms account for at least 50 percent or, alternatively, the eight largest firms for 70 percent of total industry sales.²⁷ Other critical percentages suggested in the literature are 50 percent for a single company and 80 percent for four or fewer companies, if these positions are kept for five years or more.²⁸ German writers in particular set great store by market share as an indicator of market power.²⁹ This is reflected in the recently amended Act against Restraints of Competition, which is discussed in detail in Chapter 7. We should take care, however, not to put too high a value on market share as definite proof of market power, particularly when measuring the influence of a single firm. For the scope that a firm with a large market share may have in pricing policy, production planning and other elements of market strategy is determined chiefly by the resources available to competitors, the conditions of entry to the market and the structure and characteristics of the other side of the market. The first of these factors is a matter of the economic power that any seller may possess, irrespective of market share. For instance, it may happen that the subsidiary of a conglomerate firm which is larger in absolute terms (measured by total assets) than its competitors will be quite capable, given the financial backing it has from the parent company, of affecting the conduct of a large competitor which does not have the benefit of such support. In such circumstances, the large competitor's scope for action may be reduced, and so may its ability to keep its large market share. Whether this is important depends in the first place on the weight of the specific factors governing the lead of the firm with the largest market share over its rivals. As a rule, the more the leading firm owes its market position to factors such as the sole ownership of patents under which competitors cannot obtain licenses (or only at prohibitive prices), control of sources of raw materials or semimanufactures on which competitors also depend, or exclusive possession of licenses, concessions and the like, the less entrenched its market position is likely to be. A second element determining a firm's market position is how eager its competitors are to catch up with it (assuming this to be financially feasible). For a large market share may persist despite the fact that competitors *could* eliminate it, because they are not interested in doing so for the moment.

The height of barriers to entry (including the specific factors already mentioned) is another factor that conditions the freedom of action of firms with a large market share. Depending on their origin, barriers to entry are classified

as natural or artificial. Natural barriers result mainly from the nature of the product and the production process. One of the natural barriers often mentioned is economies of scale, particularly where in the case of suboptimal plant size unit costs are rising sharply. Except in declining-cost industries, this usually happens in very small plants only, so it is not always necessary for new entrants to start off immediately at the optimum scale of production.³⁰ And in all but a few industries, scale economies are not a widespread feature – as was explained in Chapter 2. Apart from the advantages that the leading firm may enjoy in obtaining licenses or scarce raw materials, new entrants and existing competitors alike may find difficulty in obtaining skilled workers, favorable sites and a large network of dealers.³¹ High absolute capital requirements constitute another barrier to entry, since new firms may be at a disadvantage in raising capital. This type of barrier can result from vertical integration, a point that will be discussed later in this chapter. Artificial barriers may be a consequence of legal provisions, but product differentiation can constitute an even higher barrier: intensive brand advertising and a well-established sales organization, perhaps helped by tied distributors, may concentrate consumer preferences on established products and turn them against

²⁷ Joe S. Bain, *Industrial Organization* Ch. 11 (New York: Wiley, 2d ed. 1968), *Barriers to New Competition* (Cambridge, Mass.: Harvard UP, 1956), 'Relation of Profit Rate to Industry Concentration: American Manufacturing, 1936-40', 65 *QJ Econ.* 293, 312-14 (1951), and 'A Note on Pricing in Monopoly and Oligopoly', 39 *Am. Econ. Rev.* 448 (1949); H. Michael Mann and David R. Kamerschen, 'The Determination of Profit Rates in "Oligopolistic" Industries', 42 *J. Bus. U. Chi.* 293 (1969). See also the *Merger Guidelines* released on 30 May 1968 by the US Department of Justice, which will be discussed in Chapter 5 *infra*.

²⁸ Kaysen and Turner, *op. cit. supra* note 21, at 98. See also *id.* at 27, 72, and the review of the work by Corwin D. Edwards in 50 *Am. Econ. Rev.* 1102, 1104 (1960).

²⁹ See, e.g., Oswald Lehnich, *Die Wettbewerbsbeschränkung* 639 (Cologne and Berlin: Heymann, 1956); Harold Rasch, 'Der Begriff des Oligopols im Kartellgesetzentwurf', 6 *Wirtschaft und Wettbewerb* 1 (1956); Eugen Langen, *Marktbeherrschung und ihr Missbrauch nach Art. 86 des EWG-Vertrages* (Baden-Baden and Bonn: Lutzeyer, 1959); Walter Eucken, *Grundsätze der Wirtschaftspolitik* (Tübingen: Mohr, 2d ed. 1955), and 'Die Wettbewerbsordnung und ihre Verwirklichung', in *Ordo: Jahrbuch für die Ordnung von Wirtschaft und Gesellschaft* Vol. 2 (Düsseldorf and Munich: Küpper, 1949); Knut Borchardt and Wolfgang Fikentscher, *Wettbewerb, Wettbewerbsbeschränkung, Marktbeherrschung* (Stuttgart: Enke, 1957).

³⁰ Richard B. Heflebower, 'Barriers to New Competition' (review of Joe S. Bain, *Barriers to New Competition*), 47 *Am. Econ. Rev.* 363, 370 (1957).

³¹ The importance of this last factor in the automobile industry, for instance, comes out very clearly in Hearings before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary, 84th Cong., 1st Sess., *A Study of the Antitrust Laws* Pt. 7: 'General Motors' (1955), and the Subcommittee's Staff Report, 84th Cong., 2d Sess., *Bigness and Concentration of Economic Power: A Case Study of General Motors Corporation* (1956).

anything new. In a number of important industries, however, new entrants are often firms with substantial financial resources and marketing systems of their own, willing and able to make substantial capital commitments, and they may be in a position to surmount these artificial barriers.

How far should account be taken of the probable introduction of new products which might be real substitutes for the relevant product? We are inclined to think that this factor should be taken into consideration in the assessment of competitive conditions only where the products in question can already be seen to be viable technical substitutes but have not yet gained general acceptance.

The importance of market share as an indicium of discretionary power over the market should also be appraised in the light of the characteristics of demand. Financially powerful customers who are themselves capable of producing the goods they buy may effectively limit their suppliers' freedom of action, even when the latter have a large market share. In the absence of such countervailing factors, demand elasticity may work in the same direction if the price elasticity of demand for the product of the oligopolistic industry is high, thus severely restricting a dominant firm in exercising its power. For as there is a direct link between price elasticity and marginal revenue, firms have every interest in enlarging their market share and vigorous price competition will generally develop, even if the market is already concentrated.

For the same reasons, concentration figures for a group of firms (generally the concentration ratio) must be handled with caution if they are to serve as a pointer to market power. Then there are some specific aspects that deserve attention. First of all, account must be taken of the structure of the group. The degree of symmetry in an oligopoly is particularly relevant. The more concentrated production is in the hands of only some of the oligopolists, the more likely it is that the group will act as if it were one firm, whereas a rather different type of interfirm behavior is found among oligopolistic equals – a point which will be examined in more detail in the next subsection. So one and the same concentration ratio may give a very different impression of competition depending on whether the oligopoly situation in question is symmetrical or not. Apart from the influence of potential competition on the behavior of the oligopolists, that of smaller competitors (marginal sellers) should also be investigated; as we shall see below, this factor may decisively influence performance in an oligopoly. Finally, the study of size mobility may be a useful complement to concentration ratios as an indicium of competitive rivalry in an oligopoly. We may therefore agree with Preston when he says:

If we should find, for example, that the shape of the firm size distribution was

closely associated with size or age of industry, rate of industry growth, et cetera, we could develop finer criteria for distinguishing between normal and abnormal concentration levels and between the causes of particular concentration patterns and their effects. Second, size mobility may be of interest for its own sake as an expected characteristic of competitive markets.³²

Even where the concentration ratio for a group of firms remains the same over a number of years, there may be considerable changes in the identity of the firms making up the group – because new firms have entered and existing ones dropped out – in rank order or in relative size. The value of mobility studies for our purposes is somewhat diminished, however, by the fact that several of them have shown a positive correlation between the height of industry concentration and rigidity in the rank order of the largest firms. This means that in certain highly concentrated industries the position of the big firms is safer from attack (by competitive or other forces) than in a less concentrated environment.

It is interesting at this stage to mention briefly the results of a considerable number of empirical inquiries into the relation between concentration ratios and one important facet of market performance – rates of return, averaged over the period of investigation. The studies differ greatly both in the samples of firms and industries used and the time periods studied and in the definition of profit margin. The oldest and best-known contributions in this field are from Bain, Mann and Stigler. Bain found a positive correlation between the rate of return (profits as a percentage of total assets, value of shipments, etc.) and concentration in 42 four-digit industries for the period 1936–40. However, Bain stresses barriers to entry as the real reason for profits above the competitive level. A later investigation by Mann, examining the effect of concentration and barriers to entry on average rates of return for 30 four-digit industries for the years 1950–60, came to comparable conclusions.³³

³² Statement of Dr. Lee E. Preston, University of California at Berkeley, in *Economic Concentration*, 88th Cong., 2d Sess., Pt. 1: 'Overall and Conglomerate Aspects', at 60 (1964). See also Norman R. Collins and Lee E. Preston, 'The Size Structure of the Largest Industrial Firms, 1909–1958', 51 *Am. Econ. Rev.* 986 (1961); Michael Gort, 'Analysis of Stability and Change in Market Shares', 71 *J. Pol. Econ.* 52 (1963); Herbert A. Simon and Charles P. Bonini, 'The Size Distribution of Business Firms', 48 *Am. Econ. Rev.* 607, 616 (1958); Edwin A. Mansfield, 'Entry, Gibrat's Law, Innovation and the Growth of Firms', 52 *Am. Econ. Rev.* 1023 (1962).

³³ Bain, 'Relation of Profit Rate to Industry Concentration: American Manufacturing, 1936–40', *supra* note 27, and *Barriers to New Competition*, *op. cit. supra* note 27; H. Michael Mann, 'Seller Concentration, Barriers to Entry and Rates of Return in Thirty Industries, 1950–1960', 48 *Rev. of Economics and Statistics* 296 (1966). For a brief description of more recent studies that have followed Bain's approach, see Louis Philips, *Effects of Industrial Concentration* 39–42 (Amsterdam: North Holland, 1971).

Stigler also found a positive correlation using a sample of 99 three-digit industries for 1938–57, though the correlation became insignificant when an adjustment was made for proprietors' earnings.³⁴ Apart from these earlier contributions, more recent studies have revealed positive correlations as well. Miller has found highly significant regression coefficients. From his sample he found that a one-percent increase in the four-firm concentration ratio caused a 0.76-percent increase in the industry profit rate. When the marginal sellers grow in importance and the big firms are subject to keener competition, the opposite can be expected: Miller established that a one-percent increase in the eight-firm marginal concentration ratio will cause a 0.28-percent decrease in the industry profit rate. In a penetrating study Collins and Preston, using four-digit and two-digit industry samples and correlating concentration ratios with rates of return and with average price/cost margins, also found a positive relationship, though a less strong one in the four-digit sample.³⁵

We cannot necessarily deduce from these correlations that the industries investigated were characterized by market power. On a technical level, the results of the empirical investigations were rather uneven because the industry samples and time periods chosen were different or the profit rates used did not represent net profits. A number of students, using updated time series, larger samples and more sophisticated statistical processes, have recently found no relation between profitability and concentration. An additional problem is how far concentration ratios based on Census industries (which all studies used) correctly reflect power relationships in the industries concerned.³⁶ Then there is the question whether the profit figures used for the inquiries can really be regarded as above-average profits. For instance, Mann and Meehan correctly observe that Collin's and Preston's measurement of the price/cost margin does not reflect net profit but includes advertising outlays, which, as we shall see, can be positively correlated with concentration.³⁷ This necessitates adjusting the company profit data for all kinds of fortuitous factors; we shall consider this point in detail in discussing the value of profit rate as an indicium of market power later in this chapter. It also means, however, that no presumptive conclusions may be drawn from these inquiries either.

To sum up, then: however valuable a thorough knowledge of the competitive environment may be in tracking down market power, it will not give us *proof* of the existence of market power. The only exception is the rare case of a firm that accounts for more than half the total sales on the relevant market and shows no signs whatsoever of losing its market share in the near future because of the emergence of new competitive products or of new entry by strong competitors. As 'definitive statements cannot be made concerning those conditions of market structure that are and are not conducive to a reasonably

good . . . performance,'³⁸ we also have to examine market behavior before we can judge how competition is functioning on the relevant market.

3.3.3 Indicia of Market Power: Behavior and Performance Standards

What criteria may usefully be called upon to strengthen evidence of the existence of market power that has come to light on an examination of structural factors? For the economist, the effectiveness or workability of competition is to be judged by the quality of performance. As competition cannot function properly under conditions of market power, the performance of the

³⁴ George J. Stigler, *Capital and Rates of Return in Manufacturing Industries* Ch. 3 (Princeton, NJ: Princeton UP, 1963), and 'A Theory of Oligopoly', 72 *J. Pol. Econ.* 44 (1964). See also Victor R. Fuchs, 'Integration, Concentration and Profits in Manufacturing Industries', 75 *QJ Econ.* 278 (1961). Philips gives a good description of these studies, *op. cit. supra* note 33, at 42-48.

³⁵ Richard A. Miller, 'Marginal Concentration Ratios and Industrial Profit Rates: Some Empirical Results of Oligopoly Behavior', 34 *Southern Economic J.* 259 (1967). See also idem, 'Market Structure and Industrial Performance: Relation of Profit Rates to Concentration, Advertising Intensity and Diversity', 17 *J. of Industrial Economics* 104 (1968-69). Norman R. Collins and Lee E. Preston, *Concentration and Price-Cost Margins in Manufacturing Industries* 108 (Berkeley and Los Angeles: University of California Press, 1968), found that 'Concentration alone . . . never explained as much as a half, and rarely as much as a fourth, of the variation in margins among four-digit industries.' In 'Price-Cost Margins and Industry Structure', 51 *Rev. of Economics and Statistics* 272, 283 (1969), Collins and Preston found 'a significant association' among four-digit industries and a 'substantially stronger association between concentration and margins in consumer goods industries, as compared to producer goods industries.'

³⁶ Yale Brozen, 'Bain's Concentration and Rates of Return Revisited', 14 *J. of Law and Economics* 351 (1971); H. Michael Mann and James W. Meehan, Jr., 'Concentration and Profitability: An Examination of a Recent Study', 14 *Antitrust Bull.* 385, 391-92 (1969). See also Yale Brozen, 'Concentration and Structural and Market Disequilibria', 16 *Antitrust Bull.* 241 (1971), in which it is suggested that higher profits in concentrated industries are not the result of concentration, barriers to entry, etc., but may be explained by disequilibrium (i.e. changes in the rate of growth of demand). However, John T. Wenders, 'Profits and Antitrust Policy: The Question of Disequilibrium', 16 *Antitrust Bull.* 249 (1971), has shown that the relationship between profit rates and disequilibrium only holds good for unconcentrated industries.

³⁷ Mann and Meehan, *supra* note 36, at 392. See also Yale Brozen, 'Significance of Profit Data for Antitrust Policy', 14 *Antitrust Bull.* 119, 126-30 (1969); J. Fred Weston and Stanley I. Ornstein (eds.), *The Impact of Large Firms on the US Economy* Pt. 2 (Lexington, Mass.: Heath, Lexington Books, 1973).

³⁸ Bain, *Industrial Organization*, *op. cit. supra* note 27, at 464. See also John Perry Miller, 'Measures of Monopoly Power and Concentration: Their Economic Significance', in Universities-National Bureau Committee for Economic Research, *Business Concentration and Price Policy* 119, 127-29 (Princeton, NJ: Princeton UP, 1955).

firms in such a market will generally fall short of what would be feasible in a workably competitive environment and the discovery of such instances of suboptimal performance presumably entitles us to infer market power. In the practical application of competition theory, on the other hand, particularly by lawyers, the behavior of the firm or group of firms will generally play an important part as evidence, since a modicum of basic economic knowledge at least is needed in handling performance standards and abusive behavior is generally considered the best proof of market power. Market behavior by dominant firms or groups of firms may be regarded as abusive if other market participants have their freedom of action restricted or completely destroyed thereby. Unless evidence of abusive behavior can be found in the fact that a substantial number of market participants are harmed by a dominant firm's business practices, an unfavorable impact on market performance must be shown. For only a dominant firm is in a position to apply restrictive practices successfully, holding back on performance by limiting production or otherwise. In all cases where it is impossible to show sufficient evidence of collusive behavior in an oligopoly from the observable actions of the oligopolists, we must therefore rely exclusively on performance. In the following three subsections we shall go into greater detail on the aspects of market behavior and performance relevant to a showing of market power.

3.3.3.1 *Corporate Behavior as Indicium of Market Power*

A distinction should be made between practices or strategies that are *per se* abusive (by reason of the way they are employed or because of their nature) and patterns of conduct which, though they may be considered more or less normal business practices in themselves, may hamper or totally block such freedom of choice as remains when employed by a dominant firm. The use of practices which are abusive *per se* is not a monopoly of dominant firms, so they cannot serve as conclusive proof of market power in themselves. Certain patterns of abusive behavior may frequently be employed by dominant firms, however, for the stronger a firm's position on the market, the easier it is to resort to abusive practices without fear of retaliatory action. Patterns of abuse may be found in exclusionary practices, for instance, but as the excesses of 'rugged capitalism' with its gross infringements of proper or fair market conduct as a means of driving competitors out of the market are inconceivable nowadays, typically exclusionary practices are hard to find in any great quantity. It is chiefly where a firm's competitors are dependent on it for supplies of raw materials or where it is a major purchaser of their products that a firm's conduct toward its competitors may readily assume an exclusionary character if the firm has market power. Here we come up against

the problems of competitive relations between integrated and nonintegrated firms. If the nonintegrated firms in a market are to an appreciable extent dependent for their supplies on integrated firms which are also their competitors, then the latter are in a position to influence their costs and sales, or even their very existence, in periods of short supply by refusals to deal. A well-known abuse of integration is the practice of squeezing. In price squeezing, for instance, the integrated firm charges its competitors considerably higher prices than it charges its own processing divisions, while at the same time maintaining the price of the end product or even reducing it. By these tactics, nonintegrated firms may either be forced out of business or have to accept a merger with their big integrated competitor. Two further practices which may also be considered inherently abusive are the use of tying contracts and reciprocal dealing. The tying contract is a device employed by a producer (who should generally have a quasi-monopoly position to make the practice work) to oblige his customers to purchase other goods from him in which he has no advantage over his competitors. Reciprocal dealing is often favored by diversified or conglomerate firms, which are both buyers and sellers on a number of markets, because they can use their considerable purchasing power to coerce suppliers to buy from them in return. These practices are not so popular in firms whose various divisions act as highly independent units, since a firm that imposes reciprocal dealing on its suppliers cannot be sure of obtaining the lowest price for the goods it buys.

The abusive character of a firm's strategy may also be deduced from the nature of its acts, some of which may furnish pointers to market power. A typical instance of this is geographic price discrimination, i.e. the charging of different prices in different areas. This is a practice whereby a seller operates at lower or even negative margins in those parts of his product market where he has to face keen competition and compensates by charging too high a price in other areas. Such a strategy bespeaks a freedom of action that indicates market power in the latter areas.

Extension of the rights under a patent beyond the purposes for which it was granted may in certain circumstances be a vehicle for establishing or amplifying market power, i.e. if the effect is to drive competitors out, to frustrate attempts by newcomers to gain entry to a market or to limit retailers' opportunities of passing on economies to their customers. From the large catalogue of abuses that are practiced in this field we may cite the policy of consistently buying up all new patents in a specific area and engaging in constant litigation to prevent other firms from using them, that of withholding know-how and that of preventing relatively rare kinds of senior employee (technicians and marketing specialists, for instance) from joining competitors

or newcomers. Then there is the practice whereby oligopolists having only partial patent protection in a complicated production process cross-license each other but refuse to license smaller competitors or new entrants. If they have new patents ready to replace expiring patents, such firms may enjoy virtually permanent patent protection and thus permanently foreclose their competitors from certain activities.

More important than these *per se* abuses because of their frequency and scope are those forms of market behavior that can generally be considered normal business practice but may take on an abusive character when employed by a dominant firm. This should not imply that pointers to market power should be sought in *any* evidence that a dominant firm has benefited from its position in a way that would have been impossible had it not in fact occupied such a position. Only if we were to take the view that all participants in the market should necessarily operate from the same starting point because healthy competition is not guaranteed otherwise could we argue along these lines. But this view, though designed to protect competitors, would deprive many firms of their incentive to expand and thus remove a substantial element of competition. One suitable means of detecting market power is to enumerate patterns of behavior that a firm may adopt toward the various groups of transactors with which it deals and from which evidence of abuse of market power may be deduced. Up to a certain point these examples may also hold good for the conduct of oligopolists. But then there are quite distinctive aspects of oligopolistic conduct which justify separate treatment of the showing of *joint* dominance in oligopolistic markets.

A firm's conduct toward competitors, though not *per se* abusive, may nevertheless restrain competition if it prevents the competitors from performing their function. One instance of this is where a firm employs profits earned on one product to sell another product on more favorable terms than would have been possible without this transfer of earnings – a practice comparable with geographic price discrimination. This may allow a firm to sell at a loss or at prices that produce only a below-average profit margin. Such a strategy, known as product discrimination, does not always provide sufficient evidence of market power by itself. It fails to do so, for instance, where a firm is offsetting the losses incurred in setting up a new plant. Abuse that might be attributable to market power should be presumed only where a firm accepts considerable losses over a fairly long period and compensates this by the profits it obtains in other markets. Since a policy of this kind is only conceivable if the firm makes above-average profits in these markets, product discrimination must be considered indicative of abuse of dominance in the markets where the firm is already established and a vehicle for the extension of its

dominance to the new market.

Another field in which action may have abusive effects on competitors and thus restrain competition is advertising. An advertising budget that is very large in proportion to total sales in a market may indicate a desire to keep or attain a dominant position in that market; in oligopolistic industries, we should expect much higher advertising outlays. But is there a significant positive relationship between advertising and market concentration? Antitrust policy has inspired a number of American economists to test empirically the presumed relationship. Their conclusions are highly divergent: some have found a positive relationship, while others have come to the conclusion that no significant positive correlation exists.³⁹ However, these studies employed diverse statistical techniques and levels of data aggregation (three-digit as against four-digit data), which may explain some of the differences in the findings. Another reason may be connected with the sample of industries used for the correlation. A study on the reasons underlying concentration processes has observed that advertising and other sales promotion outlays may be as well made in the introductory and expansion phases of a product, when market structure is still relatively unconcentrated, as afterwards in the maturity stage and under rigid oligopolistic conditions. And, as we have remarked before, consumer goods are generally in the last category, whereas many producer goods are manufactured under relatively unconcentrated conditions.⁴⁰ The statistical absence of a positive correlation, then, does not necessarily lead to the conclusion that advertising does not confer monopoly power. For, as has correctly been pointed out, heavy advertising may be an expression of vigorous nonprice competition in an oligopoly, resulting in more unstable market shares than occur in markets where only price competition prevails, and this, as we observed in Chapter 2, may be one of the inducements to seek as high as possible a market share.⁴¹

Restrictive conduct toward potential competitors from which evidence of market power may be deduced can take a variety of forms. Apart from the

³⁹ An overview of this literature is presented by Robert B. Ekelund, Jr., and William P. Gramm, 'Advertising and Concentration: Some New Evidence', 15 *Antitrust Bull.* 243 (1970), who themselves found no significant correlation. See also their 'Advertising and Concentration: More on Tests of the Kaldor Hypothesis', 16 *Antitrust Bull.* 105 (1971); L. G. Telser, 'Some Aspects of the Economics of Advertising', 41 *J. Bus. U. Chi.* 166 (1968). H. Michael Mann and James W. Meehan, Jr., 'Advertising and Concentration: New Data and an Old Problem', 16 *Antitrust Bull.* 101 (1971), have criticized Ekelund's and Gramm's findings.

⁴⁰ De Jong, *op. cit. supra* note 26, at 101-04.

⁴¹ See Scherer, *op. cit. supra* note 23, at 342-43.

difficulty of matching dominant firms' expenditures on advertising, for instance, new entrants may find it difficult to acquire raw materials because integrated firms resort to harsh practices such as refusals to deal or more subtle ones such as higher prices and long delivery dates even though they do not need the raw materials for their own purposes. And when competitors and potential competitors are caused serious difficulties in disposing of their products because by obliging its dealers to refrain from selling competitors' goods a firm is able to reserve the best and greatest number of sales outlets to itself exclusively, this too is a strong indication of market dominance. A related form of arrangement is the tying contract. This, however, is not the place to discuss the implications of exclusive dealing agreements and tying contracts for competition.⁴²

Types of conduct toward suppliers, such as unilateral determination of terms of delivery or sharp variation in orders, may point to market power on the buyers' side of the market if suppliers are unable to find other outlets for their production. Most often, it is subcontractors who are exposed to such practices.

A firm's conduct toward its customers may also be indicative of market power. For instance, evidence of a dominant position may be found in the terms on which a firm supplies its products if these terms are considerably stiffer than those that its competitors impose on their customers but its position on the relevant market is not thereby affected. Though this practice may stand alone, it is mostly the consequence of reciprocal buying practices by conglomerate firms in which they use their purchasing power to induce customers to favor the products of a parent or affiliated company. However, reciprocity need not go so far in order to have an unfavorable impact on competition, for it generally enables large diversified firms to increase their market share at the cost of small specialized competitors. Over a longer time span, this may give an unconcentrated industry an oligopolistic structure and heighten entry barriers. Finally, evidence of market power may be found in practices designed to extend the legal rights of the owners of trademarks – for instance, by imposing resale-price maintenance and other sales conditions. Here, evidence of bad performance may point to abusive conduct, as in some cases on which the Court of Justice of the European Communities in Luxembourg has ruled.⁴³

Finally, market dominance by a seller may manifest itself in price and production strategy toward the final consumer – as when he is able to charge much higher prices than his competitors or to show a poor record in other aspects of performance without losing a substantial share of his customers. We shall be going into some detail on performance criteria in the following subsection. Here it should be added that anticompetitive conduct of the types

mentioned above may automatically diminish the quality of competition.

We must now turn our attention to the question when joint market power can be presumed in oligopolistic structures. Of course, joint market power can be inferred most readily from joint acts against the other market participants of the kind described above as typifying abuse by dominant firms. But if actual instances of this are not to hand, indicia of joint dominance must be sought in the oligopolists' conduct toward each other. A major ground for inferring joint market power could be the existence of agreements between the firms making up the oligopoly. If the number of sellers is relatively large, with none of them big enough to be dominant, monopolistic conduct and performance are only conceivable if the sellers have an overt agreement and are able at least to bar entry to the market. However, in the many markets where a small number of big firms account for either total output or most of the output, there may be little or no competition between the oligopolists, even if there is no overt agreement. For the nature of oligopolistic competition is determined by the relation between the oligopolists themselves and by that between the oligopolists and the rest of the market. In an oligopolistic market the market strategy of the sellers must take account not only of the demand reactions of their customers but also of their competitors' reactions. For the sales of each of the oligopolists constitute a substantial part of total sales; if we assume that demand is inelastic in the short run (which is in fact the case with most goods), any increase in demand for the products of one seller will automatically mean lower sales for all the others. In order to find out how far conduct of this kind reveals a behavioral pattern from which market power may be deduced, we shall be going into some of the major aspects of competition in oligopoly below. We shall begin with pure oligopoly, where

⁴² There is an extensive literature on exclusive dealing. See, e.g., John Perry Miller, *Unfair Competition* Ch. 10 (Cambridge, Mass.: Harvard UP, 1941); A. G. Papandreou and J. T. Wheeler, *Competition and Its Regulation* Ch. 20 (New York: Prentice-Hall, 1954); *Att'y Gen. Nat'l Comm. Antitrust Rep.* 137-49 (Washington, DC: Government Printing Office, 1955); Milton Handler, *Antitrust in Perspective* Ch. 2 (New York: Columbia UP, 1957). See also the EEC Commission's decision in the *Grundig-Consten* case, filed under Article 85 of the EEC Treaty: *Décision de la Commission du 23 septembre 1964 relative à une procédure au titre de l'article 85 du traité* (IV-A/00004-03344 'Grundig-Consten'), 7 *Journal officiel des Communautés européennes* No. 161, 20 Oct. 1964, p. 2545.

⁴³ In *Sirena Srl v. Eda Srl*, Case 40/70, 18 Feb. 1971, 17 *Raccolta della giurisprudenza della Corte* 69, but much more so in the spectacular *Deutsche Grammophon Gesellschaft mbH v. Metro-SB-Grossmärkte GmbH & Co. KG*, Case 78/70, 8 June 1971, 17 *Sammlung der Rechtsprechung des Gerichtshofes* 487, the Court, ruling on Article 86 of the EEC Treaty, severely limited the freedom of the owner of a trademark to impose unilateral obligations on his customers.

total output is completely controlled by a few large firms, and then go on to consider partial oligopoly, where we need to inquire into the influence of small competitors on the oligopolists' conduct and their reactions to this influence.

The crux of any theory of oligopoly is the assumptions made about a firm's reactions to the behavior of its rivals. The theorists have attempted to solve these problems (sometimes with the help of mathematical models) on the basis of certain assumptions, and empirical studies of pricing in a number of oligopolistic industries have also been carried out. Models have been constructed for homogeneous oligopoly⁴⁴ and heterogeneous oligopoly.⁴⁵ There is a celebrated theory of heterogeneous oligopoly that assumes a kink in the demand curve of the oligopolist, arguing that if the oligopolist lowers his price, his competitors will follow suit for fear of losing sales but will not follow if he raises his price.⁴⁶ As the oligopolist would be in a worse position than before in either case, oligopoly, at least under the assumptions of this theory, leads to price rigidity. The value of such conclusions about the course of events on oligopolistic markets, however, is sharply reduced by the fact that the theory does not explain the level at which prices will be fixed or where the kink will occur, points which are specifically relevant once basic changes in cost or demand occur. Apart from this, the underlying assumptions are too narrow. For instance, entrepreneurs have decidedly wider aims than the independent profit maximization presumed in the models. Another of the models' failings is that they take into consideration only the reactions to changes in rivals' prices, while rivals' responses to these reactions are ignored. Nor do they take account of the influence of potential competition on pricing policies. Finally, the models utilized are static, ignoring the influence of growth and expectations of growth, dependent upon the development stage of the product, which are crucial in explaining oligopolistic behavior.⁴⁷ In view of these unrealistic assumptions, we shall not be discussing these static models in greater detail in this study.

A number of writers have used game theory to explain what pattern of oligopolistic behavior emerges where account is taken of rivals' responses to initial reactions,⁴⁸ but the results obtained so far, especially in games with more than two players, do not enable us to make statements on the most probable pattern of conduct either. Fellner considers that the oligopolists attain peaceful coexistence by damping down the intensity of price competition among themselves through formal or informal agreements (sometimes called quasi-agreements or agreements to agree).⁴⁹ If restrictive agreements are against the law, the vigor of competition can be weakened by some sort of coordination in the market strategies of the firms. Parallelism of action such as price leadership may lessen competition for a time, but not indefinitely.⁵⁰

An example of this phenomenon occurs when one of the sellers has a much bigger market share than his competitors. In this case, the leadership of this firm is a logical consequence of the structure of the market: its small competitors have no option but to follow its lead. A typical example of such a market situation is found in the American steel industry, where US Steel has long played a dominant role. (We shall be giving fuller attention to the characteristic problems of competition in this industry in Part 2.) Another example of price leadership is where the oligopolists follow the prices or other terms set by one of their number because it proved in the past that he had the feel of the market; this what is known as 'barometric price leader-

⁴⁴ Augustin A. Cournot, *Recherches sur les principes mathématiques de la théorie de la richesse* (Paris: Hachette, 1838). For comment on Cournot's theory, see J. Bertrand, 'Théorie mathématique de la richesse sociale' (review), *Journal des savants* 499 (Sept. 1883), and F. Y. Edgeworth, *Papers relating to Political Economy* Vol. 1 (London: Macmillan, 1925). See also Wilhelm Krelle, *Preistheorie* (Tübingen: Mohr, 1961), and A. Heertje's discussion of the development of the Cournot model ('Oligopolie', 115 *De Economist* 611, 632 (1967)).

⁴⁵ Von Stackelberg, *op. cit. supra* note 5; Chamberlin, *op. cit. supra* note 2. See also Krelle, *op. cit. supra* note 44; Alexander Henderson, 'The Theory of Duopoly', 68 *QJ Econ.* 565 (1954); and authors cited note 48 *infra*. See also Peter Asch, *Economic Theory and the Antitrust Dilemma* 54-64 (New York: Wiley, 1970), for a concise discussion of some of these models.

⁴⁶ For discussion of oligopolistic behavior on these assumptions, see R. L. Hall and C. J. Hitch, 'Price Theory and Business Behaviour', 2 *Oxford Economic Papers* 12 (1939). See also Paul M. Sweezy, 'Demand under Conditions of Oligopoly', 47 *J. Pol. Econ.* 568 (1939). The kinked demand curve is assessed in Committee on Price Determination, Conference on Price Research, *Cost Behavior and Price Policy* 278 (Princeton, NJ: Princeton UP, for National Bureau of Economic Research, 1943); George J. Stigler, 'The Kinky Oligopoly Demand Curve and Rigid Prices', 55 *J. Pol. Econ.* 432 (1947), reprinted in American Economic Ass'n, *Readings in Price Theory* 410, 421-34 (Homewood, Ill.: Irwin, 1952); C. W. Efrogmson, 'The Kinked Oligopoly Curve Reconsidered', 69 *QJ Econ.* 119 (1955); Andriesen, *op. cit. supra* note 13, at 117-20.

⁴⁷ De Jong, *op. cit. supra* note 26, at 116-20. An attempt to introduce an element of dynamics into the models of Cournot, Chamberlin and Fellner (cited note 49 *infra*) is made by A. Heertje and R. A. Hirschfeld, 'Quelques remarques sur la dynamisation de la théorie de l'oligopole', 16 *Economie appliquée* 29 (1963).

⁴⁸ The standard work is J. von Neumann and O. Morgenstern, *Theory of Games and Economic Behavior* (Princeton, NJ: Princeton UP, 1944). See also Martin Shubik, *Strategy and Market Structure* (New York: Wiley, 1959). Although game theory tries to provide a certain psychological explanation of entrepreneurial behavior on oligopolistic markets, it does not solve the problem of the reaction hypothesis, as is rightly pointed out by A. Heertje, *De prijsvorming van consumptiegoederen op oligopolistische markten* 98 (Leiden: Stenfert Kroese, 1960).

⁴⁹ William Fellner, *Competition among the Few* 22, 35 (New York: Knopf, 1949).

⁵⁰ For a discussion of price leadership, see Stigler, *supra* note 46, 55 *J. Pol. Econ.* 432, 434 (1947); Jesse W. Markham, 'The Nature and Significance of Price Leadership', 41 *Am. Econ. Rev.* 891 (1951). See also Almarin Phillips, *Market Structure, Organization and Performance* 21-46 (Cambridge, Mass.: Harvard UP, 1962).

ship.⁵¹ But it may also be that the price leader is the firm with the lowest profit-maximizing price. Over a time span, price leadership may then pass into the hands of different firms if market positions among these firms change.⁵² Knowing the existence of these types of behavior, however, gives no insight into market performance (e.g. the level at which prices will be set). For the price leader has the choice between short-run profit maximization and seeking a price level that enables the other firms to obtain more satisfactory profits (if there is a difference between the two price levels). Apart from this, price leadership should not be considered a cause of collusive behavior in an oligopoly but one of its expressions; so it is not by forbidding it that competitive conditions in an oligopoly will be restored, for oligopolists will then turn to other forms of mutual understanding. Zimmerman has shown that the inclination for oligopolists to cooperate is particularly strong in capital-intensive industries making a product that is not easily differentiated and where the growth of demand is slight, a situation that resembles the reaction of oligopolists to the stagnation phase in a product's life cycle.⁵³ For the oligopolists know that vigorous price competition on such markets can easily lead to price warfare. The upshot of all these theories, then, is that downward price rigidity is a probable outcome of oligopolistic behavior. Oligopolists may well try to raise prices toward a pure monopoly level, but their success will be conditional on the vulnerability of the market to outside competitive pressures.

The theories discussed above all start from the assumption that the firm is a profit maximizer in the short run, but this is a doubtful assumption where market structures are no longer atomistic. The conclusions about price behavior on oligopolistic markets to be drawn from these theories, then, cannot be accepted without further examination unless it is assumed that the firm regards its other goals as constant, i.e. that their marginal utility is zero. This, however, would be another limited assumption, so these theories must be considered to give no clear picture of the way in which competition functions in concentrated markets.

Guidelines for the solution of competition problems must therefore be sought in theories which make more realistic assumptions about entrepreneurial goals. Such theories, however, are few and far between. Rothschild assumes that the aim of the oligopolist, especially on perfect markets, is to survive and that he will therefore be content to secure a minimum level of profit rather than try constantly to maximize profits. In the longer run this may even be more likely to yield maximum profit (because new rivals are deprived of incentive to enter the market, for instance, and periods of keener competition are thus avoided) than concentrating on immediate gains. Rothschild takes the view that this will bring about something of an armed truce

between the oligopolists, who will set neither high nor low prices, using price as a parameter of action only where substantial changes occur in the supply or demand situation.⁵⁴ Baumol regards maximization of sales, given a minimum level of profits, as a realistic assumption about the goal of oligopolistic behavior.⁵⁵ For Baumol, this means that the entrepreneur's primary aim will be to increase his share of the market and thus strengthen his position. Baumol's views seem most relevant for firms in growth industries in which the demand curve for the products of the individual sellers can be pushed to the right but leave us without guidance for the assessment of behavior in those oligopolies in which joint market power may most often arise. Another descriptive theory, known as the 'behavioral theory', in which the actions of the firm are determined by a process of consultation and conflict between its different divisions, does not really explain oligopoly pricing either.⁵⁶ These theories offer certain insights into what lies behind corporate behavior but certainly do not provide the material for a reasonable assessment of the workings of the market mechanism.

We should therefore proceed to empirical observations on firms' behavior in concentrated markets over a rather long time span. The knowledge so far obtained by empirical means is limited, but it does confirm certain aspects of oligopolistic strategy put forward in theory. With the growing interest in pricing on oligopolistic markets it was discovered in the 1930s that for a number of products investigated prices were generally inflexible in the short run – one of the characteristics of what was baptized 'administered pricing.'⁵⁷ As

⁵¹ This terminology stems from Stigler, in American Economic Ass'n, *op. cit. supra* note 46, at 431.

⁵² See William Hamburger, 'Conscious Parallelism and the Kinked Oligopoly Demand Curve', 57 *Am. Econ. Rev.* 266 (1967, Proceedings), and P. Pashigian's discussion of Hamburger's paper, *id.* at 271.

⁵³ Zimmerman, *op. cit. supra* note 25, at 47; de Jong, *op. cit. supra* note 26, at 116–130.

⁵⁴ K. W. Rothschild, 'Price Theory and Oligopoly', 57 *Economic J.* 299 (1947), reprinted in American Economic Ass'n, *op. cit. supra* note 46, at 440, 450–63.

⁵⁵ William J. Baumol, *Business Behavior, Value and Growth* (New York: Harcourt, Brace & World, rev. ed. 1967).

⁵⁶ See R. M. Cyert and James G. March, *A Behavioral Theory of the Firm* (Englewood Cliffs, NJ: Prentice-Hall, 1963).

⁵⁷ Gardiner C. Means, *Industrial Prices and Their Relative Inflexibility*, S. Doc. 13, 74th Cong., 1st Sess. (Washington, DC: Government Printing Office, 1935). See also John M. Blair, 'Means, Thorp and Neal on Price Inflexibility', 38 *Rev. of Economics and Statistics* 427 (1956), and 'Administered Prices: A Phenomenon in Search of a Theory', 49 *Am. Econ. Rev.* 431 (1959); Hearings before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary, 85th Cong., 1st Sess., *Administered Prices Pt. 1: 'Opening Phase: Economists' Views'* (1957).

in the short run substantial changes in the supply or demand situation will not generally occur, other types of competition may come to the fore, such as quality competition, brand advertising, gift schemes or discounts.⁵⁸ And we should not overlook the fact that a certain degree of price inflexibility in the short run with many products today is encouraged by all kinds of technical factors, such as the cost of changing price lists, the inconvenience to which this puts processors and, even more, distributors (especially inventory losses incurred when prices are reduced), damage to brand images and so on. This last factor takes on even more importance on certain markets which have a relatively homogeneous product (gasoline, soap powder and detergents, for instance) but where sellers nevertheless try to build up a brand image.

In the longer run things may be different, and it is on this point that any investigation into the existence of joint market dominance may fruitfully concentrate. Whether nonprice competition devices will remain much of a substitute for price competition depends on the one hand on such factors as whether any changes in demand are spread evenly among the oligopolists and on the pressure of potential competition and on the other hand on the psychological climate among the oligopolists. If the big sellers all realize that they each have the financial means to wage a price war, peaceful coexistence (meaning the absence of fierce price competition) may be favored – even in the longer run. Such community of interest may even extend to several geographic and product markets and may take in potential competitors as well in the case of conglomerate firms. A typical example of such a situation was the international chemical cartel, constituted by the United States' du Pont, Britain's Imperial Chemical Industries and Germany's IG Farben, dividing world markets between these firms and restricting price competition where they already met as competitors.⁵⁹ However, apart from cases of international cartels there is little empirical evidence, no doubt because of the severe anti-cartel legislation in the United States.⁶⁰ Aggressive price competition may also be absent in those markets where one firm has financial staying power on such a scale that it could drive all its rivals out of the market if competitive warfare should break out. Examples of types of parallelism arising for this last reason can be found not only in the United States (the steel industry) but also in Europe (the margarine industry). In the end, the success of coordination will largely be determined by the personalities of the businessmen involved and may be measured by the extent to which oligopolists are able to escape the consequences of basic changes in demand or cost conditions which could unfavorably affect them. Particularly clear indications of joint market power may thus be found when price rigidity is practiced in the face of a recession or when firms are able to avoid introducing new cost-saving techniques. Two

observations should be made here. First, the existence of price rigidity should preferably not be deduced solely from the fact that list prices have not changed. For many industries indulge in price shading, so that the frequency and importance of discounts should also be taken into account, though we concede that empirical evidence may be meager since much of it is deliberately kept secret. Second, price rigidity may not under all circumstances be consistent with profit maximization – assuming this to be the main target of the firm or firms involved. Whether it will be depends on the shape of the marginal cost function and the degree of elasticity of demand. If marginal costs are constant, price rigidity or even price increases in a recession will pay only if demand elasticity does not change or decreases. If the marginal cost function is upward sloping but shifts downward under the influence of diminishing input costs, a profit-maximizing monopolist will only raise his price when demand becomes less elastic and if so doing will have a greater effect than shifting downward along his marginal cost curve by reducing output. In all other circumstances a price reduction may favorably affect total profits of the firms in highly concentrated oligopolies too.

Evidence of long-term price behavior in concentrated industries is not particularly abundant. There are a number of general studies written with a view to establishing a relationship between market structure and inflation, to which we shall briefly return later in this chapter, but their results are inconclusive, partly because they relate to industries operating under different cost and demand conditions. More conclusive evidence is to be found in studies of individual industries. A number of studies of American industries with oligopolistic structure show a rather high degree of price sensitivity among the sellers in homogeneous oligopoly, where, depending on the form of parallel action that has emerged, firms are generally quick to follow a price cut by

⁵⁸ See Lawrence Abbott, *Quality and Competition* (New York: Columbia UP, 1955).

⁵⁹ See Alfred E. Kahn, 'The Chemical Industry' in Walter Adams (ed.), *The Structure of American Industry* 246–52 (New York: Macmillan, 3d ed. 1961); George W. Stocking and Myron W. Watkins, *Cartels in Action* Chs. 9–11 (New York: Twentieth Century Fund, 1946).

⁶⁰ A 'spheres of influence' hypothesis as a more generalized danger accompanying the rise of conglomerate firms was first put forward by Corwin D. Edwards, 'Conglomerate Bigness as a Source of Power', in Universities-National Bureau Committee for Economic Research, *op. cit. supra* note 38, at 335. See also Scherer, *op. cit. supra* note 23, at 278–80.

one of their number but hesitate to indulge in price increases.⁶¹ In industries characterized by heterogeneous oligopoly, on the other hand, a less immediate reaction to price changes can be observed, though firms follow the lead of other firms with regard to many other aspects of market strategy.⁶² An interesting illustration is provided by the results of an inquiry made some fifteen years ago by Kaplan, Dirlam and Lanzillotti into the pricing policies of twenty big American firms in oligopolistic industries. They found that the firms investigated virtually all used 'target-return pricing', whereby a percentage for the desired return on invested capital is added to average total cost at normal utilization of plant.⁶³ Later, Lanzillotti pointed out that this method of pricing was employed chiefly by highly diversified firms because in such cases management had limited knowledge of the profit outlook. Moreover, these big firms were more concerned to maintain their market position than to exploit it, because the latter policy would attract new competitors when profit margins were high.⁶⁴ It may be added that this method of pricing, together with the use of full-cost pricing, makes it easier for oligopolists to predict each other's price policies and avoids price warfare to a certain extent.⁶⁵ What is important in seeking indicia of market power is to investigate how far firms really try to attain the target return, irrespective of the sales situation. Now a comparison of actual with target profits (expressed as a percentage of sales) for the twenty firms over the years 1947 to 1955 showed that the former were substantially higher in nearly all cases.⁶⁶ Since there were demand fluctuations in both directions during this period, it may be deduced that prices were rather rigid downward but were flexible upward. As we have already observed, such a market strategy is feasible only when the oligopolists enjoy discretionary power over the market.⁶⁷ The same conclusion may be drawn in the case of industries with a substantial concentration of undiversified firms when over a long time span prices allow a profit margin that is appreciably higher than a normal average return.⁶⁸ However, there is need for more recent information in these and other industries to establish whether these relationships still hold.

We should now turn our attention to the influence of oligopolistic structure on market conduct where the oligopolists control not the whole of production but a large part of it, the remainder being shared by a larger number of relatively small firms (marginal sellers). It will be clear that the activities of the marginal sellers in a partial oligopoly of this kind can limit the oligopolists' strategy in a way which in a pure oligopoly with inelastic demand is possible only if there are active potential competitors. Competition from the marginal sellers, however, will generally have a more direct impact on the conduct of the oligopolists because they are already part of the industry. A relevant point here, however, is whether the position of the marginal sellers is permanent or

only temporary, for the influence they exercise may draw reprisals from the oligopolists.

Although partial oligopoly is much more common than pure oligopoly in the real world, theoretical expositions of the situation are not very numerous. The theory of joint profit maximization used by Fellner to explain pure oligopolistic behavior has been applied to partial oligopoly too: where a proportion of total demand is satisfied by the marginal firms, the oligopolists may set the price for that part of total demand for which they account in such a way that they attain joint profit maximization.⁶⁹ Although this price may be an

⁶¹ E.g., Jesse W. Markham, *Competition in the Rayon Industry* (Cambridge, Mass.: Harvard UP, 1952); Merton J. Peck, *Competition in the Aluminum Industry 1945-1958* (Cambridge, Mass.: Harvard UP, 1961); Samuel M. Loescher, *Imperfect Collusion in the Cement Industry* (Cambridge, Mass.: Harvard UP, 1959); Robert F. Lanzillotti, 'The Aluminum Industry', in Adams (ed.), *op. cit. supra* note 59; and the chapters on aluminum (13) and cement (19) in Simon N. Whitney, *Antitrust Policies* Vol. 2 (New York: Twentieth Century Fund, 1958). We shall be discussing Peck's study in another context in Chapter 6 *infra*.

⁶² William H. Nicholls, *Pricing Policies in the Cigarette Industry* (Nashville, Tenn.: Vanderbilt UP, 1951); James W. McKie, *Tin Cans and Tin Plate* (Cambridge, Mass.: Harvard UP, 1959); Richard B. Tennant, 'The Cigarette Industry', and Charles H. Hession, 'The Metal Container Industry', in Adams (ed.), *op. cit. supra* note 59. We shall be referring to these studies also in Chapter 6 *infra*. See also H. Booij, *Prijnsreacties en oligopolie* Ch. 9 (Leiden: Stenfort Kroese, 1965), who discusses a German study on the automobile industry and a British study on the soap industry as well as a number of American inquiries.

⁶³ A. D. H. Kaplan, Joel B. Dirlam and Robert F. Lanzillotti, *Pricing in Big Business* (Washington, DC: Brookings Institution, 1958); Lanzillotti, 'Pricing Objectives in Large Companies', 48 *Am. Econ. Rev.* 921 (1958). See also Richard B. Heflebower, 'Full Costs, Cost Changes and Prices', in Universities-National Bureau Committee for Economic Research, *op. cit. supra* note 38, at 361.

⁶⁴ Lanzillotti, 'Pricing Objectives in Large Companies: Reply', 49 *Am. Econ. Rev.* 679, 685 (1959).

⁶⁵ See Otto Eckstein and Gary Fromm, 'The Price Equation', 58 *Am. Econ. Rev.* 1159, 1165 (1968).

⁶⁶ Lanzillotti, *supra* note 63, table at 926. Weston and Ornstein (eds.), *op. cit. supra* note 37, at 153, 234-35, conclude differently. But see Blair, *op. cit. supra* note 21, at 470-95.

⁶⁷ See Jesse W. Markham, Review of Kaplan, Dirlam and Lanzillotti, *Pricing in Big Business*, 49 *Am. Econ. Rev.* 473 (1959); Alfred E. Kahn, 'Pricing Objectives in Large Companies: Comment', 49 *Am. Econ. Rev.* 670 (1959). General Motors provides an interesting example. During the Senate Subcommittee hearings cited in note 31 *supra*, a spokesman for GM remarked that 'efficiency,' for the corporation, meant 'its ability to achieve its planned return on investment.' The Subcommittee's answer was: 'This is not economic efficiency and GM's return is more a reflection of its market power than its economic efficiency.' *Op. cit.* Pt. 1, at 8.

⁶⁸ This can be seen from studies on highly concentrated industries such as newsprint and petroleum refining. J. A. Guthrie, *The Newsprint Paper Industry* (Cambridge, Mass.: Harvard UP, 1941); Joe S. Bain, *The Economics of the Pacific Coast Petroleum Industry* (Berkeley and Los Angeles: University of California Press, 1944-47).

⁶⁹ Fellner, *op. cit. supra* note 49, at 136; Fritz Machlup, *The Economics of Sellers' Competition* 495 (Baltimore: Johns Hopkins, 1952).

equilibrium price for the oligopolists, it will not necessarily be such for the whole market. This is the case, for instance, when, as a result of the price fixed by the oligopolists, the marginal sellers also make a profit. As they will adapt to that quantity point at which marginal cost equals price, they will step up their supplies, and with a given demand function for all buyers the oligopolists will not be in as good a supply position as before. The oligopolists will react by lowering prices and this in turn will reduce the marginal sellers' share of the market. Long-term equilibrium will then be at a point where price equals the average total cost of the marginal firms. This determines their share in total supply.⁷⁰ It also means that in equilibrium conditions there is a price ceiling set by the average cost of the marginal sellers.

Oligopolists may pursue aggressive price policies as well in an attempt to force their small competitors out of the market. But any attempt to raise prices afterwards will be limited by the possibility that marginal firms, attracted by the prospects of profit, will again enter the market (depending on the initial cost of entry), or that large potential competitors may even come in too. And it is doubtful if the extension of the sales of the oligopolists to that part of the market formerly supplied by the marginal firms will raise their total profit, because the small firms often satisfy special wishes of which the big firm takes no account. Due weight must also be given to the fact that smaller firms which have entered the market because of the prospects of profit may be able to attain a minimum optimal scale of production that will enable them more effectively to compete with the big sellers and thus obtain a bigger share of sales than was possible when they were marginal sellers. Finally, it should be noted that even if at a given moment the market is in equilibrium, with the oligopolists fixing their price at the level of the average total cost of the marginal sellers, this situation may change in the course of time because of technical developments operating in favor of the small firm (as with the development of the service computer, for instance) by changing the existing cost relation between small and big firms and consequently their share in total supply.⁷¹

If the average cost of the oligopolists is much lower than that of their marginal competitors because of substantial scale economies, price behavior that is oriented toward the average total cost of the marginal sellers may allow the large producers to make considerable profits. Keeping a price shield over the heads of small firms in these circumstances may be profit maximizing if the products concerned are relatively price insensitive, despite the fact that scale economies are not utilized to the full by the big producers. Besides, such behavior may attract less attention from the antitrust authorities. Only where substantially more can be sold by reducing price may the elimination of marginal competitors in such circumstances make sense.

Concluding our remarks on evidence of joint market power, we may observe that elimination of actual or potential competitors may be an important indicium since these can make substantial inroads on oligopolists' opportunities for exercising joint market power. Apart from the fact that account must be taken of how this is done, it is relevant to investigate whether the oligopolists act in collusion or whether each firm acts of its own accord. If the oligopolists act in collusion against competitors by means of a formal agreement or by some such device as basing-point pricing, this is evidence of a clear attempt to gain joint dominance of the market. Much the same conclusion may be drawn where all the oligopolists take concurrent action by identical means. Another indicium of joint market power may be found in price behavior over a long time span, i.e. in which basic changes in demand and cost occur. For if concentrated industries' prices remain rigid even during a recession or in spite of the introduction of labor- or capital-saving techniques, this shows the oligopolists to be acting in collusion. However, if there is no such clear evidence, it is appreciably more difficult to show joint market dominance. It is no solution at all to look for evidence in meetings between officers of the firms involved, as the American antitrust agencies have attempted on occasion in the past. Nor is price leadership alone proof of joint dominance,⁷² for some forms of price leadership may simply reflect the intensity of the competition that is inherent in oligopoly. Every oligopolistic market situation has its own particular complex of problems, then, whereas at the present stage of knowledge we have no theory of corporate strategy in an oligopoly that relies sufficiently on realistic assumptions. This is also true of factors such as the importance of entry to competition in the oligopoly. Full knowledge of corporate objectives would therefore be desirable, but this is largely lacking at the moment.⁷³ Consequently, we have to incorporate performance standards in our search for market power, i.e. to discover instances of performance diverging from what would be possible under workably competitive market conditions.

⁷⁰ A model has been constructed by H. J. Witteveen, *Winsttaandeel en economische groei* (Haarlem: Bohn, 1961).

⁷¹ See Th. C. M. J. van de Klundert, 'Het tijdselement in de theorie van het partiële oligopolie', 26 *Economie* 82, 95 (1961-62).

⁷² *Contra*, Werner Zöhlhörer, *Wettbewerbspolitik im Oligopol* 214-20 (Basle: Kyklos, 1968).

⁷³ This is not to say that there is no literature on managerial objectives, especially as far as the profit-maximization hypothesis is concerned. But the insights thus obtained are not applicable in devising a competition policy toward concentrated markets, as we pointed out earlier.

3.3.3.2 Microeconomic Performance Standards

Introduction

The traditional performance dimension of the classically oriented competition theories is price, and the competitive price dictates the rate of return obtainable. Over the years, the literature of such theories has thrown up a number of standards for judging what profit margin on sales in a given industry is indicative of the exercise of market power. One of the best-known attempts to develop a standard for detecting excess profit margins – that made by Lerner – uses the formula $\frac{p-mc}{p}$ (where p is price and mc marginal cost). If p equals

mc , revenue is at its maximum under the model conditions: the formula works out at zero. The other extreme is where it works out at unity, i.e. where demand elasticity is zero. The closer to unity, the bigger the monopoly, at least if the firm makes full use of its dominance. This standard has all the drawbacks involved in comparing performance on markets as they are in real life with the competition process under model conditions. That the one cannot be compared with the other has already been shown elsewhere in this chapter. Moreover, marginal cost does not constitute a basis for costing over a space of time that includes a number of planning periods.⁷⁴

The workable-competition theorists in particular have been right to point out that under dynamic conditions the underlying rate of return cannot be the only microeconomic performance dimension but that others are important as well.⁷⁵ They have generally tried to make the microeconomic welfare function dynamic by introducing factors such as the scale of technological research and development and the investment entailed. Although these theories can be used to make a general evaluation of competition processes on concentrated markets, on the whole they have not developed standards for judging performance that are sufficiently precise to make them applicable in the enforcement of competition policy. In our search for performance standards which satisfy this requirement, then, we are left basically with the rate of return.

The value of the profit margin as a guide to whether a firm has market power is limited in several respects: if it is to be used for policy purposes, a number of precautions must be taken. First, the profit margin being the difference between price and average total cost for a given product, the profit margin declared by a firm under antitrust investigation does not reflect the true profit that it makes on the product in question if the costing underlying it has not been determined as it would have been under competitive circumstances, i.e. with no overevaluation or underevaluation of the various cost categories.⁷⁶ Apart from that, a profit margin is rarely published for individual

products. In practice, then, the profit margin has to be determined as the difference between the price that prevailed during the period of investigation and average total cost. The latter has to be determined in the light of current efficiency requirements, i.e. on the basis of optimum plant and firm scale and the best current technology.

A second set of difficulties is related to the evaluation of the profit margin thus found, which comes down to comparing it with the normal rate of return. The normal rate of return for an industry ought to be the same as the rate of return in other but competitive industries, taking into account differences in risk. If there is a difference between the two rates, that may indicate monopoly profit. Such a procedure is clearly redundant if adequate comparison can be made with the level of prices on other markets. An ideal example of comparability occurs in the case of geographic price discrimination, where a difference in price can be regarded automatically as an indicium of market power. The pricing of substitute products may also provide sufficient indication of the competitive price in certain circumstances.⁷⁷ In the absence of such circumstances, the excess profit margin will have to be worked out along the lines set out above.

⁷⁴ A. P. Lerner, 'The Concept of Monopoly and the Measurement of Monopoly Power', 1 *Rev. of Economic Studies* 157 (1933-34).

⁷⁵ The change of approach was summed up neatly by J. M. Clark, *Competition as a Dynamic Process* 63 (Washington, DC: Brookings Institution, 1961), in his remark that the problem is not to establish what competition is but to decide 'what do we want competition to do for us?' See also A. D. H. Kaplan, *Big Enterprise in a Competitive System* (Washington, DC: Brookings Institution, 1954), and 'Influence of Size of Firms on the Functioning of the Economy', 40 *Am. Econ. Rev.* 74 (1950, Proceedings); Business Advisory Council, *Effective Competition* (Washington, DC: Department of Commerce, 1952); Clare E. Griffin, *An Economic Approach to Antitrust Problems* (New York: American Enterprise Ass'n, 1951); Paul Lambert, 'Luci e ombre della concorrenza', 9 *Mercurio* 59 (1966).

⁷⁶ It is quite possible that this will bring us into conflict with the accounting conventions of the industry in question, as has been pointed out by many economists who have studied the relevance of the profit rate for antitrust purposes. See, e.g., Joe S. Bain, 'The Profit Rate as a Measure of Monopoly Power', 55 *QJ Econ.* 271 (1941); Corwin D. Edwards, *op. cit. supra* note 21, at 125.

⁷⁷ Comparative tests are sometimes advocated as a means of helping to judge competitive price. Although these tests can help considerably in improving knowledge of market conditions, particularly at the level of the final consumer, their usefulness for policy purposes is only very limited. For instance, where the prices and perhaps certain other terms of the different sellers are uniform (as is often the case in oligopolistic markets), comparative tests will be meaningful only if there are substantial and easily recognizable differences in quality between the goods in question. Apart from the fact that there may be some divergence of opinion on the extent of these differences, a comparable level of quality among the various sellers may still conceal an uncompetitive price level and therefore unsatisfactory performance. How far this is the case can only be judged by an examination of the component parts of the prices.

Finally, problems arise in determining whether the excess profits are indicative of monopoly power. We have to remember not only that the size of the profit margin can be determined by factors other than the existence of market power but also that market circumstances have to be favorable before monopoly profits can be made.⁷⁸ Again, profit margins often fluctuate in the short run in order to allow a firm to adjust to changes in circumstances.⁷⁹ In assessing profit, however, it is essential not to pay heed to incidental peaks but rather to concentrate on the influence of fluctuations in demand which are induced by the cyclical movements in the economy, in order to establish whether the firm has adjusted sufficiently to altered circumstances. So the period of inquiry should preferably be one that includes both a recession and a phase of overheating.

The Evaluation of Cost Level

A proper determination of average total cost depends in the first place on the allocation of overheads, in particular those which are not specifically related to the production process.⁸⁰ This has become more complicated ever since firms, particularly in the United States, began to base their short-term pricing on direct costs (those that can be identified with a specific unit of output), total indirect costs being deducted from the gross profit. This method of accounting is particularly appropriate for multiproduct firms, where different products can be manufactured by the same production facilities, so that within a given planning period the firm decides which goods to produce on the basis of what each can be expected to earn.⁸¹ As it would seem best for policy purposes to concentrate as far as possible on the total cost of the relevant product or product group in order to obtain an accurate idea of the firm's profit margin, precise calculation of the indirect costs included in the gross profit margin is needed, but direct costing is not equipped to do this.

However, many conventional costing methods also fail to permit a proper allocation of overheads for the calculation of average total cost per unit of output. Experience has shown, for instance, that in the allocation of indirect manufacturing costs firms use the same percentage to represent these costs for too long and give too little consideration to the differing degrees in which these costs derive from different products. In particular, difficulties have appeared with the allocation of selling, research and administrative costs.⁸² Despite the fact that there are highly sophisticated accounting methods for doing this, an element of arbitrariness always remains in a number of cases. Fewer practical difficulties should arise from determining total cost per product group (including allied products). In any case, the investigator should ensure that costs are allocated to the various products in proportion to factor inputs.

Finally, the valuation of overheads as such in the accounting figures may also lead to a distorted cost picture. Apart from the case of the valuation of capital goods not being adjusted after a period of sharp price increases, this can also occur as a result of the method of depreciation employed, especially for machinery, if insufficient account is taken of its economic life.

Secondly, the determination of the average cost of the product or product group under investigation should be based on a full utilization of efficiencies both in producing and in selling. Efficiency refers traditionally to cost minimization or production maximization at a given cost level.⁸³ There must be

⁷⁸ For discussion, see Brozen, *supra* note 37, who concludes that profits cannot be used as a guide to antitrust action or policy. In our view, Brozen overemphasizes the difficulties involved in cost allocation over time and products.

⁷⁹ See, e.g., Kaplan, Dirlam and Lanzillotti, *op. cit. supra* note 63; B. Fog, *Industrial Pricing Policies* (Amsterdam: North Holland, 1960). In the Netherlands, Andriessen has bridged the gap between theory and practice by including long-term considerations in marginal analysis. *Op. cit. supra* note 13, at 192-223. In the present study we need not go into a discussion of the significance of marginal analysis, a controversy that reached its height in the United States in the late 1940s with the discussion between Lester and Machlup on the utility of marginal analysis in explaining economic behavior. Richard A. Lester, 'Shortcomings of Marginal Analysis for Wage-Employment Problems', 36 *Am. Econ. Rev.* 63 (1946); Fritz Machlup, 'Marginal Analysis and Empirical Research', 36 *Am. Econ. Rev.* 519 (1946). Reference to American criticism of marginal cost pricing may also be found in Lucile S. Keyes, 'The Proposed Concentrated Industries Act: A Critique', 15 *Antitrust Bull.* 469, 476 (1970). In our view the controversy does not reflect a real problem (marginal analysis does not claim to impose accounting rules on the firm), and it centers on price as a means whereby firms adapt to changing circumstances, to the exclusion of other decision variables used under present-day conditions.

⁸⁰ In developing his alternative method for identifying monopoly power by examining expected profits, Schwartzman excludes centralized selling, general and administrative costs and is thus able to avoid most of these allocation problems. This is acceptable only in examining producer goods, where these costs do not play a decisive role and it is possible, as Schwartzman does, to establish a potential entrant's expected normal rate of return on plant investment alone for purposes of comparison. In consumer-goods industries, where selling costs in the widest sense do play a decisive role, the normal rate of return and thus the existence of monopoly profits can only be determined by reference to the total cost of the product. David Schwartzman, 'The Expected-Profits Method of Locating Monopoly Power', 17 *Antitrust Bull.* 1057, 1068-74 (1972).

⁸¹ For the development, significance and application of direct costing in the United States, see, e.g., National Association of Accountants, *Direct Costing* (New York, 1953) and *Current Application of Direct Costing* (New York, 1961). This and much other American material was made accessible to Dutch readers by R. Slot, *Kostenvariabiliteit en variabele-kosten-calculeatie (direct costing)* (Leiden: Stenfort Kroese, 3d ed. 1968). For Germany, see H. G. Plaut, 'Die Grenz-Plankostenrechnung', 23 *Zeitschrift für Betriebswirtschaft* 347 & 402 (1953), 'Die Grenz-Plankostenrechnung', 25 *ibid.* 25 (1955), and 'Die Grenz-Plankostenrechnung in der Diskussion und ihrer weiteren Entwicklung', 28 *ibid.* 251 (1958).

⁸² See Slot, *op. cit. supra* note 81, at 167-68, and the American literature he cites.

⁸³ See Joe S. Bain, 'Workable Competition in Oligopoly: Theoretical Considerations and Some Empirical Evidence', 40 *Am. Econ. Rev.* 35 (1950, Proceedings).

no possibility of a substantial reduction in average total costs because of a change either in the volume of production, or in the technique of production, or in both. The determination of the representative average production cost for antitrust investigations, then, should start from an estimation of the scale and costs of the relevant factor inputs for a plant of optimum size and take into account the best current technology.⁸⁴ There are, however, other types of efficiency as well as the allocative type mentioned here that may have some relevance. It has been pointed out, for instance, that worker motivation, the correct interplay of production techniques, and so forth, may play a much more important role in reducing unit cost by raising labor productivity than input allocation at minimal cost.⁸⁵ One well-known means of raising motivational efficiency is the introduction of payment by results. But other methods of improving efficiency or the terms on which certain inputs can be obtained may also achieve substantial cost savings, as has been shown by a number of empirical studies in this field.⁸⁶ In evaluating a firm's cost situation we must therefore take into account how far the firm keeps up to a generally accepted standard in these other efficiency dimensions too.

There are many operational difficulties in defining the concept of normal capacity utilization as well. It needs to be borne in mind that a large number of factors prevent the full utilization of production capacity. First of all, there are a number of permanent underutilization losses that are difficult to avoid, such as those caused by repair and maintenance. And then initial overcapacity is inevitable if the capacity of a new production unit exceeds for a time the additional demand for the products that it can manufacture. Seasonal fluctuations in the pattern of sales may affect capacity utilization, but (more important) so may cyclical fluctuations. Underutilization may occur either when demand is declining or in an expansionary phase when essential production factors (labor, raw materials) are in short supply and can only be obtained at an appreciably higher price. Lastly, a firm will sometimes keep a certain amount of capacity in reserve so that it can satisfy the requirements of existing or new customers promptly. An entrepreneur's idea of what should be considered normal in this respect will differ from industry to industry and from country to country. For instance, firms generally seem to run much nearer to capacity in Europe than in the United States.

Only the first of the causes of underutilization can be taken wholly into account in determining the appropriate average cost level. In all other cases it must be established whether fixed unit costs cannot be lowered by putting idle capacity into operation or by utilizing plant more intensively through accepting special orders, producing for stock, etc. The most liberal attitude would be to allow for an average underutilization due to business-cycle fluctu-

tuations as part of normal output. But it is more appropriate for the authorities to confine themselves to the economic situation at the time of the investigation. Capacity utilization in declining industries is a special case. If in such a situation productive equipment cannot easily be adapted to the declining demand, the resulting rise in unit costs has to be taken into account.

The third cost factor to which special attention should be given is the level of selling costs in the broadest sense. Sales promotion generally takes up an increasing proportion of the firm's budget as the firm grows, for it is used as a means of removing uncertainties on the demand side and guaranteeing continuity for big firms. But when certain aspects of marketing, and particularly advertising, take up a growing share of total unit costs, more consideration must be given to the question whether workable competition is still present, given the purpose of such high costs may be to maintain the firm's position on the market. It seems impossible, however, to formulate a guideline that is not based implicitly or explicitly on value judgments. In practice, the most advisable policy would seem to be to compare the selling costs of different industries manufacturing comparable products. It is in fact at the final consumption stage that this problem of evaluation will generally arise: the opportunities for sales promotion are far fewer for firms producing intermediate goods.

The Evaluation of Profit Margin

The difference between the average total cost thus established and the average price over the period of investigation determines the rate of return. For policy purposes, the main point is to ascertain whether the firm in question is not earning more than it would earn under competitive circumstances. The rate of return found for the firm has thus to be compared with a normal competitive rate of return, any difference being indicative of market power. But what rate is to be taken as the standard? Several measures have been proposed in the literature. Bain uses the difference between the firm's rate of return and the rate of interest as an indicator of market power, both measured

⁸⁴ In some cases the introduction of new techniques can cost such considerable sums, especially where plant size has to be increased or reduced, that the process of adjustment to technological developments may last a long time. What is important in such an eventuality is that adjustment does in fact take place, and costs may be calculated on the basis of the production process still being employed.

⁸⁵ There have been a large number of studies in this field; for a recent summary, see Harvey Leibenstein, 'Allocative Efficiency vs. "X-Efficiency"', 56 *Am. Econ. Rev.* 392 (1966).

⁸⁶ See the examples cited by Leibenstein, *id.* at 397-406.

over a period long enough to make temporary advantages – even the advantage of patent protection – irrelevant.⁸⁷ But the rate of interest is too severe a test; it is generally not realistic to assume that a firm is willing to remain on the market for this return. Kaysen and Turner state that only where demand is stationary can a standard such as Bain's be used.⁸⁸ With demand rising in the long run, average return after taxes may be higher than the long-run supply price of capital – roughly equivalent in practice to the yield on first-grade industrial bonds – while firms in declining industries will be operating at a loss.

We noted earlier that the concept 'long run' is difficult to define. One thing that is certain is that demand has kept on rising since the end of World War II; even during recessions the trend has been reversed only very rarely. This implies that during this period a firm's profit may have exceeded the standard rate without this necessarily indicating exercise of market power. It should also be borne in mind that the yield on long-run first-grade industrial bonds may be too low to serve as a standard of return because if the yield on stock were not allowed to be higher than the return on these bonds this would make investors prefer bonds to stock. It is important to note Means's study of the American steel industry, where he gives most attention to the calculation of a reasonable standard of return.⁸⁹ He takes as his basis the return on capital that a firm must offer if it is to raise enough funds on the capital market. The return to be calculated on sales during a given period can be determined from the velocity of circulation of capital in that period. The calculation can also be made to cover a period of several years in order to even out cyclical and fortuitous interest-rate fluctuations. Such calculations may give some pointers to the minimum permissible profit margin on a product. This implies that investigators, courts or enforcement agencies should not be too inflexible in taking a margin that is normal in competitive industries as their standard, especially where the industries concerned are not comparable in all respects. A margin slightly wider than the standard is acceptable; how big a difference this embraces will depend on circumstances and the size of the margins in question. Finally, Schwartzman favors determining the minimum expected rate of return required by firms operating under competitive conditions and manufacturing the same or comparable products to invest in the industry under examination. The information could be obtained from a firm's cost analyses concerning whether to buy certain items or to manufacture them itself.⁹⁰ From a policy viewpoint Schwartzman's proposal accords better with available theory than does Means's since the normal rate of return for an industry should equal the expected rate of return in other, competitive industries, the only correction to be made being for risk. However, in practice it

might not be so easy to obtain such information, particularly as in high-barrier industries serious potential competitors are lacking. Preparation of engineering studies to provide this information may be difficult and costly, as Schwartzman admits. In a number of cases, then, we must take as our standard of return that which is found in firms manufacturing the product in question or similar products and operating in competitive industries.

It may be asked whether many instances of substantial differences between the actual and the normal rate of return will be found. Although a dominant firm or group of firms, by definition, will obviously be able to set a much higher rate of return than sellers operating under pressure of competition, there is nevertheless a maximum price that it can charge – what Bain has called the ‘limit price’ – and this curtails any tendency to take excessively large profits. This is particularly the case for goods with an elastic demand. Even if a firm has no immediate competitors, it must still bear in mind the possibility of new entrants and/or the emergence of substitute products (interindustry competition), either of which may reduce its sales.⁹¹ In the industrial sector at any rate a firm, even if it has market power, will most often realize that its current price policy must not be such as to jeopardize its future sales position and will therefore attempt to maximize its profit in the long run. This implies that it will generally abstain from short-run profit maximization by selling below the maximum price obtainable – for instance, just at the point where potential competitors will still find it an unattractive proposition to enter the market.⁹² In the United States, another factor which encourages firms to some extent to stick to a policy of moderate profits is the influence of antitrust.

⁸⁷ Bain, *supra* note 76; ‘Measurements of the Degree of Monopoly: A Note’, 10 *Economica* 66 (1943); ‘Relation of Profit Rate to Industry Concentration: American Manufacturing, 1936–40’, 65 *QJ Econ.* 293 (1951); and *Industrial Organization*, *op. cit. supra* note 27. See also K. W. Rothschild, ‘The Degree of Monopoly’, 9 *Economica* 24 (1942), and ‘A Further Note on the Degree of Monopoly’, 10 *Economica* 69 (1943); Jacques Houssiaux, *Le pouvoir de monopole* 20–24 (Paris: Sirey, 1958).

⁸⁸ *Op. cit. supra* note 21, at 63.

⁸⁹ Gardiner C. Means, *Pricing Power and the Public Interest* (New York: Harper, 1962). *Supra* note 80, at 1070.

⁹¹ See Joe S. Bain, ‘A Note on Pricing in Monopoly and Oligopoly’, 39 *Am. Econ. Rev.* 448, 454–64 (1949); Scherer, *op. cit. supra* note 23, at 219–34.

⁹² Here we are referring to the whole range of a firm’s supply, not only its price, because, as we noted earlier, a firm has many facilities for profit maximization other than price alone (quality, service etc.). When we are calculating its profit, of course, it amounts ultimately to the same thing whether the costs on which the selling price is based turn out higher in view of the product’s superior quality and better service (which means that the price must be higher too) or lower prices are a result of savings on these cost categories in particular.

Market power need not necessarily be expressed in a rate of return which is higher than the normal or standard rate. It may well exist where the rate of return is below that. But we should be wary of seeing every instance of selling below cost as an indicium of monopoly power. For it is a fact that firms – especially multiproduct firms – often start selling an item before they realize that they will make a loss on it. One might even go so far as to assume that if a firm sells below cost for any length of time it is more likely to point to errors in costing and management than to a dominant position – except where selling below cost is practiced in only certain parts of a geographically relevant market. Loss-leader selling is frequently said to be practiced typically by the conglomerate firm, which draws upon its profitable activities to subsidize losses elsewhere, a course not open to single-line producers. However, evidence that this does in fact occur is extremely scanty, probably because there is no apparent rationale for such behavior.⁹³

The last major problem in using rates of return as indicators of market power resides in the fact that not all excess profits can be related to that phenomenon or that, if they can, they are only temporary and are backed by respectable economic motives. Schumpeter's defense of high profits in the case of innovators is well known. In a number of industries where technological advance is very rapid, it is generally essential for firms not only to apply new production processes and consequently to replace their plant in good time (a question of cost, and whether it can be passed on will depend on market circumstances) but also to develop and introduce new processes or products ahead of their rivals. Investment in technological research and development is normally a highly expensive business, and as a general rule only the giant firms have the financial status required – either because they have easier access to the capital market than smaller firms, or because they have more profits available for plowing back. However, there may be very great risks attendant upon such investment, whether technical (in the case of research that has to continue for years before there is any result) or economic (where potential buyers have to be familiarized with completely new products). Excess profits in such cases should be considered, according to Schumpeter, a reward for risk, as it were – a recompense to the entrepreneur for his initiative and for the risk that it will not immediately produce the desired result; in fact, it is the only incentive for management to venture into pastures new.⁹⁴

The assessment of these cases will be particularly difficult if the firms in question have an appreciable influence on the economy's growth rate. And these difficulties will increase as production processes become more complex and R & D costs higher and higher. This may produce a conflict between macroeconomic and microeconomic considerations. When investments made

by firms of this kind are consistent with the welfare targets that have been set, inhibiting corporate growth may entail the risk of impeding economic growth. This certainly does not mean, however, that competition policy has no part to play at all. It is to be regarded as a sign of workable competition if a firm does not maintain its lead in a given field for too long so that excess profits disappear after a time because they are passed on in quality improvements and/or lower prices under pressure of competition. If this does not happen, it can be assumed that latent dominance has been consolidated into actual dominance. A close watch should be kept on the market conduct of such firms, and it should be ascertained whether there are any instances of suppression of existing or potential competition.

Another source of high profits unrelated to uncompetitive market power may be extraordinary efficiency resulting from factors such as organization, particularly competent staff, location, etc. These factors may give a firm a lead over its competitors and potential entrants for some time, though under present-day circumstances of rapid technological change such advantages will be eroded away soon. If they are not, this aspect should be considered in more detail.

In conclusion, excess profits may be considered evidence of market power, then, only where the difference between them and a standard rate of return can clearly be established and no particular factors are at hand to explain it. This means that in the majority of antitrust cases performance will be only one of the elements of investigation and an analysis of market structure and conduct has to be made as well.

Price Differentiation and Competition

Lastly, some consideration should also be given to a form of sales policy which makes use of differences in purchasing power and the accompanying differences in the elasticity of demand among the various groups of buyers. Technically, the seller can do this by supplying his product in different pres-

⁹³ The 'deep pocket' hypothesis has been particularly stressed by Edwards, *supra* note 60. But several sources indicate that it is inherently improbable that predatory pricing would be employed to gain a foothold in other markets. See, e.g., the *Report of the Task Force on Productivity and Competition* (18 Feb. 1969) [hereinafter cited as *Stigler Report*]; Federal Trade Commission, *Conglomerate Merger Performance* (Nov. 1972); Scherer, *op. cit. supra* note 23, Ch. 11. Scherer concludes that 'the cases in which conglomerate size *per se* leads in this way to serious anticompetitive effects appear to be uncommon.' *Id.* at 278.

⁹⁴ Schumpeter, *op. cit. supra* note 25, at 105. Other writers, such as Brozen, *supra* note 37, at 118-19, have stressed the availability of scarce entrepreneurial talents in certain industries as a reason for higher accounting rates of return.

entations (e.g. luxury and standard packaging) which are intended to give the impression that price differences are justified but the cost of which does not really account for the differences in the price asked. The most extreme case is where the price of the cheapest version of the product equals direct cost while the price of the other versions has to offset total indirect costs plus the profit margin. Since the sales figures for the cheapest version will often be higher (and perhaps considerably higher) than those for the others, prices may in fact vary appreciably. There may be less extreme forms of this practice, as when revenue from the cheapest version is also intended to defray part of the indirect cost.

Seen from the angle of the firm, price differentiation is a proper instrument of sales policy where pricing on the basis of average unit cost would in view of the elasticity of demand by a large proportion of potential customers result in a sales volume that would not cover total cost whereas charging different prices according to the elasticity of demand from different groups of customers would enable the seller to cover his total cost and make a profit. Seen in the context of the economy as a whole, this cannot be judged in so straightforward a manner. If price differentiation makes much higher sales possible, it could be argued that the community will be better supplied with the good in question and that lower average unit cost and lower prices will ensure that buyers with the lowest purchasing power will benefit. Only in the case of essential goods can it be assumed that such transfer of purchasing power to the lower income groups leads in fact to a better satisfaction of needs; in other cases we must ask whether the lower income groups really need to buy so much of the goods in question or would not be better advised to spend their money on something else. However, anticompetitive effects will arise if indirect cost is allocated disproportionately to certain sales and these make up a not insignificant part of total sales. As in the case of product and geographic discrimination mentioned above, what this amounts to is a transfer of monopoly profits, which distorts competition. Where in industries with high fixed costs it is only thanks to price differentiation that large groups of buyers are in a position to acquire basic essentials at a reasonable price, some form or other of government supervision is required so as to check abuse in pricing.

Technological Progress as a Performance Standard

Whether an industry is workably competitive also depends on the extent to which the firms in that industry take advantage of technological progress. This covers a whole range of phenomena – from improving the quality of existing products to bringing entirely new products onto the market. The assessment of performance in this field should concentrate on real improve-

ments – either major quality changes in existing products or the development and application of more efficient techniques of producing them, or the development of completely new products. A search for monopoly power where these achievements are not in evidence will often be warranted in the light of our suggestion in Chapter 2 that highly concentrated markets protected by high barriers to entry are not conducive to innovational effort. But how are we to find practicable criteria for ascertaining whether firms have shown signs of monopolistic lethargy in these fields? One useful indication is the size of a firm's research facilities, which can be measured alongside those of firms in comparable industries or – in the age of growing international competition – of firms in the same industries in other countries. International comparisons, however, are impeded by the fact that government subsidies or other incentives to industrial research vary from one country to the next.

However, whether the firm has a good R & D record depends not only on how much money is invested in research but also on how this investment is used. Here it is relevant to know whether a firm has been a leader or a follower in industrial research. And if it has been a follower, how long did it take for it to start imitating newly developed products or to introduce more efficient production techniques already proved elsewhere? Even if firms have not been leaders in industrial research, promptness in following the lead given by others implies that their position is such as will not allow them to remain inactive. If large firms feel no need to respond, or if they respond only after a considerable period of time when current production facilities have to be replaced for technical reasons or sufficient demand for the new product has been generated, this implies that the firm's position is very comfortable and sheltered from competition. It should be added, however, that it may sometimes be difficult to distinguish between normal delays in introducing a new product because of financial or technical risks and delays resulting from the fact that a firm is in such a comfortable situation that it can amortize its current plant completely before undertaking new investments. Nor need an active follower be an active competitor when competitive influences from outside, either from other firms in its own industry or from those in other industries, are lacking. Concentrated industries in which development ought normally to be rapid – all capital-intensive industries – but which are slow in introducing new techniques or new products also point clearly to the influence of economic power. It is impossible to give more precise standards which could be generally applicable, since the opportunities for engaging actively in R & D differ sharply among industries. Only by studying actual cases is it possible to arrive at more accurate conclusions.

3.3.3.3 Macroeconomic Performance Standards

As has already been observed, there can be no general theory regarding the link between target attainment in an industry and in the economy as a whole unless the Pareto conditions are fulfilled, and in the real world they are not. Here we come up against the same sort of difficulty we met earlier in discussing the relationship between structure and performance in the individual industry. Whereas, for instance, in the classical model there was *eo ipso* complete utilization of all factors of production and no possibility of inflationary or deflationary movements, we do not find an automatic adjustment process under dynamic circumstances on which a link can be based between market organization and macroeconomic performance. This implies that, having judged the competitive situation in a given market on microeconomic standards, we should consider macroeconomic standards (welfare maximization norms) as well. So a policy aimed at the maintenance of workable competition should also prevent firms from creating conditions that hinder the attainment of these targets. In this subsection we will briefly explore the ways in which the business strategies of large firms described in the foregoing parts of this chapter may adversely affect the attainment of macroeconomic targets. Following international usage, we include as basic targets internal and external equilibrium, satisfactory and structurally balanced growth, full and stable employment and an equitable distribution of income.

Not all policy aims need necessarily be realized through the operation of the market. For instance, the links between the working of the market and realization of the objectives of full employment, external economic equilibrium and equitable distribution of income are difficult to establish, because they are only incidental, so that competition policy will have no major impact on them. As far as the first target is concerned, fluctuations in total demand or shifts in demand often occur independently of the way in which the market operates. Technology is another important autonomous factor governing the level of employment; and this is a point that is not altered by the fact that the speed with which new labor-saving techniques are introduced may be influenced by the way in which competition functions. In a situation in which competition is absent because of market power, employment may still be higher than would be possible if competition were functioning properly because the technology is not as advanced as it might be. Such a situation would imply, however, a misallocation of the labor force, so no essential conflict between a policy of full aggregate employment and antitrust goals can be inferred in this case. Corporate rationalization, with or without merger, may bring about a curtailment of employment in the industry in which it takes place – at least for a time. For if it proves successful, demand may rise and

there may well be an increase in aggregate employment. All in all, no significant correlation can be established between business size and aggregate employment. However, a relationship may be construed between stability of employment and firm size. First, it is a known fact that big firms are generally more interested in consolidating or reinforcing their market position than smaller ones. Furthermore, they have much more money available to achieve this aim and consequently to help stabilize employment. Second, conglomerate expansion too may have a stabilizing impact to the extent that conglomerate firms can absorb some of the fluctuations in labor supply and demand from one industry to another. It is therefore not surprising that empirical studies show that in the great majority of industries stability of employment tends to increase with business size.⁹⁵

Movements on the capital account of the balance of payments are mainly governed by factors that do not depend on the performance of the competitive system. However, competition – in terms of the economy's export performance on the one hand and whether or not the internal price level induces import substitution on the other – may have a significant impact on the current account. Finally, we should not fail to mention the fact that market power has a direct influence in particular on the terms of trade between primary-producing countries and industrial countries to the detriment of the former if integrated firms with market power keep up the price of finished products while endeavoring to depress the price of raw materials.

Although the working of the market affects primary income distribution, a properly functioning competitive system does not guarantee equitable distribution. In order to attain this, the government has to take corrective action. However, where competition is hampered by market power and monopoly profits appear, income distribution may be less equitable than before because these amount to transfer payments from the final consumer to the monopolist. The dissolution of dominant positions may therefore have a redistribution aspect inasmuch as it may lead to the disappearance of the monopoly profits inherent in them. It must be admitted, however, that it is especially difficult to calculate the social losses resulting from the existence and exercise of market power because the calculations must take account not only of the cost of inefficiencies and substantial sales promotion but also of welfare losses due

⁹⁵ Ferguson, *op. cit. supra* note 8, Ch. 4, finds that, out of seventeen industries sampled, size appears to promote stability in all but one, though the correlation was not significant in several cases.

to resource misallocation as a result of market power.⁹⁶ It is a rather different matter if we extend the concept of equitable distribution to include capital. The main problems then are those arising from accumulations of capital and the accumulations of profit induced thereby, which are assuming ever-greater proportions (witness the growth of overall concentration). Here, however, we come up against factors which go beyond the way in which the market mechanism performs its function, and we shall not be discussing them in this study.

Internal equilibrium and economic growth are the two targets whose attainment is to a considerable extent determined by the functioning of the market mechanism and which can thus be influenced by firms with market power. The internal-equilibrium target is generally translated into a stable-price target. By stable prices we mean prices that remain the same over a single business cycle (i.e. the absence of inflation). This should not necessarily imply rigid prices: the price level may go up when real aggregate demand is expanding and may be correspondingly adjusted downward when real aggregate demand slackens. The shape of a cyclical movement such as this depends in part on the way in which competition functions. When after a depression real demand starts to increase, firms that are exposed to competition will normally increase their sales and leave their prices unchanged, at least as long as they are still running below capacity. If inventories decline and producers start to accumulate a backlog of demand, they may raise prices and thus restore or improve their profit margins after the depression. Expansion of production capacity then stimulates demand for available factors of production, the price of which – at least in the competitive model – does not start to rise until they become scarce. If the prices of the components of GNP are rising, they may offset the impact of a rise in real demand on the degree of utilization of the factors of production, and this will take the heat out of the economy. The sooner this happens (before all productive reserves are dried up) the better. Once the boom has reached its peak and real aggregate demand slackens off, the number of unfilled orders will disappear. Under competitive circumstances firms will try to keep up their sales by lowering their prices and/or intensifying competition other than price competition.

Firms with market power may considerably distort this process and thus hamper the attainment of economic-policy targets. Because of long-run profit-maximizing objectives, such firms may adapt their prices to an increase in demand after a recession much more slowly than firms working in competitive conditions and will continue to raise prices even when the increase in demand is slowing down. Both types of behavior encourage inflationary forces, as Galbraith has pointed out.⁹⁷ The labor unions also play a considerable part

in stimulating inflation, in Galbraith's opinion, by their obvious success in procuring the biggest wage increases from the large firms wielding market power, which in turn display these cost increases to the outside world as justification for putting up their prices. The unions then use this price behavior as grounds for further wage claims later in the boom. The relationship Galbraith thus assumes between market structure and price movements originating in cyclically induced changes in real aggregate demand may also hold good when aggregate demand remains the same but there are shifts in demand from one industry to another. In the case of declining-demand industries firms with discretionary power may hinder a downward price adjustment in the same way as when aggregate demand declines as a result of cyclical movements.

The relationship that Galbraith assumed between wage level and concentration ratio has been empirically demonstrated.⁹⁸ The reason why a positive correlation was found may be that the higher level of profits in the industries investigated attracts wage claims – leaving aside the question whether the profit level is itself a consequence of higher productivity or of monopoly pricing. A number of studies have shown at least that wage-rate increases are posi-

⁹⁸ The extent of these losses in the United States has been calculated by A. C. Harberger, 'Monopoly and Resource Allocation', 44 *Am. Econ. Rev.* 77 (1954), Leibenstein, *supra* note 85, and David Schwartzman, 'The Economics of Antitrust Policy', 6 *Antitrust Bull.* 235, 240–41 (1961). Whereas these authors conclude that monopoly in fact does not significantly misallocate resources or lower welfare (by 0.1% of GNP at most), more recent calculations of the deadweight loss due to monopoly come to a much higher estimate. Scherer, *op. cit. supra* note 23, at 400–08; David R. Kamerschen, 'An Estimation of the "Welfare Losses" from Monopoly in the American Economy', 4 *Western Economic J.* 221 (1966). See also Michael E. DePrano and Jeffrey B. Nugent, 'Economies as an Antitrust Defence: Comment', 59 *Am. Econ. Rev.* 947 (1969), and the literature cited there; David R. Kamerschen and Richard L. Wallace, 'The Costs of Monopoly', 17 *Antitrust Bull.* 485 (1972).

⁹⁷ According to Galbraith, 'Market Structure and Stabilization Policy', 39 *Rev. of Economics and Statistics* 124 (1957), firms with discretionary power over the market are therefore permanently engaged in realizing the unliquidated margin of monopoly revenue which they have accumulated by this behavior. Means too has put forward similar ideas; see his statement in Hearings, *op. cit. supra* note 57, Pt. 1, at 124–25.

⁹⁸ One well-known study is L. W. Weiss, 'Concentration and Labor Earnings' 56 *Am. Econ. Rev.* 96 (1966). Philips, *op. cit. supra* note 33, at 89–113, and Ira Horowitz, 'An International Comparison of the Intrnational Effects of Concentration on Industry Wages, Investment and Sales', 19 *J. of Industrial Economics* 166 (1970–71), have come to comparable conclusions for a number of EEC countries. References to more literature on the subject may be found in Horowitz, *supra*, and in Scherer, *op. cit. supra* note 23, at 298–303.

tively correlated with the level of profits and with increases in profits.⁹⁹ But a good deal of criticism has been leveled against Galbraith's thesis linking market power and inflationary price movements. Stigler has pointed out that a monopolist reacts passively to his macroeconomic environment in his pricing.¹⁰⁰ Even if it is true that pricing under conditions of market power does not trigger off inflationary movements, the fact established by Stigler is not sufficient reason for denying that market power shares responsibility for the strengthening of inflationary pressures. However, studies on the role of administered pricing in the inflationary process in the United States have generally found no positive relationship. Ruggles, for instance, shows that in the period he investigated (1947-57) the price of industrial goods in the United States went up no more than was necessitated by cost increases: even a rise in real aggregate demand did not send prices up.¹⁰¹ Nor do other studies using advanced statistical methods and more recent time series come up with more pertinent conclusions, even when the relationship between concentration and changes in wage rates mentioned above is excluded from the sample.¹⁰² Studies with particular reference to European countries have not led to different conclusions either. The OECD's report *The Problem of Rising Prices*, which studies price movements in Europe between 1953 and 1960, puts much of the blame for price increases on rising costs external to the firm, especially labor costs, while monopolistic pricing is not seen as a significant factor. Philips, basically using Weiss's method for seventeen manufacturing industries for the period 1958 to 1964 in the Netherlands, Belgium and France, has produced similar results.¹⁰³ As recent years in particular have witnessed increasing degrees of inflation, it would be interesting to test the market-power hypothesis again for these years.

The studies we have considered, then, have concluded that though market power may explain why some prices are higher than they would be under more competitive conditions, it does not explain certain movements in the price level. In spite of the massive statistical proof presented, some doubts remain as to the general validity of this conclusion. First, if market power plays a role in inflationary movements, it should generally be expected to make itself felt in periods of lagging demand in which under competitive circumstances a downward price movement would be expected. However, even in competitive markets downward price adjustments may be hampered by a number of factors extraneous to the market mechanism, which obscures the cause-and-effect relation in the picture provided by the statistics. For instance, different countries can be at different phases of the business cycle at the same time, so that the level of import prices remains an independent source of price increases in a country experiencing a recession. A country will be more sensitive to

cyclical movements in neighboring countries if it is smaller than its neighbors and if its economy is open to influences from abroad. Government action may be a further source of autonomous price increases. Again, downward adjustment of wages is often prevented by institutional factors and social considerations, especially if it is accompanied by a loss of purchasing power, so this is a cost component that can hardly be expected to have much influence in pushing down the level of costs reached during the boom. Secondly, clear countercyclical behavior is observed only in industries in which market power is well established, without too much corrective influence coming from outside. As far as the United States is concerned, the behavior of the big steel firms provides a typical example of how price increases can occur even when demand is declining. The countercyclical behavior of these firms has become much more prominent since the 'voluntary' import-restriction agreements which they signed with their major foreign competitors in 1968 relieved the industry of considerable competitive pressures because they allowed for sharp and frequent price increases, thus undoubtedly contributing to the acceleration of infla-

⁹⁹ See Harold M. Levinson, *Postwar Movements of Prices and Wages in Manufacturing Industries* (Joint Economic Committee, Study of Employment, Growth and Price Levels, Study Paper No. 21, 86th Cong., 1st Sess., 1959); Otto Eckstein and Thomas A. Wilson, 'The Determination of Money Wages in American Industry', 76 *QJ Econ.* 379 (1962); Gail Pierson, 'The Effect of Union Strength on the US "Phillips Curve"', 58 *Am. Econ. Rev.* 456 (1968).

¹⁰⁰ George J. Stigler, 'Administered Prices and Oligopolistic Inflation', 35 *J. Bus. U. Chi.* 8 (1962).

¹⁰¹ Testimony in Hearings, *op. cit. supra* note 57, Pt. 1, at 128-62; Ferguson, *op. cit. supra* note 8, Ch. 5.

¹⁰² A well-known study using a simple correlation analysis of price changes in a number of US industries for the years 1953-59 and the concentration ratios for these industries is H. J. DePodwin and R. T. Selden, 'Business Pricing Policies and Inflation', 71 *J. Pol. Econ.* 116 (1963). Selden alone had already come to similar conclusions a few years before in 'Cost-Push vs. Demand-Pull Inflation: 1955-57', 67 *J. Pol. Econ.* 1 (1959). But see Gardiner C. Means, 'Business Pricing Policies and Inflation: A Comment', in *Economic Concentration*, 88th Cong., 2d Sess., Pt. 1, at 489-97 (1964), and 'The Administered-Price Thesis Reconfirmed', 62 *Am. Econ. Rev.* 292 (1972). Weiss found some positive relationship between concentration and price changes for 1953-59 but no relationship for subsequent years. L. W. Weiss, 'Business Pricing Policies and Inflation Reconsidered', 74 *J. Pol. Econ.* 177, 182 (1966). See also Weston and Ornstein (eds.), *op. cit. supra* note 37, at 154, 225-32.

¹⁰³ William Fellner, Milton Gilbert, Bent Hansen, Richard Kahn, Friedrich Lutz and Pieter de Wolff, *The Problem of Rising Prices* (Paris: OECD, 1961); Philips, *op. cit. supra* note 33, at 7-25.

tionary tendencies in the American economy in the late 1960s.¹⁰⁴ However, the number of industries witnessing such price behavior seems to be rather small, as was found by Markham in a comparative study.¹⁰⁵ We may conclude, then, that investigations into the relationship between market power and inflationary price movements have not produced much valuable evidence.

The second target of economic policy on which the operation of the competitive system may have an impact is the rate and stability of economic growth. The growth rate is largely determined by the drive shown by businessmen in their investment policies. As in many countries investment growth is largely determined by the activity of the large firms, market power in the hands of these firms might induce them to reduce their efforts (sleeping monopolists or oligopolists). However, it is only on the basis of investigation by industry that this can be ascertained, and this is especially necessary if we remember that investment is also dependent on all kinds of stimulus which do not necessarily put the big firm ahead; these include siting, labor supply, government aid for specific regions. As for the stability of growth, a sample survey carried out by Ferguson¹⁰⁶ in fifteen industries revealed that there is a positive correlation between business size and the stability of growth of assets, no doubt because of the fact that big firms generally have long-term investment plans.

3.3.4 Summary and Conclusions

Our judgment of competition on concentrated markets is naturally affected by the concept of competition that we work with. In the classical view any reduction in the number of market participants as a result of concentration is anticompetitive *per se*; however, this view has rightly been abandoned by most writers today. The consensus now seems to be that concentration as such will not normally be detrimental to competition unless it permits a firm (or group of firms) to obtain market power (a dominant position) and thus act without being influenced substantially by the other market participants. The market mechanism then necessarily becomes 'unworkable', which implies the risk not only of suboptimal performance in microeconomic terms but also of the nonattainment of certain macroeconomic targets.

If public policy is to deal effectively with the phenomenon, criteria have to be found to define when market power exists. An economically meaningful market definition has to be taken as the starting point for investigation. For the determination of the product market we have found that there are so many factors besides technical substitutability and price that may determine whether the products of the two suppliers should be considered competing products that simple tests may not apply and the concept of the industry (a group of firms producing similar goods) will in most circumstances prove to be a useful

guide. Determination of the geographic market should be based on the area or areas where under normal conditions most of the product is sold; this is generally dependent on such items as freight costs and buyers' habits, which may sometimes give us relatively small submarkets in a market area that may well grow bigger as a result of increasing international integration. This last point is particularly relevant to the situation in which a firm in one of the EEC countries, for instance, may find itself.

However, differences of opinion arise when it comes to defining the criteria on which the market position of a firm or group of firms must be judged in order to determine whether it has market power. They parallel the differences as to the content of workable-competition standards. Many advocates of the structural approach to competition believe that the presence of market power can be assessed from a number of structural characteristics. But in a non-classical world there is no fixed relation between the structure of the market and the performance of the firms forming part of it, so that structural criteria at best can only give rise to certain presumptions concerning the quality of competition in a market. Only the relatively rare case of a single firm which accounts for a very substantial part of the output of its market and has no fear of new entrants can be said to constitute sufficient evidence of market power on its own. Nor do yardsticks such as the intensity of competition, which measure the operation of the market mechanism by the way in which firms compete, provide an adequate basis for a definitive judgment. Finally, there remains the problem that predicting the outcome of the firm's behavior on the market is not possible at the present stage of economic theory once we reject short-term profit maximization as a realistic entrepreneurial goal. What economic theory can contribute to solving the competition problems with which policymakers will be confronted is a proper definition of the problems and of the criteria for their solution so that as much consideration as possible can be given to the economic aspects involved in forthcoming cases.

In general, a combination of structural, behavior and performance elements

¹⁰⁴ For evidence on price behavior in the steel industry in earlier years, see Means, *op. cit. supra* note 89, at 115; Otto Eckstein and Gary Fromm, *Steel and the Postwar Inflation* (Joint Economic Committee, Study of Employment, Growth and Price Levels, Study Paper No. 2, 86th Cong., 1st Sess., 1959); Walter Adams and Joel B. Dirlam, 'Steel Imports and Vertical Oligopoly Power', 54 *Am. Econ. Rev.* 626 (1964). For a detailed discussion of more recent developments, the reader is referred to Chapter 6 *infra*.

¹⁰⁵ Jesse W. Markham, 'Administered Prices and the Recent Inflation', in Commission on Money and Credit, *Inflation, Growth and Employment* 144-73 (Englewood Cliffs, NJ: Prentice-Hall, 1964), cited by Scherer, *op. cit. supra* note 23, at 298 n.44.

¹⁰⁶ *Op. cit. supra* note 8, Ch. 6.

will be needed to determine the presence or absence of market power. The major structural indicia for tracking down market power are the market share of the firm in question, that of its chief competitors, the resources available to all of them and the height and nature of any barriers to entry to the relevant market. An analysis of market behavior is required because certain of a dominant firm's acts may involve a restraint of competition if other market participants have their freedom of action and choice limited or destroyed thereby; evidence of market power may be deduced from such consequences. This is clearly the case with certain practices which are *per se* abusive, such as price discrimination. Much more frequent, but also much more difficult to recognize as such, are those practices which are not abusive *per se* but may have a comparable effect if used by dominant firms. Examples of this have been found in types of conduct toward the various groups of transactors with which a firm comes into contact or which it influences indirectly. To find conclusive proof of abuse of market power in these practices, however, requires that a substantial number of firms in the same category (suppliers, customers, competitors, etc.) are shown to be harmed by them; if this cannot be shown, the impact of the firm's acts on market performance is the only factor that can give an indication of the existence of market power. Evaluation of the quality of performance may even be the only way to prove market power in the case of oligopolies. For here we are severely handicapped by the fact that in the present state of knowledge there is no theory of corporate strategy that relies sufficiently on realistic assumptions to detect uncompetitive joint market conduct in cases where collusion cannot be shown. If a firm's behavior is designed to exclude competition and this purpose is achieved because the firm in question has market power either alone or in conjunction with others, then market performance will deviate from competitive standards. It is in this area, where behavior and performance aspects are interwoven in the showing of market power, that the economist and the lawyer can work closely together in detecting anticompetitive situations on concentrated markets.

The traditional microeconomic performance criteria that seem particularly relevant where market power is involved are competitive price and satisfactory technological achievement. In order to judge whether a product is reasonably priced we have to evaluate production cost and profit margin. As far as cost categories are concerned, we need to make an evaluation of the efficiency of the production process – especially allocative efficiency and capacity utilization rate – and the level of selling costs in the broadest sense. If profits are being made by a firm – profits calculated as the difference between sales revenue and production cost – that lie well above the average return obtained by firms in roughly similar but competitive industries without attracting new

investment, this may point to market power. But excessive profit margins will occur relatively infrequently because in the long run no firm can escape the impact of the various changes occurring on other markets as a result of technical advance, increasing pressure of international competition and the like. Less clear deviations from the norm can therefore be regarded as indicative of market power as well, provided there are also other pointers to that effect. In order to avoid condemning firms with an outstanding profit performance based on exceptional efficiency and/or managerial talent, high profits should only be regarded as indicative of uncompetitive market power, seeking to escape competitive influences, if they are maintained for an appreciable length of time. The burden of proof can of course be lightened if there are instances of noncompetitive market behavior as well. It is more difficult to detect market power by way of suboptimal technological achievement than by the size of the profit margin because the concept is so indeterminate; only where such achievement lags conspicuously behind growth potential at home and abroad over a given period may this be some indication of abuse of economic power.

Apart from these traditional performance standards we have examined the feasibility of applying macroeconomic performance criteria to the competition problems raised by the presumed existence of market power. The condemnation of firms that are in a position to thwart the attainment of the government's economic policy and thus to influence the growth and composition of the national product at will is proper. Among these targets, full employment, equitable distribution of income and external equilibrium are, however, affected by so many factors that they cannot be taken into account in an investigation of the influence of market power. Internal equilibrium and satisfactory growth rate do have a connection with the operation of the competitive system, but no clear general empirical evidence has been found that lends support to the thesis that concentration leads to or reinforces inflationary tendencies.

In seeking an appropriate remedy once individual or joint market power has been shown, we must ascertain before tampering with the market mechanism that the result will be greater social gains than social losses. This can best be done by building a model based on assumptions excluding the influence of changes that take place outside the particular market. Failing this, however, it can generally be assumed that action to eliminate market dominance will produce more benefits than drawbacks since it may provide new opportunities for actual and potential competitors and may therefore benefit not only the performance of the industry in question but also the economy as a whole through better allocation of resources. This also holds good even

if the dominant firm has not been abusing its power – against whatever group of market participants – during a recent period of investigation; for the potential for exercising a harmful influence on performance is still present. If market power is not destroyed, the government may well be obliged to introduce stringent controls on the activities of the firm or firms involved (price controls, for instance).

It should be emphasized here, however, that there may be cases in which elimination of market power will not be an appropriate remedy because it does not lead to better performance or because there are noneconomic considerations militating against it. In the first place, production techniques may be such that a firm has to be so large that it manufactures most or all of the supply of a given good. This relates to one of the major conditions of workable competition – that corporate efficiency must approximate to the optimum attainable. What we are here concerned with are the somewhat uncommon cases in which the optimum-efficiency curve reaches its lowest point only at a very high volume of output (in declining-cost industries) and where firms which do not reach this optimum scale incur considerably higher production costs. Secondly, market power need not necessarily be condemned where a firm has obtained dominance as a result of its own performance – Schumpeter's innovator, for instance, who produces something that has not been made before and is consequently the only supplier of the product for a time. An eventuality such as this will normally lead to temporary monopoly at most. But if market power persists as a semipermanent feature, then anticompetitive forces may be at work and its elimination may be called for. Finally, a firm's market power may rest upon the legal working of patents. Such statutory rights can preclude competition in several ways, but this is not the place to discuss them.

The most radical measure, and the one that is most effective in eliminating market power, is undoubtedly dissolution. So far-reaching a remedy requires, however, that market power is shown in an economically conclusive manner, and this can be difficult – particularly in oligopoly situations. Great caution must also be exercised in ordering dissolution where a firm is dominant only on some of its geographic markets in the relevant product (i.e. where a relevant geographic market constitutes but a relatively small part of its total market). Splitting off that part of the firm that is responsible for the product group in question might then have undesirable repercussions on competition on those markets where the firm is not dominant. Apart from this, there may be practical drawbacks to *ex post* control of dominance – for instance, if unemployment should result from dissolution or if political considerations should tell in favor of a big firm. In view of these difficulties, and in view of the fact that action against market power usually cannot be taken until harm has al-

ready been occasioned to competition, control of market power must be *ex ante* if it is to be effective, i.e. it must concentrate on preventing the rise of excessive concentration rather than on remedying it after the event. In the next and final section of this chapter we shall work out economic guidelines for such a policy.

3.4 THE ASSESSMENT OF MERGERS

3.4.1 Introduction

In assessing the impact of corporate growth, current opinion generally makes a clear distinction between internal growth and external growth (the various forms of which we shall refer to for convenience by the collective name of merger). It is reasoned that with internal expansion there is no disappearance of independent firms, whereas external expansion removes one or more such firms from the market. (The joint venture is a special case which will be discussed later.) It is true that those removed may not have been active competitors and that it may improve the operation of the market if the corporation resulting from the merger is a very active one, but it *is* felt that there is a basic risk that conditions of competition will be impaired by merger. Apart from this, it is observed that internal expansion increases supply on the market, and this will normally have a stimulating effect on competition since the increased supply will have to seek out increased demand. A merger does not enlarge the supply of goods: it may even lead to a cutback in production, especially on grounds of rationalization. Furthermore, it has been said that internal expansion is a direct reaction to opportunities offered to an entrepreneur by the market, while a merger is often planned and put into effect without this being dictated by the market situation.¹⁰⁷ Clearly, these views of the problem of growth are too simplistic. First, we need not labor the point that corporate expansion in the form of internal growth does not simply ap-

¹⁰⁷ Corwin D. Edwards, in his review of P. Lesley Cook (and Ruth L. Cohen), *Effects of Mergers: Six Studies* (London: Allen & Unwin, 1958), in 49 *Am. Econ. Rev.* 783 (1959), points out that three theories on this matter are often advanced in the United States: 'first, that mergers are less desirable than other forms of concentration because, unlike these other forms, they have not been preceded by a period of competitive struggle, a period that is desirable in itself; second, that in combining activities that were not originally designed to fit together and have not been brought together under the pressures of competition, mergers are less likely than other forms of expansion to attain whatever economies are possible for a large business unit; third, that whereas concentration that develops from competition is likely to be limited by diseconomies of scale and by the stubborn competition of the remaining competitors, mergers have no such natural limits.'

pear out of the blue when market conditions happen to be favorable but must be prepared some time ahead in the expectation of increasing sales and profits. And as far as a merger is concerned, it surely seems highly unlikely that it will be planned irrespective of current or expected trends in these items. Second, it is doubtful whether internal growth is necessarily procompetitive or growth by merger anticompetitive. For, as has already been pointed out, in only very few cases is the number of firms a decisive element of proof of market power. And it is not difficult to find evidence in the past of predatory instances of internal growth where a big company has expanded its productive capacity solely with a view to driving out weaker competitors.

However, from the standpoint of competition policy mergers deserve special attention as the only form of corporate growth that can be counteracted as a means of halting concentration. Mergers can be stopped before they are consummated, whereas there are insurmountable obstacles to prior checks on internal growth so it can be attacked only after abuse has been shown. Direct and timely intervention in the process whereby economic power is created is only possible, therefore, where merger is the growth route and provided the intervention takes place before the merger has been consummated. A ban on mergers can also be made more readily acceptable than restrictions on investment. Not only would the latter course encounter resistance for psychological reasons (direct interference with private enterprise), but the limitation of investment on other than economic-policy grounds may have undesirable macroeconomic consequences. Outside the business world, on the other hand, the attitude to preventing a merger is much less critical. An effective merger policy, i.e. one that is directed against mergers that are not yet consummated, implies, however, that postmerger performance data must be discounted, which means that under dynamic circumstances we can never establish with certainty the influence that a merger may have on competition; the remaining tests can only answer our questions with a reasonable degree of probability. But if we wait until after the event to decide on the permissibility of a merger, then we encounter the same difficulties as in the case of existing firms in correcting competitive conditions should the merger prove to have unwanted consequences.¹⁰⁸ And in reflecting upon the risk that potentially desirable mergers may be proscribed we should bear it in mind that economies of scale may also be obtained by the internal growth route.

What use can be made of a tradeoff approach, weighing the pros and cons of the change provoked by mergers, in judging their economic impact in the context of competition policy? The relevant point here is to compare the benefits to the corporations concerned with the impact on the world outside. Not all economies realized by merger are macroeconomically relevant: this is

notably the case with 'promotional economies.' As defined in Chapter 2, these relate to cost savings in displaying and selling the product, which may lead to a reduction in advertising costs per unit of output. Only where cost savings are of a nonpromotional nature and represent improved resource allocation are they macroeconomically relevant. Nonpromotional economies have to be weighed against the possibly unfavorable effects that mergers may have on the working of the market mechanism, which will become apparent particularly if market power is thereby created or reinforced.

This tradeoff approach raises several problems, however. First, we need to have a precise idea of the efficiencies that are presumed to flow from a merger, i.e. what kind of efficiencies they are and whether they are substantial. As can be seen in practice, the predictions of the firms in this respect may differ considerably from what can be observed some years after the consummation of the merger. Secondly, we need to know rather precisely what influence a merger will have on various aspects of market performance. Here, an appreciable amount of prediction is required if, as should be the case, a judgment has to be made before the merger is consummated, and it will have become sufficiently clear from the foregoing that the prediction can never be made with any certainty. Economic theory is not equipped to predict the influence of changes in market structure on performance, since we do not know through what aspect of performance the firm will act. Only in the rather imaginary case, then, that both the economies from the merger and the impact of increased market power on performance can be sufficiently quantified is a tradeoff analysis possible.

The judgment of mergers for antitrust purposes, then, should focus on an analysis of its presumed impact on competition. Where postmerger evidence is not available, this exercise will have to rely mainly on elements of market structure. Only in cases where anticompetitive effects cannot be clearly shown by this means may efficiency arguments usefully be taken into account.

Heavy reliance on a market-structure approach implies a careful determination of the relevant market – particularly in merger cases presenting horizontal aspects. The basic components of market determination are the same as in cases of market dominance; they have been discussed in detail in section 2 of this chapter. If market determination in a merger case reveals distinct product or geographic markets, then the merger is a product- or market-ex-

¹⁰⁸ Proceeding *ex post*, of course, will be unavoidable in all cases where the authorities are unable to begin their assessment of a merger until after it has been consummated or where a merger that had originally been approved is subsequently shown to have undesirable consequences.

tension merger. In doubtful cases, knowledge of the market conduct of the merging firms toward each other and toward other firms may provide significant pointers. In the case of geographic market determination in particular, as well as national or even international markets, submarkets with a local or regional aspect may be found relevant if the merging firms are especially active competitors there. Then it is also possible that firms operating in geographically distinct markets have partly overlapping market areas. In such a case the merger presents horizontal features (for the overlapping area) as well as market-extension characteristics. If the overlapping area is important in economic terms and accounts for a substantial part of the total sales of the merging firms, it should be considered a relevant market on which the impact of the merger has to be studied. If the first of these criteria is not met, the total area, comprising the overlapping and nonoverlapping segments, should be considered to constitute the geographic market. If only a small proportion of the total sales of the merging firms is in the same area (say, under 20 percent), then the merger should be considered a market-extension merger.

In discussing the impact on competition of mergers, we distinguish between several types of combination – horizontal, vertical, product-extension, market-extension, pure conglomerate and joint ventures.

3.4.2 Horizontal Mergers

For purposes of analysis, it is useful to distinguish between highly concentrated oligopolies – where the four largest firms together account for at least half of total sales and the eight largest for at least three fourths – and less concentrated oligopolistic market structures and to differentiate between those markets which present moderately high to high barriers to entry and those which do not. In analyzing the impact of mergers on competition in highly concentrated oligopolistic market settings, we can distinguish three types of merger situation – merger creating an oligopolist who is larger than his competitors, merger that results in a firm that is as large as the biggest existing oligopolist and merger between an oligopolist and a smaller firm outside the group of oligopolists. In a highly concentrated oligopoly with no appreciable differences in market share and influence between the oligopolists (i.e. the oligopoly is symmetric) but with substantial barriers to entry, a merger between the oligopolists should be condemned in all circumstances. For the creation of one major firm increases the likelihood of collusive behavior among the oligopolists and thus of a deterioration of market performance. The same grounds for disapproval hold good, of course, if one of the oligopolists already has a considerably larger share of the market than his competitors and increases this still further by horizontal merger.

But what should be our attitude where two oligopolists whose size after the merger would rival that of the biggest firm on the market defend their merger by pointing out that it will give them more chance of success in competing against the leading firm? A merger of this type would produce a duopoly, with all the attendant risks of collusive behavior between the two biggest firms and much weaker competition from the other oligopolists. There is a reasonable probability that the merger will have anticompetitive effects if there is active competition between the prospective merger partners and between each of them and their other competitors. In such a case it is not necessary to investigate the potential economies that the merging firms might derive from joining forces since there is no reasonable certainty that any cost saving effected by the merger will be passed on to the customer in the form of lower prices or improved quality. Such economies do need to be taken into account, however, in the appraisal of mergers in industries which, though highly concentrated, present no substantial natural or artificial barriers to entry. The economies from merger should be nonpromotional so that the merger will as far as possible have no impact on entry conditions. Further, a merger should not increase whatever asymmetry there exists in the market.

A last group of horizontal merger cases that deserves separate attention involves acquisitions by big companies of their smaller competitors (i.e. firms outside the group of oligopolists). If the acquiring firm is dominant, an acquisition of this type provokes anticompetitive effects because the dominant firm reinforces its position on the market. Though the anticompetitive effects remain, it is more difficult to pass judgment on the permissibility of such a merger if the small competitor has been looking for a merger partner and accepts a good offer from the dominant firm. We are of the opinion that such a merger should be allowed where the small company has got into financial difficulties through no fault of its big competitor and the latter is the only company to come forward with an offer of merger at an acceptable price. For not only would the failing company in any case have been likely to go out of business and be lost as a competitor but employment would certainly have been reduced as well.

The essential antitrust problems connected with the acquisition of viable small competitors remain when the acquiring corporation does not enjoy single-firm dominance on the market but forms part of a concentrated oligopoly. Acquisition of a marginal firm by one of the oligopolists should be disapproved of when (1) the acquired company holds patents for an improved product or process and consequently enjoys a lead over the oligopolists or is an active competitor, or when (2) the oligopolists are few and big and there are high barriers to entry.

Anticompetitive effects will not normally flow from mergers between firms belonging to less concentrated oligopolies. However, one merger may rapidly be imitated by other firms fearing that they will lose ground, and the market may sooner or later be transformed into a concentrated oligopoly. If barriers to entry are high, it may therefore be wise to hinge the permissibility of horizontal mergers in less concentrated markets on proof of clear nonpromotional economies which cannot profitably be obtained except by merger.

Premarket performance is of no great importance in judging mergers. Where there is workable competition in an oligopoly, that alone is not sufficient reason to welcome further concentration as a positive contribution to competition. But where performance is poor and this can be put down to the state of competition in the prevailing market structure, there are still no grounds for doing so, unless more *effective* competition can confidently be expected to result. And this will generally be the case only with mergers between firms which have but a small share of the market and lack a strong financial base, provided merger enables these firms to produce nearer to optimal scale and gives them more financial power to compete actively with the big concerns.

Finally, there is the question how far a distinction should be made between mergers between firms belonging to markets characterized by growing demand and those between firms in stagnating markets. Applying a tradeoff approach, Williamson points out that mergers in expanding industries serve no useful purpose since the cost saving desired can be much better obtained by internal processes because the increase in demand may enable the firm to operate on a scale that will allow it to introduce cost-saving techniques. In static markets, however, or where the underlying trend of demand is declining, savings resulting from better allocation of resources would be attained more readily by merger.¹⁰⁹ Although the distinction has its attractiveness, it is also one-sided and therefore not suitable for use in the application of merger policy. As far as markets characterized by growing demand are concerned, Williamson's observations do not apply in two relatively frequent situations. First, as we saw in Chapter 2, there are a number of industries in which several optimal scales for plants are conceivable, each of them suited to a given volume of sales. In industries of this kind a merger may help a firm to reach a more efficient scale earlier than would be possible via the internal growth route because of the larger outlets created. Second, even in industries where there is only one minimum efficient scale, merger may be a vehicle whereby small firms can reap cost benefits ensuing from scale economies in different fields (production, as well as sales or research) much earlier as well. This argument is particularly relevant for mergers between smaller firms in other-

wise concentrated markets since they can rapidly improve their market position and thus strengthen competitive forces. For in a growing market the increase in sales will often go to those firms that have sufficient resources to enable them not only to satisfy the rise in demand swiftly but also to finance an aggressive market strategy. Firms that cannot do this fall behind and lose part of their markets to their more powerful competitors.

As regards stagnating markets, Williamson, in estimating the net welfare effects of cost-reducing mergers, is basing his merger defense on the conclusion that the tradeoff between increased efficiency and a strengthening of monopolistic tendencies is generally in favor of the former since macroeconomically the benefits that result from a 5- to 10-percent reduction in average costs in most cases are so great that they outweigh whatever unfavorable influence there may be on market performance, such as price increases.¹¹⁰ But Williamson seems to have underestimated the deleterious effects on market performance of the creation of market power by merger or of strengthening market power that existed already before the merger. More recent contributions in this field have reached completely different conclusions, showing that performance may easily be diminished to such an extent that a net welfare loss will result.¹¹¹

3.4.3 Vertical Mergers

Vertical integration has a foreclosure effect: if a firm takes over a customer, it may deny that customer the right to buy from any other firm; if it takes over a supplier, it may deny the supplier the right to sell to any other firm.¹¹² The result of this is that competing nonintegrated suppliers lose the acquired firm as a customer or competing customers lose it as a supplier, so that part of the flow of trade is withdrawn from the market. But this foreclosure effect of vertical integration has no anticompetitive implications as long as the non-

¹⁰⁹ O. E. Williamson, 'Economies as an Antitrust Defense: The Welfare Tradeoffs', 85 *Am. Econ. Rev.* 18 (1968). Williamson rightly notes that the timing of the merger is relevant here. He recommends the antitrust agencies to delay authorizing a combination if the proposed merger promises potential economies that will not be realized for some time, e.g. when existing plants have not yet exhausted their useful life and have limited value in other uses. *Id.* at 25-26.

¹¹⁰ *Id.* at 34.

¹¹¹ DePrano and Nugent, *op. cit. supra* note 96.

¹¹² Only in exceptional circumstances is it to be expected that an integrated firm will refrain from limiting its dealings to affiliated suppliers or outlets but instead will deal with independent firms - for instance, when a high level of concentration or high barriers to entry prevent competition from becoming fully workable. The celebrated example of GM is cited in Peter F. Drucker, *The Concept of the Corporation* 50 (New York: John Day, 1946).

integrated sector of the market still has sufficient outlets or sources of supply available elsewhere.¹¹³ This is governed by the position of the integrating firms on their markets and the degree of integration in the industry. The higher the sales of the integrating firms on their respective markets and/or the more widespread integration is, the more likely it is that competition will be lessened as a result of integration.

At this point it may be useful to ask what difference it makes for the non-integrated firms if the processing and sales requirements of the integrating firms do not complement each other fully and they still have to deal with the nonintegrated sector for some of their requirements. It has been pointed out that such an unbalanced integration may provide a lever against nonintegrated competitors which can result in abuse.¹¹⁴ For instance, if a firm takes over a supplier but remains an outlet for nonintegrated competitors at the newly entered stage, the integrated firm may discriminate against these competitors as regards conditions of sale. A comparable situation arises if the acquired supplier produces more than is needed to satisfy the requirements of the acquiring customer and competing (nonintegrated) customers have to buy from the integrated firm and sell their products in competition with it: here, the integrated firm can discriminate against its competitors at customer level as regards price and availability of supplies at times of shortage and try to squeeze them out of the market. In competitive circumstances, however, such conduct will generally not be too frequent. For the integrated firm may be afraid of losing its reputation with nonintegrated customers or suppliers as long as it is dependent on them and of pushing them into the arms of its own competitors. Moreover, operating a price squeeze implies lower prices, with the danger already mentioned that this will cause permanent deterioration of profit margins.¹¹⁵ What will often happen, however, is that firms will try to become less dependent on such outside sources and try – by merger, by internal expansion or by exclusive arrangements – to fill up whatever part of the chain of production does not yet correspond to the requirements of the other part. These considerations are generally inapplicable to dominant firms, and it is there that we have had examples of predatory practices in the past. The likelihood of such practices being employed is especially great if the dominant firm has managed to gain control of sources of raw materials because this puts its nonintegrated competitors completely in its power and enables it to extend its influence on the market.

All these examples illustrate the point that concentration levels tend to extend from one stage of production to another because of integration; this causes competition problems as soon as market power is involved. However, the mere result of foreclosure does not lead to the rise or strengthening of

market power.¹¹⁶ Does vertical integration have other effects on competition that may bring this about? We will have to focus on possibly adverse impacts on the conditions of entry to the market. Vertical integration faces potential competitors with higher barriers to entry, which may eventually worsen competitive conditions on the market. But not all barriers are heightened to the same extent. The capital requirements of entry will in any case be increased; smaller newcomers in particular will have difficulty in raising the additional funds needed. At the same time, absolute cost disadvantages may arise for the newcomer if vertical integration has given the established firms definitive control of scarce resources or the best channels of distribution. Although it is true that in a case such as this the scarcity of resources or the lack of a good distribution network is the cause of barriers to entry and that these might still be there without integration,¹¹⁷ all market participants will normally have access to what is available if there are no vertical ties. If these resources or distribution channels are in the hands of a single firm or a small group of firms, they can be used as a means of bringing pressure to bear both on nonintegrated existing firms and on newcomers. It is only on economies of scale – the third major barrier to entry – that vertical integration has no direct influence. Lastly, vertical integration between the manufacturing and the distribution stage may provide a means for a manufacturer to augment the influence of product differentiation, which may also raise or reinforce barriers to entry.¹¹⁸

¹¹³ It will, of course, always have some impact on performance since the vertical integration will oblige nonintegrated suppliers and customers to deal with each other, which would not have been necessary had there been no integration. This could mean that resources are not being used in the most efficient way. Board of Trade, *Mergers: A Guide to Board of Trade Practice* para. 47 (London: HMSO, 1969).

¹¹⁴ See, e.g., M. A. Adelman, 'Integration and Antitrust Policy', 63 *Harv. L. Rev.* 27, 43 (1949); Board of Trade, *op. cit. supra* note 113, para. 46.

¹¹⁵ Naturally, nonintegrated firms always run the risk of being the first victims of any reduction of supply or demand in periods of recession, but this can scarcely be regarded as anticompetitive. See Corwin D. Edwards, 'Vertical Integration and the Monopoly Problem', 17 *J. of Marketing* 404 (1952–53).

¹¹⁶ William S. Comanor, 'Vertical Mergers, Market Powers and the Antitrust Laws', 57 *Am. Econ. Rev.* 254, 259 (1967, Proceedings).

¹¹⁷ As is pointed out by Comanor, *id.* at 258.

¹¹⁸ Comanor, *id.* at 262 & n.17, notes that Bain had already reached the same conclusion in his *Barriers to New Competition*, *op. cit. supra* note 27, at 142. For a compendium of views on the impact of vertical mergers on competition, see also Robert Bork, 'Vertical Integration and Competitive Processes', Williard F. Mueller, 'Public Policy Toward Vertical Mergers', and Sam Peltzman, 'Issues in Vertical Integration Policy', in J. Fred Weston and Sam Peltzman (eds.), *Public Policy Toward Mergers* Chs. 10–12 (Pacific Palisades, Cal.: Goodyear, 1969).

The extent to which vertical integration may influence conditions of entry naturally depends on the size of the integrated in relation to the nonintegrated sector of the market. A firm will not be compelled to enter at both stages if there are enough nonintegrated firms which are willing and able to supply it with raw materials or to buy its products and are not themselves dependent on sources of supply or channels of distribution controlled by integrated competitors. If, on the other hand, integrated firms account for the majority of total sales, nonintegrated newcomers will be dependent on them for some of their sales or supplies. Hence, newcomers must enter at both stages if they are to be successful, and this may substantially reinforce barriers to entry. In such cases vertical integration reduces the competitive pressure on the integrated firms and may give rise to the extension of market power or enable the integrated firms to build up a stronger position on the market than they had before.

Where there is active competition between the integrating firm and its competitors, restrictions can hardly be placed on integration on the ground that it raises barriers to entry. This argument may well be adduced, however, in the assessment of cases where workable competition between the integrating firm and its competitors is lacking but potential competition exerts a considerable regulatory influence – which will generally arise only if integration starts from a position of individual or joint market power. In such cases, the merger has an anticompetitive effect because it lessens whatever competitive influences there were left so that any cost savings flowing from the integration are not transferred to the next stages, quite apart from the fact that the uncompetitive structure may well be transplanted too. For the same reasons, integration of dominant firms by the merger route is undesirable. Now it has been pointed out in this connection that vertical integration of single-stage monopolies will lead to a lower final price than would obtain without integration since the monopoly profit per unit at the final stage may be smaller than the sum of monopoly profits at the single stages.¹¹⁹ Though from a theoretical viewpoint this reasoning is correct, it cannot be considered sufficient of itself to sanction vertical mergers by a dominant firm because there is no certainty at all that it will pass on to other stages whatever benefits it may reap from integration since it has no real incentive to do so. Nor should it be overlooked that the closer the monopoly element to the final consumer the bigger the monopoly profit margin in absolute terms. It should, however, be added that from a competition viewpoint investing in new facilities may not be welcomed either because in so doing the dominant firm is still evading competitive influences on the market into which it integrates, thus strengthening its position.

A final point that should briefly be touched upon is what antitrust agencies should do in those borderline cases where it may be presumed that certain anticompetitive effects will flow from merger but the internal growth route is either unsuitable or even impossible. This may happen, for instance, if important desiderata such as a regular supply of scarce raw materials should be allowed to prevail over other considerations. In such cases there should be sufficient guarantee that a reasonable proportion of the cost saving obtained from integration will be passed on to other stages. Obliging the merging firms to allow the nonintegrated firms regular access to raw materials or other sources of supply or to outlets, however important these firms may be as a corrective force to the conduct of their big competitors, does not meet this requirement. In cases such as this, then, it may be unavoidable that some form or other of supervision be imposed on the integrating firms, a point to which we shall return in more detail in Chapter 7.

3.4.4 Conglomerate Mergers

The mergers commonly known as 'conglomerate' make up an extremely heterogeneous group, at least if we accept the usage that lumps together as conglomerates all acquisitions other than horizontal and vertical.¹²⁰ The distinction is normally made between product-extension and market-extension mergers on the one hand and 'pure' conglomerates on the other. In the first two types of merger, firms come together which are not direct competitors but which either utilize common production facilities or distribution channels or sell the same product in different markets.¹²¹ In a pure conglomerate merger, firms producing wholly unrelated products combine. As it is much easier to increase efficiency and spread risks if the acquiring firm has excess resources which it can usefully invest in the acquired firm, the degree to which certain of the parent company's production factors can profitably be used by the subsidiary¹²² will generally be quite considerable, even in the case of pure

¹¹⁹ Comanor, *supra* note 116, at 257-58. For an exposition of pricing policy after vertical merger between monopolists, see also de Jong, *op. cit. supra* note 26, at 184-90.

¹²⁰ See, e.g., Donald F. Turner, 'Conglomerate Mergers and Section 7 of the Clayton Act', 78 *Harv. L. Rev.* 1313, 1315 (1964-65).

¹²¹ The boundary between these groups and horizontal or vertical mergers is undefined, of course. As the Board of Trade puts it, 'there is no generally accepted definition by which a conglomerate merger can be distinguished from certain kinds of horizontal or vertical mergers.' *Op. cit. supra* note 113, para. 50.

¹²² This has been called 'node commonality' by John C. Narver, *Conglomerate Mergers and Market Competition* 3-6 (Berkeley and Los Angeles: University of California Press, 1967).

conglomerates, as we saw in Chapter 2. Apart from cost savings due to increased efficiency, conglomerates may have beneficial macroeconomic results as well. This is the case where a shortage of production factors such as management or capital in the acquired firm is made up, which results in a better allocation of resources, and the acquired firm is in an industry with considerable growth potential but does not have sufficient resources to develop it.¹²³ Moreover, recent years have shown, especially in the United States, where the phenomenon has reached the greatest proportions, that the threat of takeover spurs many firms to become more dynamic, whereupon they raise their takeover price so much that they cease to be an attractive proposition for conglomerates.

The internal transfer of resources that is inherent in a conglomerate firm may affect competition in the different markets in which the firm operates to a greater extent than its size in each market would otherwise have made possible without conglomerate ties. As far as negative influences are concerned, some writers consider it typical of conglomerates that they are less sensitive to competitive influences on these markets since the overall aims of the company may not require it to seize every opportunity that is offered on one or other of its markets.¹²⁴ Then, conglomerates are sometimes alleged to engage in a number of anticompetitive practices, including reciprocal buying, predatory pricing ('deep pocket') and mutual forbearance. The deep-pocket argument is that a large conglomerate firm can sell below cost for a considerable length of time by subsidizing losses in a given line of business by drawing on profits from other activities, which enables it to drive smaller, single-line rivals out of business. The mutual-forbearance argument essentially is that large conglomerates will meet in a wide variety of markets, will recognize their interdependence, and will adopt a live-and-let-live policy rather than compete vigorously, since a firm engaging in vigorous competition is liable to encounter retaliation in markets where it is vulnerable. Finally, acquisition of a large firm – be it a dominant firm or an oligopolist – may unfavorably affect competitive conditions if that firm's position is strengthened as a result. On the positive side, the strengthening of the position of a small firm in a highly concentrated market by way of conglomerate merger ('toehold acquisition') will be generally beneficial to competition if the conglomerate uses its resources to challenge the leaders in the newly entered market; such procompetitive effects will be particularly apparent if barriers to entry are high.

Relevant factors to be taken into account in judging the competitive impact of conglomerate mergers are how far potential competition is eliminated thereby, the competitive situation on the market in which the acquisition

takes place and the extent to which resources may be transferred and the nature of these resources. The anticompetitive business practices referred to above should be taken into consideration only if they are items of postmerger evidence or if the conglomerate firm has engaged in them in other transactions already. The first factor is important in that when the acquiring firm is the only potential competitor or the most likely one, other firms facing higher barriers to entry, its elimination may have undesirable consequences for competition. A firm will generally be a most likely entrant to a market by virtue of its specific experience and capabilities and its possession of excess resources there that may make it a full-fledged competitor of the firms in the market. It is therefore important to examine the nature and scope of such excess resources for a judgment on the potential-entrant status of a firm. Here we should again recall the distinction made in Chapter 2 between the non-promotional and promotional economies inherent in conglomerate mergers. In view of the financial gains that may accrue to a firm if it is able to utilize its promotional resources better, the prospect of realizing promotional economies should be considered a major incentive for a firm to enter a market. Whereas these economies may be realized if a firm diversifies through market- or product-extension mergers, they will generally be absent in the case of pure conglomerate mergers.

The second factor that has to be taken into account is the competitive situation on the market in which the acquisition takes place – the position of the acquired firm in particular. Here again, the true impact the merger may have on competition can only be judged in the light of the economies flowing from the merger. The more scope there is for the acquired firm to use excess resources of its parent company and the greater the economies (in absolute terms) thus accruing to the affiliate – which depends on the size relationship between the two firms – the more extensive the internal transfer of resources and the greater the advantages over the acquired firm's competitors and potential competitors arising from the merger. If resource transfer is appreciable and the conglomerate merger involves a leading firm, the monopolistic structure of the market will be strengthened. This need not be a reason for disallowing the merger provided it can reasonably be expected that the resources transferred will improve the performance of the acquired firm.

¹²³ As was remarked in Chapter 2 *supra* (p. 36), of firms of the same size conglomerates have in the past invested more in research than firms whose activities were confined to a single industry.

¹²⁴ This view is advanced by the Board of Trade too, *op. cit. supra* note 113, paras. 55–56, though it adds that there may be no real gain in efficiency.

A lasting improvement in performance can be expected only if the conglomerate merger brings in its wake substantial nonpromotional economies. In practice, such a situation will arise only in the case of mergers between firms producing wholly unrelated products. For in the case of product-extension or market-extension mergers the parent company has the major opportunity of strengthening the position of its newly acquired subsidiary by financing a large-scale advertising campaign or else incorporating the subsidiary's product in its sales strategy. This may present an insurmountable obstacle to actual competitors of the subsidiary not having the benefit of such promotional backing, and it may considerably heighten barriers to entry at the same time. However, as we observed in section 3 of this chapter, there is only limited evidence available that such resources are used to enable the subsidiary to undersell its competitors in order to increase its market share; prolonged subsidization will ultimately be feasible only for firms which are able to make above-normal profits elsewhere because of their market power.

Nor does it seem that the procompetitive effects of toehold acquisitions by conglomerate firms are important. In any case, a recent FTC study of patterns of conglomerate expansion has found little evidence of such acquisitions in the period 1963-69 in the United States:

Toehold-type situations [market shares of under 5 percent in industries with a four-firm concentration ratio over 60 percent] accounted for only 22 of 222 product classes the conglomerates as a group acquired. An examination of changes in market share after acquisition shows more declines than increases. Overall, 127 of the 218 acquired market positions for which data were available showed declines between the time of acquisition and 1969. In the 'toehold' class for concentrated industries, 13 of the 22 market shares declined. In sum, these data provide no support for the toehold hypothesis. More generally, they show no evidence that conglomerates aggressively expand market shares after acquisition, either in a 'good' toehold sense or a 'bad' deep-pockets-predatory sense.¹²⁵

3.4.5 Joint Ventures

A corporate joint venture is an association of two or more firms to establish a new company, most or all of whose share capital the parent firms control. The emphasis here is on the creation of a *new* firm: the joint purchase by two or more firms of an *existing* firm normally has similar competitive effects to those of a merger.¹²⁶ As they have not been mentioned before, it will be useful to summarize the economic advantages of joint ventures at this point. The two main reasons generally adduced in justification of a joint venture are that it is a means of sharing risks that a single company would be unwilling to take on its own or that it enables the participants to reap economies

inherent in the performance of functions that neither of them could profitably undertake independently because of large capital requirements or technical or other considerations.¹²⁷ There are more specific points stemming from this second reason which seem to be decisive in practice. For instance, there may be not insignificant economies involved in setting up a joint subsidiary which can benefit from the parents' complementary or overlapping technology and research facilities. Or a joint venture may be undertaken in order to enhance the degree of integration of the parent companies. This may range from the setting up of a joint production facility supplying the parent companies with raw materials or intermediate products to the creation of a joint sales agency.¹²⁸

Unlike a merger, the creation of a joint venture means the entry of a new competitor into a market. This may have desirable consequences for competition on that market and for economic performance; these advantages will be all the greater if competition on the market is not working satisfactorily and barriers to entry are high. However, joint ventures may have detrimental effects on competition as well. The most important negative impact arises from the fact that the joint venture creates a community of interests between the parents which may go beyond the mere operation of the joint venture.¹²⁹ There may be no problem in this respect if the constituent firms form part of different competitive environments, because there would be no danger of collusive behavior in such circumstances. If the firms are horizontally related

¹²⁵ Federal Trade Commission, *op. cit. supra* note 93, at 198-99.

¹²⁶ There is agreement on the definition of the joint venture in the American literature at least. See, e.g., Kaysen and Turner, *op. cit. supra* note 21, at 136; Michael Bergman, 'The Corporate Joint Venture Under the Antitrust Laws', 37 *NYUL Rev.* 712 (1962); Walter J. Mead, 'The Competitive Significance of Joint Ventures', 12 *Antitrust Bull.* 819, 821 (1967). But see Helmut Henrichs, 'Sect. 7 Clayton Act und die sog. "joint ventures"', 16 *Wirtschaft und Wettbewerb* 29, 30 (1966).

¹²⁷ The staff of the Cabinet Committee on Price Stability comes to the conclusion, however, that large capital requirements are seldom involved, even though joint ventures are commonly set up by the very largest firms. Study Paper No. 2: 'Industrial Structure and Competition Policy', in Cabinet Committee on Price Stability, *Staff Studies* 51 (Washington, DC: Government Printing Office, 1969).

¹²⁸ This seems to have played a major role in the creation of joint ventures in the United States. See Stanley E. Boyle, 'The Joint Subsidiary: An Economic Appraisal', 5 *Antitrust Bull.* 303, 306 (1960), citing Daniel R. Fusfeld, 'Joint Subsidiaries in the Iron and Steel Industry', 48 *Am. Econ. Rev.* 578 (1958, Proceedings).

¹²⁹ Perhaps this is the main reason why a very large number of joint ventures in the United States are owned by corporate parents manufacturing products in the same Census product classes, i.e. direct competitors. Cabinet Committee on Price Stability, *op. cit. supra* note 127, at 50. Mead, *supra* note 126, reports on his investigation into this point in respect of joint bidding agreements in public oil and gas resource auction markets in Alaska and the Gulf of Mexico.

and form part of a concentrated oligopoly, on the other hand, collusion might well be profitable. If absolutely necessary, the potential undesirable competitive consequences in such a case can be judged by the same criteria as apply to horizontal mergers. If the parent firms are vertically related, there may be preferential treatment between them and foreclosure issues may arise; here, the competitive effects may resemble those of vertical mergers. Over and above this, undesirable competitive effects could arise if the joint venture were set up by two potential entrants to the market, because this would mean one actual entrant instead of two potential entrants. Finally, the joint creation of a firm that would occupy a dominant position on its market could be considered undesirable.

As the relationship between the parents as a result of their entering into a joint venture is not comparable with the relationship resulting from a merger, however, and in view of the procompetitive effects that the entry of a new firm may have (unless it is dominant), the yardsticks for judging joint ventures should not be as severe as those for mergers. More specifically, they should leave room for allowing joint ventures between companies occupying an important position on their respective markets if there are clear economic justifications for their establishment, if joint venture is the only way by which entry can be realized and if the prospective parents are the only firms interested in joint penetration of the new market. Acceptable economic justifications for joint entry include high minimum capital requirements which could not reasonably be supported by only one of the firms, exceptional risks (an argument which can only hold if the joint venture is exploring new fields or entering specific geographic markets such as politically unstable regions) and substantial savings in private and social cost.¹³⁰

3.4.6 Summary and Conclusions

There is real scope for antitrust action on mergers only where they have not yet been consummated. For if action is taken afterwards, the authorities have to focus on the presence of market dominance – with all the problems that this may entail. With preventive action, moreover, there are none of the troublesome problems involved in restoring the conditions for competition on a market once a merger is deemed to have anticompetitive effects. However, in giving a premerger judgment, we must disregard much of the analytical apparatus developed for judging the workability of competition. This also implies that under dynamic circumstances inquiry into the changes in the structure of a market that may be caused by concentration can never establish with certainty whether a merger will have anticompetitive effects, i.e. whether it will result sooner or later in a deterioration of market performance; pre-

merger assessments of its competitive consequences, therefore, can never do more than state 'reasonable probabilities.'

Mergers between small firms in otherwise concentrated industries should normally be welcomed without reservation. Particularly if the merging firms had previously lacked the individual financial power to compete actively with their big competitors but are then enabled to do so by reaping economies, the result of the merger will be that they can more effectively exert a restraining influence on market power. Toehold acquisitions by conglomerate firms in highly concentrated industries may have a similar beneficial effect. On the other hand, mergers in which a dominant firm is involved must be rejected out of hand because they would result in a reinforcement of its market power and would thus constitute an abuse *per se*. Between these two extremes lies an area in which the likely competitive consequences of merger can only be judged from case to case. Rigid quantitative limitations on corporate growth cannot serve as a definite guide for the economist. For there are many aspects other than market share or the absolute size of the firm that ought to be taken into account, and quantitative data mean different things in different industries. Apart from a full examination of market structure, another point that has to be carefully studied in a case-by-case analysis is the conduct of the prospective merger partners. It makes a considerable difference whether the merging companies are already working closely together or are active competitors: in the first case a merger will have much less effect on competition than in the second. Efficiencies that may flow from a merger and other evidence submitted by parties proving that it is well founded should not be taken into consideration when indicia of structure and conduct point clearly in the direction of probable anticompetitive effects. For there is then no certainty that any cost saving effected by the merger will be passed on to the customer in the shape of better performance. Only in cases where no clear judgment can be formed about the likely competitive consequences of a planned combination will there be any point in analyzing the expected economies so as to gain a better insight into the economic issues involved in the merger. It should be assumed that only where merger is the sole means of bringing about a marked increase in efficiency without delay does an efficiency defense by the merging parties deserve sympathetic consideration.

¹³⁰ Typical examples of such cost savings can be found in the joint operation of certain 'natural monopolies' such as natural gas and oil wells and railroad terminals. Mead, *id.* at 824, cites an instance of cost saving by a number of oil companies in Alaska which joined together to conduct seismic work. And the saving was not only in private cost: fish life would have been destroyed in the shooting phase of the work if each firm had engaged in its own exploration.

Assessment of the influence that a *horizontal* merger may exert on competition depends mainly on the degree of concentration on the relevant market. If the market does not show features of a monopoly or of a highly concentrated oligopoly and there is no danger of such an environment developing after the merger, there may be no anticompetitive effects arising from the merger. If these features are present, however, and barriers to entry are high, a merger should not normally be allowed, because there is an imminent danger of anticompetitive consequences even if the merging partners present an appropriate economies defense. On the other hand, such a defense might well be presented successfully by prospective merging partners in markets which, though highly concentrated, have no significant barriers to entry. A merger between a dominant firm and one of its competitors may generally be allowed if the latter is in failing circumstances or wants to go out of business and there are no other prospective purchasers forthcoming.

The influence that *vertical* mergers may exert on competition is determined chiefly by the position of the acquiring and acquired firms on their respective markets. For the process of foreclosure that may accompany vertical mergers means that market shares are extended from one stage of production to another. Vertical integration may also lead to the creation or strengthening of market power through its impact on the height of entry barriers and through product differentiation. Consequently, only such mergers as will not have these effects are compatible with the requirements of competition. Vertical mergers involving one or more firms belonging to concentrated and highly concentrated oligopolies should be rejected unless there is workable competition on the markets on which they are active, nonintegrated competitors will not be deprived of their outlets or sources of supply on such a scale as to endanger their existence, and integration can be expected to bring in its wake important economies (and these are all conditions that will only rarely be met in practice). In marginal cases in which anticompetitive effects are not too marked and there are important economies to be realized, the dilemma can be resolved if it is certain that nonintegrated competitors will not be driven out of the market and that a reasonable share of the economies flowing from the merger will be reflected in better performance.

Traditional tools of market analysis are inadequate for judging problems created by *conglomerate* mergers. For interindustry competition or even competition on markets in quite unrelated products may be lessened when firms know that competitive vigor displayed in one market may incite conglomerate competitors to retaliate in other markets where they have a stronger position. Apart from this aspect, we consider that clear anticompetitive effects may flow from product- or market-extension mergers either where the firm to be ac-

quired is a leading firm in its market, or where the acquiring firm is the most likely entrant and there are no other important potential entrants left. On the other hand, we feel that pure conglomerate mergers involving a leading firm should be allowed, provided that substantial nonpromotional economies may reasonably be expected to flow from them. Clearly procompetitive results may flow from conglomerate acquisitions of small firms in concentrated industries or in industries protected by high entry barriers, irrespective of the type of conglomerateness involved.¹³¹

The problems created by *joint ventures* differ from those of merger in that joint ventures allow the entry of a new competitor into a market. Their impact on competition, however, arises from the fact that the joint venture may constitute a meeting place for the parent companies, and competition between them may suffer as a result. This is especially so if the parents are horizontally or vertically related, but as this relationship is not comparable with the one resulting from a merger, even joint ventures between companies occupying an important position on their respective markets should be allowed if this is the only way to gain access to otherwise closed markets.

In practice, quantitative guidelines should be rejected and antitrust authorities should use their discretion in the prohibition of mergers. But it should be borne in mind as well that prohibition of a merger that has not yet been consummated is a less far-reaching and therefore more readily acceptable restriction on entrepreneurial activity than dissolution, divorcement or divestiture of an existing entity. The implementation of a merger policy has to take both aspects into account. Besides that, the economic aspects of the competition problem, on which our observations in this chapter are based, should be supplemented by extraneous considerations before a considered policy recommendation is made. However, insight into the practical problems encountered in detecting and judging dominant positions and mergers can best be obtained by looking at how these problems have in fact been dealt with. Our approach in the following chapters of this study, then, will be to examine actual policies, mainly with a view to gaining practical knowledge of the conflict between economic and noneconomic desiderata in this complex field.

¹³¹ A view also held by James S. Campbell and William G. Shepherd, 'Leading-firm Conglomerate Mergers', 13 *Antitrust Bull.* 1361, 1371 (1968). More detailed economic analysis on the potential-entrant theory is contained in D. Berger and M. Peterson, 'Conglomerate Mergers and Criteria for Defining Potential Entrants', 15 *Antitrust Bull.* 489 (1970).

PART 2

THE ANTITRUST LAWS APPLIED TO COMBINATION

We concluded in Part 1 that the existence of firms having market power, alone or in conjunction with others, and the process of industrial concentration that gives rise to market power, may lead in a variety of ways to situations where acceptable performance is no longer guaranteed, even if abuse of power is not apparent. Can antitrust laws forestall consequences of this kind? And how should these laws be framed? We must now tackle the problems raised by these questions.

For the European student, the American antitrust law under the Sherman Act and Section 7 of the Clayton Act constitutes a most interesting approach to the solution of problems of industrial concentration from the competition angle. This is true as regards both the content of the law and the remedies available under it. Where an infringement of the Sherman Act is proved, the antitrust agencies need not confine themselves to seeking condemnation of the pattern of conduct that was at the root of market power or its exercise but can ask the courts for relief that will destroy monopoly power as such – by way of dissolution or divestiture. In European eyes, these are far-reaching powers. Similar powers are available under Section 7 of the Clayton Act, which prohibits mergers, whether consummated or not, in order to protect markets from excessive concentration.

Another part of the law under the Sherman Act, that relating to oligopolies, also deserves particular attention. As we saw in Part 1, oligopoly situations – in which a few firms account for much the greater part of an industry's output – may result in performance which resembles that of a market in which one firm holds a position of market power. Besides, most modern markets are oligopolistic in structure. The antitrust agencies have attempted to bring oligopoly situations as such within the reach of the Sherman Act; the main difficulty they have encountered has been in respect of proof. More particularly, they have tried either to extend the legal meaning of 'conspiracy' under Section 1 to cover conscious parallelism of action or to apply the wording of Section 2

to instances of joint monopolization. In both cases, market conduct becomes an important item of evidence.

The American antitrust laws also contain provisions that prohibit price discrimination (under Section 2 of the Clayton Act, as amended by the Robinson-Patman Act) and exclusive dealing and tying contracts (under Section 3 of the Clayton Act), 'where the effect . . . may be substantially to lessen competition or tend to create a monopoly . . .'. In conformity with the intent of Congress, actions under these two sections have frequently been brought against firms with substantial market influence, since the tendency of powerful firms engaging in such practices and contracts may be to foreclose their small competitors from the market.

The present study will deal chiefly with case law under Section 2 of the Sherman Act and Section 7 of the Clayton Act, and also with that under Section 1 of the Sherman Act – in its application to oligopoly situations and mergers. Since we are concerned only with the problem of corporate combinations other than restrictive agreements, the case law on contracts in restraint of trade under Section 1 of the Sherman Act will not be treated.

Discussion will be in two steps. Part 2 (Chapters 4 and 5) is given over to an analysis and assessment of the case law in the light of the criteria set out in Chapter 3. Part 3 (Chapters 6 and 7) examines the effectiveness of this segment of American antitrust policy as regards competitive performance in the industries concerned and the more general problem of the limitations and potentialities of antitrust legislation.

The case law under the Sherman Act (on the lawfulness of existing monopolies) will be considered in Chapter 4. A distinction will be made between cases involving market power in the hands of a single firm (monopolies), cases where the antitrust agencies have challenged vertically integrated firms on account of their market influence, and cases involving oligopolists. The case law on patents and trademarks will be disregarded. As we noted in Chapter 3, the privileged position of the holder of a patent or trademark is seldom the same as that of a dominant firm from the antitrust standpoint. Every patent is a grant of monopoly power by the state and as such is necessarily immune from the prohibitions of antitrust. Antitrust law is concerned solely with attempts to carry the exercise of the patent right beyond the point needed to secure a legitimate reward for the invention and to protect it against infringement. Where shown, such exercise will be forbidden.

The case law on mergers will be dealt with in Chapter 5. Though a number of firms whose position and conduct have been challenged under the Sherman Act were in effect the product of mergers, typical cases of mergers that had only recently been concluded and constituted as such the reason for the in-

stitution of antitrust proceedings under the Sherman Act are hard to find. In fact, since the Celler-Kefauver Act amending Section 7 of the Clayton Act became law late in 1950, actions against mergers have been brought only under the Clayton Act.

CHAPTER 4

THE LAW ON MONOPOLIES

4.1 BASIC IDEAS AND INTENT OF THE ANTITRUST LAWS

The American antitrust laws, particularly the Sherman Act of 1890, are in part a codification of the common law that preceded them. For a proper understanding of these laws, some discussion is therefore required of the attitude of the courts to restraints of trade and monopolies before 1890.¹

4.1.1 The Common Law on Contracts in Restraint of Trade and Monopolies

One of the fundamental doctrines of English law – and a decisive factor in the development of American law – was that concerning restraints of trade. The original concept was that a person should not be restrained from following his trade if this trade was lawful. No person or persons acting collectively were permitted to prevent another person from carrying on the same trade. Over the years, the English courts developed this tenet to cover contracts under which one of the parties agreed not to enter the territory of the other. These were known as ‘contracts in restraint of trade.’ If such an agreement was all that the contract contained, then this was a ‘nonancillary restraint of trade.’ It is generally agreed that until about 1800 the English courts declared such contracts unlawful *per se*. Later, however, they adopted a more flexible attitude toward them. A *per se* approach was also adopted toward ‘restraints upon alienation,’ a forerunner of modern resale-price maintenance. As a rule, the argument that the manufacturer may make and sell, or not, as he chooses, and affix conditions as to the use of the article or as to the prices at which purchasers may dispose of it, was rejected. There was no reason for a manufacturer to restrain commerce between his customers, and the basic assumption for public policy purposes should be freedom of competition in all areas of trade.

¹ For a survey of the English and American common law before 1890, see Milton Handler, *A Study of the Construction and Enforcement of the Federal Antitrust Laws* (Washington, DC: Government Printing Office, 1941); Hans B. Thorelli, *The Federal Antitrust Policy* Ch. 1 (Baltimore: Johns Hopkins; London: Allen & Unwin; Stockholm: Norstedt, 1954).

What were known as 'ancillary restraints of trade' were treated differently. This was the term used to describe restraints which in a certain sense were an essential consequence of a contract that in itself was not restrictive of trade. The purchaser of a business might stipulate that the seller should refrain from certain acts, such as setting up a similar business, for a certain period in a certain area. Originally, these contracts were declared void by the English and American courts. However, the famous case of *Mitchel v. Reynolds*² reversed this attitude. The judge ruled that if the contract was limited to a specific time and place, and if the restraint of trade was 'reasonable' in view of the great importance of the restrictive stipulations to the opposing party and the relative absence of conflict with the public interest, then the contract was lawful. This 'rule of reason' has been applied to this type of contract ever since. As we shall see below, the rule of reason was to play a significant part in American antitrust law.

In the United States the English doctrine of nonancillary restraints of trade was generally applied by the courts to the new forms of industrial combination, though the courts were not fully in accord on whether this process of industrial concentration should be subject to the rule of reason. Milton Handler points to the existence of three currents of opinion in the case law and in the literature.³ The most liberal group always applied a rule of reason, even when a contract involved a substantial share of trade, provided the power acquired by the parties was not abused. A second group applied the rule of reason only in the case of contracts between two small competitors whose joint share of the market was still small. A third group favored complete prohibition of all contracts resulting in nonancillary restraint of trade. Although the first two of these views do appear incidentally in a number of court rulings before 1890, we can safely say that the third view is typical of the attitude of American courts to agreements between competitors. The courts in the United States, then, have been appreciably stricter in their attitude toward these agreements than their counterparts in England.

In addition, the Sherman Act contains the notion of conspiracy. This concept had its origin in the English common law, where it meant agreements between two or more persons for the purpose of committing, by their joint efforts, some unlawful or criminal act, or of using criminal or unlawful means to the commission of an act not in itself unlawful.⁴ It was infrequently invoked in American common law on agreements in restraint of trade.

The other basic doctrine of the English common law that concerns us here relates to the legality of monopoly. At common law the concept of monopoly had a narrow meaning: it was the exclusive right to trade in a specified good under a license granted by the Crown. This meant the exclusion by the Crown

of other producers and traders. With the Statute of Monopolies in 1623,⁵ Parliament restrained this royal prerogative, but anyone who acquired a monopoly by his own efforts was held not to have violated the Statute. (This attitude toward monopolies based on privilege is found in still higher degree in the American common law.)

An earlier statute of 1551,⁶ which also codified the common law on monopolies in England, was concerned with 'engrossing.' This statute was aimed at attempts to acquire monopoly rather than monopoly as such. However, the concept of engrossing has never enjoyed general currency in the United States.

In the American common law before 1890 the concept of monopoly was not understood in the economic sense of effective control of the market, since economic science was still at an embryonic stage. The courts made no attempt to establish whether a company or group of companies controlled a market or was in a position to do so in the future: they confined themselves to establishing whether or not the entrepreneurial freedom of other persons was restricted. And here we must note that the courts construed a link between the typical feature of a monopoly – power to exclude competitors – and the concept of restraint of trade, which was more easily handled. Combination was also prohibited on the grounds of the *ultra vires* principle, which meant that certain corporate acts, such as the transfer of authority to take decisions to another corporation, were themselves in conflict with the charter of the corporation concerned and were therefore prohibited.

4.1.2 Antitrust Measures Prior to the Sherman Act

A drawback of the common law was that the nullity of an ancillary contract in restraint of trade provided third parties with no legal remedy for damages resulting from the contract at issue. Furthermore, injured parties were unwilling to bring suit – either out of ignorance that they had a justifiable complaint or through lack of funds. Partly as a result of this situation, the nullity of an agreement did not serve to deter the conclusion of further agreements in restraint of competition. In the United States this drawback was

² 1 P. Wms. 181, 24 Eng. Rep. 347 (KB 1711). This case is reprinted in S. Chesterfield Oppenheim, *Cases on Federal Antitrust Laws* 3 (St. Paul, Minn.: West, 1st ed. 1948).

³ Handler, *op. cit. supra* note 1, at 4–5.

⁴ Henry Campbell Black, *Law Dictionary* (St. Paul, Minn.: West, 4th ed. rev. 1968).

⁵ 21 Jac. 1, c. 3 (1623). An act concerning monopolies and dispensations with penal laws and the forfeiture thereof.

⁶ 5 & 6 Edw. 6, c. 14 (1551). An act against regrators, forestallers and ingrossers.

felt more strongly in the 1880s, when trusts began to be formed and the threat to the public interest became appreciably greater. The only check on this development was provided by inadequate antitrust laws in the individual states. As a rule, the states lacked the courage and the resources to carry through a vigorous antitrust policy. And many states had no antitrust laws at all and had thus become havens for this new form of combination. This meant that the antitrust laws in such states as had enacted them became more or less a dead letter and the state lost money because no taxes could be levied on the big trusts. Furthermore, the Supreme Court of the United States, in a ruling handed down in 1886,⁷ refused the states the right to regulate any form of trade within their own borders if this could in any way be termed interstate commerce.

Opposition to corporate concentration came originally from the farmers in the West and South of the United States. The years since the end of the Civil War had not been prosperous for the farmers. The prices of farm products had fallen steadily, while those of industrial goods remained unchanged. Further, there was a relative increase in farm overheads. The farmers also had to cope with often exorbitant freight rates and other forms of discrimination practiced by the railroads. At the outset their discontent was therefore directed mainly against the policy of the railroads. The political organizations that arose from the farmers' dissatisfaction – chiefly the Granger movement – were, however, usually short-lived, and it was only secondarily that they opposed the new forms of economic organization as such.⁸ For a great number of reasons, the 'Granger laws' passed by various states in the 1870s at the instigation of the farmers in an attempt to curb the abuses of the railroad companies were never enforced in many cases.

Gradually, dissatisfaction with the process of industrial concentration spread wider and grew deeper. Other sections of the population, such as small businessmen and the workers, joined the farmers in their opposition to railroad tariffs. At length, Congress was induced to pass the Interstate Commerce Act in 1887. This forbade the railroad companies to practice discrimination in fixing rates or to enter into contracts in restraint of trade.

The development of trusts was having certain economic and social repercussions which in their turn gave rise to conflicts. And here there was a shift of emphasis: not only were the big trusts held responsible for the growth of monopolistic practices, they were also seen as a direct threat to economic and political freedom. Apart from the fact that the trusts raised prices, the trend toward concentration was also considered a restriction on equality of opportunity, which had always been regarded as an ideal. It was not really until after 1870 that full awareness of these pernicious influences dawned on

the American people, when westward migration came to a halt and their wildest years of unlimited opportunity ended. Public opinion then turned against the trusts, and toward the end of the 1880s it became strong enough to move the political parties to action.⁹

Action was required from the federal government, and a federal antitrust law was needed because this was seen to be the only way to act effectively against the big trusts operating in several states. Since the federal government was stronger than the state governments, and the laws of the individual states had proved inadequate, Congress, relying on the power reserved to it under the commerce clause of the Constitution to regulate commerce among the several states of the Union, passed in 1890 an 'Act to protect trade and commerce against unlawful restraints and monopolies,' popularly known as the Sherman Act. So federal regulation came in fairly early, and the state and federal systems are still being applied side by side. However, the federal anti-trust laws are so much more important than those of the states that we shall confine our attention exclusively to the former.

4.1.3 Design and Content of the Sherman Act

There have sometimes been differences of opinion as to the intentions of the authors of the Sherman Act; since Thorelli's penetrating study of this matter, however, a great deal of material that had previously been dispersed far and wide or had not even been published has been shown in a clearer light.

Although Senator John Sherman did not draft the final version of the act named for him, the part he played in its origins was nevertheless particularly significant. Furthermore, his views were representative of those of most members of the 50th and 51st Congresses. The purpose of Sherman and his colleagues was not to curtail corporate freedom, any more than it was to maintain or attain any other form of competition regarded as ideal by the economists of the day. The bill was intended to put mergers (or other forms of close-knit combination) that created monopoly and predatory business tactics under the ban of legislation with the ultimate aim of protecting the American consumer against the arbitrary use of economic power. The following words of Sherman have been much quoted:

⁷ *Wabash, St. Louis & Pac. Ry. v. Illinois*, 118 US 557 (1886).

⁸ See generally Thorelli, *op. cit. supra* note 1, Chs. 2 & 3.

⁹ An active part was played by literary works such as Edward Bellamy, *Looking Backward, 2000-1887* (Boston: Ticknor, 1887), and Henry George, *Progress and Poverty* (New York: Appleton, 1880).

The sole object of such a combination is to make competition impossible. . . . The law of selfishness, uncontrolled by competition, compels it to disregard the interest of the consumer. . . . Such a combination is far more dangerous than any heretofore invented, and, when it embraces the great body of all the corporations engaged in a particular industry. . . it tends to advance the price to the consumer of any article produced, it is a substantial monopoly injurious to the public, and, by the rule of both the common and the civil law, is null and void and just subject of restraint by the courts, of forfeiture of corporate rights and privileges, and in some cases should be denounced as a crime, and the individuals engaged in it should be punished as criminals. It is this kind of combination we have to deal with now.¹⁰

For Senator Sherman, then, the immediate purpose was to provide some guarantee for the free and unhindered pursuit of business. The guarantee against erosion of democracy and abuse of political power was the Constitution, and there should be comparable legal checks to the exercise of economic power.¹¹ The urge to provide such safeguards for competition did not mean, however, that the legislators wished to prohibit any form of close-knit combination warranted for technological or economic reasons, even if it would lead to monopoly. They saw free competition as the best means of ensuring that production was as economic as possible. This last point was so self-evident to them that it was touched upon but rarely in the congressional debates. One of these rare passages is the following, again from Sherman's speech in support of the proposed legislation:

Experience has shown that they [the combination of labor and capital in the form of a corporation] are the most useful agencies of modern civilization. They have enabled individuals to unite to undertake great enterprises only attempted in former times by powerful governments. The good results of corporate power are shown in the vast development of our railroads and the enormous increase of business and production of all kinds. When corporations unite merely to extend their business, as connecting lines of railway without interfering with competing lines, they are proper and lawful.¹²

So the lawmakers did not see in market power or even monopoly an evil *per se* that should be condemned, provided this power was not obtained with intent to abuse it. And even then, it is not apparent from the congressional debates whether proof of abuse of power should be held to constitute a ground for divestiture of power.

From our standpoint, the first two sections of the Sherman Act are the most important. They are worded as follows:

SECTION 1. Every contract, combination in the form of trust or otherwise, or

conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal

SEC. 2. Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a misdemeanor¹³

Corporations and individuals infringing these provisions lay themselves open to criminal prosecution. On conviction they may be punished by fines not exceeding \$5 000 (increased to \$50 000 in 1955), and individual defendants may be imprisoned for up to a year as well as being fined. The concepts used by Congress were deliberately taken from the common law. Senator George F. Hoar, who also played an important part in framing the statute, declared:

We have affirmed the old doctrine of the common law in regard to all interstate and international commerce transactions, and have clothed the United States courts with authority to enforce that doctrine by injunction.¹⁴

It was the intention of the Congress, then, to enact a federal law to codify the English and American common law.¹⁵

The introduction of the Sherman Act was an improvement of the existing situation on two counts. First, contracts in restraint of trade were now illegal, not merely void. The law, moreover, could be enforced in three ways: Sections 1, 2 and 3 are criminal provisions, and Section 4 also gives the Attorney General the power to institute proceedings in equity; but Congress probably expected that the government would only need to take action in rare cases,

¹⁰ Sherman's speech appears in 21 *Cong. Rec.* 2456-62 (1890).

¹¹ As the Senator put it, 'If we will not endure a king as a political power we should not endure a king over the production, transportation, and sale of any of the necessities of life. If we would not submit to an emperor we should not submit to an autocrat of trade, with power to prevent competition and to fix the price of any commodity.' *Id.* at 2456. This also explains the general phrasing of the statute. As Chief Justice Charles Evans Hughes remarked in *Appalachian Coals, Inc. v. US*, 288 US 344, 359 (1933), 'As a charter of freedom, the Act has a generality and adaptability comparable to that found to be desirable in constitutional provisions.'

¹² See also William L. Letwin, 'Congress and the Sherman Antitrust Law, 1887-1890', 23 *U. Chi. L. Rev.* 221 (1956); Robert H. Bork, 'Legislative Intent and the Policy of the Sherman Act', 9 *J. of Law and Economics* 7 (1966).

¹³ 26 Stat. 209 (1890), 15 USC 1-2.

¹⁴ 21 *Cong. Rec.* 3146 (1890).

¹⁵ See Thorelli, *op. cit. supra* note 1, at 228. Before Senator Hoar, Senator Sherman had expressed himself in like terms (cited by Thorelli at 181).

because Section 7 also entitled any person or corporation to sue and to 'recover threefold the damages by him sustained, and the costs of suit, including a reasonable attorney's fee.'¹⁶ As we shall see, however, this expectation of 'self-enforcement' was not to be borne out. The second improvement over the pre-1890 situation was the general scope of the statute, which was designed to cover all forms of combination. As we have noted, it had proved all but impossible under the common law for small businessmen to challenge the big trusts for recovery of damages. It was hoped that the Sherman Act would remedy this defect.

There are two other points that should be mentioned as regards the text of the Sherman Act. First of all, Section 2 is not directed against monopoly as such but against the 'attempt to monopolize' and 'monopolization.' In a ruling in 1911 the Supreme Court explained that Congress in 1890 had had so much faith in the preventive effect of the Sherman Act's prohibition of 'monopolization' as to believe that this would preclude the rise of monopolies proper.¹⁷ Monopolization is taken to mean both the maintenance and, more important, the attainment of a monopoly position by predatory means, as will be made explicit below. The second point is that oligopoly as such is not reached by the statute.

4.1.4 Other Antitrust Laws. Enforcement Agencies. Exemptions

Other Antitrust Laws. In 1914 two other important antitrust laws were enacted in the United States: the Clayton Act and the Federal Trade Commission Act. The Clayton Act in particular was intended to prevent concentration by enabling certain trade practices to be prohibited under certain circumstances. The provisions of this Act affect discrimination, exclusive dealing and mergers. Important amendments to its discrimination provisions were made by the Robinson-Patman Act in 1936 and to its merger provisions by the Celler-Kefauver Act in 1950. One of the objectives of the Federal Trade Commission Act was to set up a commission of that name with power, alongside the Antitrust Division of the Department of Justice, to enforce the antitrust laws.

Enforcement Agencies. Antitrust law enforcement is mainly in the hands of the Department of Justice and the Federal Trade Commission. The Department of Justice handles violations of the Sherman Act, the Clayton Act and occasionally the Robinson-Patman Act. The FTC is an independent regulatory agency which apart from its exclusive jurisdiction over the Federal Trade Commission Act shares responsibility for enforcing the Clayton Act with the Justice Department. More details on Clayton Act enforcement will

be given in Chapter 5. Mention must also be made of Section 5 of the Federal Trade Commission Act: this declares unlawful 'unfair methods of competition,' but the Supreme Court has ruled that conduct which violates the Sherman Act may also be an unfair method of competition and thus fall within the FTC's jurisdiction.¹⁸ As we shall see, actions have occasionally been brought under the FTC Act, particularly in recent years, the advantage of such a proceeding, especially in cases that come within the scope of the Sherman Act, being that the burden of proof is less onerous.

Exemptions. There are areas which are wholly or partly exempted from the application of the antitrust laws, either because of the peculiar nature of the exempted sectors – as in the case of farmers' cooperatives and collective bargaining by labor unions – or because they are regulated industries. In view of the all-embracing language of the Sherman Act, any exemption from its provisions has to be granted expressly by Congress, and such exemptions are to be found in the Clayton Act and other statutes.

Before 1914, court rulings in labor disputes had prohibited, as violative of the Sherman Act, certain restrictive practices by unions under collective bargaining agreements, but Section 6 of the Clayton Act stated: 'That the labor of a human being is not a commodity or article of commerce.' Nevertheless, a completely unrestricted expansion of the union movement was not possible until the Norris-LaGuardia Act was passed in 1932. The attitude of the courts has since been that a union may boycott a company for labor reasons but may not combine with an employer in any restrictive practice.¹⁹ As well as labor unions, agricultural and horticultural organizations instituted for purposes of mutual help are also exempt under Section 6 of the Clayton Act. Later, with the Capper-Volstead Act of 1922 and the Cooperative Marketing Act of 1926, the exemption of agricultural cooperatives was defined more clearly. In 1934 similar arrangements were made for the fishing industry with the Fishermen's Collective Marketing Act. Some organized sports are reached by the law, while others are not; thus far Congress has not agreed on a consistent approach.

¹⁸ Repealed by Act of 7 July 1955, 69 Stat. 283, and superseded by § 4, Clayton Act (15 USC 15).

¹⁷ *Standard Oil Co. of NJ v. US*, 221 US 1 (1911).

¹⁸ *FTC v. Cement Institute*, 333 US 683 (1948); *FTC v. Motion Picture Advertising Serv. Co.*, 344 US 392 (1953).

¹⁹ See, e.g., *US v. Hutcheson*, 312 US 219 (1941); *Allen Bradley Co. v. Local 3*, 325 US 797 (1945).

Regulation of industry in the United States rarely takes the form of public ownership: as a rule, production is left in private hands, but the government supervises the operation of the business through regulatory commissions. The tighter the government's control, the less possibility there is of enforcing anti-trust policy. Thus in quasi monopolies such as water, gas, telephone and electricity utilities, regulation takes over completely from the antitrust laws in the prevention of abuse. But in other industries, such as transportation, communications and banking, in which competitive elements are present as well, antitrust enforcement by the Department of Justice has been growing in importance, more particularly in recent years and in respect of mergers (see Chapter 5). The oldest federal regulatory commission is the Interstate Commerce Commission, originally set up in 1887 to regulate the railroads. Since then, its powers have been considerably expanded: oil pipelines were brought under the Commission's wing in 1906, telephone and telegraph services in 1910, motor carriers in 1935 and water carriers in 1940. Civil aviation is regulated by the Civil Aeronautics Board, an agency set up in 1938. The Federal Maritime Commission, which in 1961 succeeded the Federal Maritime Board (set up in 1950 as the successor agency to the US Maritime Commission of 1936), regulates international shipping. The Federal Power Commission, set up in 1920, has jurisdiction over hydroelectric projects and interstate commerce in gas and electricity. In 1934 the Federal Communications Commission took over regulation of telegraph and telephone services from the Interstate Commerce Commission and that of radio and television broadcasting from the Federal Radio Commission. Finally, we have the Atomic Energy Commission, created by the Atomic Energy Act of 1946.

Banking is also under the supervision of an administrative agency, the Board of Governors of the Federal Reserve System. Under the Federal Reserve Act of 1913, the banks were given a limited measure of exemption from the antitrust laws. The Bank Holding Company Act of 1956 extended the powers vested in the Federal Reserve Board under Section 11 of the Clayton Act to prevent further concentration in banking, and in 1966 the Bank Merger Act empowered the Department of Justice to intervene in merger cases in banking. Until 1944 the federal antitrust laws were not applied to insurance because of a number of court decisions holding that insurance was not interstate commerce within the meaning of the Sherman Act. In that year, however, the Supreme Court handed down a ruling that the Act did apply. Shortly thereafter, in 1945, Congress passed the McCarran Act, suspending enforcement of the antitrust laws against insurance until 1948, whereafter they would apply only 'to the extent that such business is not regulated by State law.' Since the several states did in fact enact laws to regulate insurance, the federal

laws are applicable only to boycotts, coercion and other such collusive practices.

Apart from these exempted sectors, certain trade practices may also be immune from the antitrust laws. One of these is resale-price maintenance when permitted by state law; otherwise it is forbidden.²⁰ This exemption was the result of action by the 'fair trade' movement in the 1930s, which condemned the reductions in the price of branded articles offered by the big chain stores as a catastrophe for independent retailers. Under Section 2 of the Webb-Pomerene Act, export trade associations are permitted provided they do not restrain trade within the United States or the export trade of any domestic competitor. The original purpose of the Act was to allow American firms to compete on equal terms with foreign cartels, but its scope has been enlarged in the course of time, antitrust exemption being possible even where American firms do not face such cartels. The Act has been limited so far to merchandise trade, but two bills are now pending before Congress that envisage extension to exports of services as well. The FTC has jurisdiction over such associations to ensure that they do not engage in 'unfair methods of competition' within the meaning of the FTC Act. One of the bills just mentioned proposes a considerable extension of these jurisdictional powers – providing, for instance, that the Commission may take action without having to refer to the Attorney General.

4.1.5 Summary and Conclusions

The basis of American thinking on antitrust is the protection of *free* competition. According to the ideas that still predominate in the United States, a system in which entrepreneurs are free to act, free to enter new markets, free to expand – in which they are not hindered by any public or private power – corresponds most closely to the political notion of democracy. For the Americans, the democratic ideal implies an aversion to anyone or anything that wields power, whether it be the state or a private individual. Consequently, it is not accepted that the state should control the operation of the market. Nor do the Americans appear to have acquiesced in private economic power upsetting the workings of the market and acquiring too great an influence on economic, social and political life.

The economic counterpart of this freedom-in-competition philosophy is the conviction that economic freedom constitutes the best foundation for opti-

²⁰ Exemption was provided by the Miller-Tydings Act, 50 Stat. 693 (1937), 15 *USC* 1, amending § 1, Sherman Act, and the McGuire Act, 66 Stat. 632 (1952), 15 *USC* 45(a), amending § 5, FTC Act.

imum economic performance, i.e. optimum satisfaction of consumers' needs. As the White House Task Force on Antitrust Policy has stated, 'The anti-trust laws are based on the recognition that optimum use of economic resources and maximum choice and utility for consumers can best be obtained under competition.'²¹ However, we should bear in mind that it was the economic structure of the United States at the turn of the century, with its enormous potential for expansion of business, that made the principle of free competition practicable. Consequently, the vast majority of Americans do not condemn the attainment of a prominent position in the economy by virtue of outstanding performance: on the whole, they ascribe their great material prosperity to big business.

We should also mention the radical groups that played an important part in producing the Sherman Act and the Robinson-Patman Act. Although these groups put great stress on the interests of small business, their position does not detract from the fundamental attitude described above.

The attitudes to the possession and use of power that we have just outlined are institutionalized in the United States in that the courts normally have sole power to decide whether the antitrust laws have been violated and to enter judgment. The Sherman Act accordingly makes no provision for administrative agencies to grant exemptions and the like as a means of adapting the law to changing circumstances. The courts alone apply the principles laid down by law. Over the years this basic approach has been somewhat relaxed. Administrative action is provided for in the laws enacted in 1914 (especially with the establishment of the Federal Trade Commission), and the Antitrust Division of the Department of Justice has been given administrative powers over and above its original duties of instituting proceedings to prevent and restrain violations of the antitrust laws. Nonetheless, the principle that competition rules of general application are applied by the courts is much stronger in the United States than in Europe, and that is an outflow of the separation of powers in the Constitution, with the executive branch subject to checks and balances exercised by the legislative and judicial branches – in the words of the Massachusetts Bill of Rights, 'a government of laws and not of men'. Antitrust enforcement is not an adjunct of economic policy but an element of civil and criminal law. This judicial basis of antitrust policy has never been tampered with. The result of this has been that economic-policy considerations do not normally interfere with antitrust considerations, though the impression sometimes gained that antitrust policy is pursued without reference at all to economic-policy targets is an exaggerated one. At times, antitrust policy has had to give way entirely to the aims of economic and social policy – as when President Franklin D. Roosevelt introduced his New Deal measures,

for instance. Enforcement was also suspended during World War II and the Korean conflict, at least in respect of action against large corporations that were essential to the war effort. And the numerous provisions of law laying down exceptions and exemptions show that the objectives of antitrust have had to be set aside for certain segments of the American economy.

Europeans are struck by the attitude of the American to his government's antitrust policy. Even the representatives of big business, who, as we shall see, have often been in violent conflict with the enforcement agencies, regard antitrust policy as preeminently a *national* policy. Clear evidence of this was provided when the members of the Attorney General's National Committee to Study the Antitrust Laws, set up in 1953, many of whom were directly or indirectly linked with big business, unanimously approved the following formulation of the basic philosophy of the antitrust laws in their final report:

Antitrust is a distinctive American means for assuring the competitive economy on which our political and social freedom under representative government in part depend. These laws have helped release energies essential to our leadership in industrial productivity and technological development. They reinforce our ideal of careers open to superior skills and talent, a crucial index of a free society. As a result, the essentials of antitrust are today proclaimed by both political parties as necessary to assure economic opportunity and some limitation on economic power incompatible with the maintenance of competitive conditions.²²

The wording and scope of the Sherman Act reflects the basic American attitude toward competition. Section 1 prohibits 'every contract, combination . . . or conspiracy, in restraint of trade or commerce among the several States . . .'. Both loose-knit associations, such as agreements between competitors, and mergers and other forms of close-knit or 'tight' combination are covered by this section on the argument that competition in any form may cease between corporations involved in a combination. Since *any* competitive arrangement or *any* combination may well lessen competition on the interpretation that was given to the concept of restraint of trade at common law before 1890,

²¹ *Neal Report* I-1. Similar language is to be found in the Declaration of policy contained in § 2(a), Small Business Act, 72 Stat. 384 (1958), 15 USC 631(a): 'Only through full and free competition can free markets, free entry into business, and opportunities for the expression and growth of personal initiative and individual judgment be assured. The preservation and expansion of such competition is basic not only to the economic well-being but to the security of this Nation.'

²² *Att'y Gen. Nat'l Comm. Antitrust Rep. 2* (Washington, DC: Government Printing Office, 1955).

a literal interpretation of Section 1 would mean a complete ban on any form of cooperation between firms. Such a view, however, was never expressed during the congressional debates on the bill.

Section 2 of the Sherman Act prohibits corporations, individually or in collusion, from 'monopolizing' or 'attempting to monopolize' trade or commerce. The Act makes no specific mention of monopoly as such because it was not the intention to prohibit the attainment of market power, in the form of either a dominant position or a complete monopoly, by fair means; the Act is directed solely against its attainment by predatory or abusive practices and against abuse of a dominant position once attained by such means. Thus the law is not opposed to a specific market structure but to those kinds of market conduct by which other firms are put at a competitive disadvantage. In construing the Sherman Act we must remember that it contains criminal as well as civil provisions and that the antitrust agencies can enforce it by either criminal or civil process. In Section 2, therefore, the element of intent is very important: monopolization is the deliberate attempt to obtain a dominant position by predatory or abusive practices or the deliberate use thereof to the detriment of competitors. In the case of attempts to monopolize, proof of specific intent is required, which has to be shown chiefly from the market behavior of the firm in question. As will be seen from the discussion of the law below, charges of attempting to monopolize have been successful only where there was a reasonable indication that the attempt had succeeded.

There is a close relation between Sections 1 and 2 of the Sherman Act on a number of points, the most important of which are the following. In the first place, restrictive agreements between competitors in which outsiders are forced to participate may be prosecuted under either Section 1 or Section 2 provided it can be shown that their originators have the clear intention of building a monopoly. Exclusive dealing contracts, which exclude competitors from access to markets or to supplies of scarce raw materials, may also infringe both sections of the Act. Secondly, Section 1 may be adduced in a complaint alleging infringement of Section 2 in all cases involving firms originally formed by merger or if, for instance, the existence of a tacit agreement between oligopolists on a market has to be shown before evidence of joint monopolization can be presented. Incidentally, there is no provision in the antitrust laws concerning conscious parallelism of action in oligopoly. This can probably be explained by the fact that the problems created by the modern market form of oligopoly were not yet the subject of general discussion at the time the Sherman Act was being formulated. Thirdly, both sections can be applied to cases where a monopoly position is attained by the combination of corporations into a single unit.

The Clayton Act and the Federal Trade Commission Act supplement certain aspects of the Sherman Act. The Clayton Act prohibits a number of specified trade practices and mergers whose effect may be substantially to lessen competition or to tend to create a monopoly. Its provisions relating to mergers in particular are conspicuously broader in scope than are the possibilities under the Sherman Act. Not only do they permit mergers to be prohibited before they have been consummated (whereas Sherman Act proceedings can be instituted against a completed combination only), but the reference to the attainment of a monopoly position which is so central to all Sherman Act proceedings on monopolization is no longer crucial. Section 5 of the Federal Trade Commission Act gives the Commission some scope to prosecute cases which could be reached by the Sherman Act as well.

The legislative history does not show how Congress intended the antitrust laws to be applied in practice, so the task of the courts in implementing the law is very important. We shall therefore have to concern ourselves in this and the following chapter with the courts' interpretations of the objectives of antitrust policy, with the legal approach to economic problems. As we stated in introducing this chapter, we shall here be dealing with the case law under Sections 1 and 2 of the Sherman Act, while Chapter 5 will be concerned with interpretation of the merger provisions of the Clayton Act. From the legal point of view, this distinction is not always easily drawn, because action may conceivably be taken under both the Sherman Act and the Clayton Act. Save for a single exception, however, the suits against monopolies created by corporate combination have all been judged under the Sherman Act, while mergers have been judged almost exclusively under the Clayton Act since it was amended in 1950. In other words, the Sherman Act is concerned principally with behavior on markets that are already highly concentrated whereas the Clayton Act is concerned with the impact of concentration on competition.

4.2 THE CASE LAW ON MONOPOLIES

The Sherman Act had little result in the years immediately after it was passed into law. This cannot in itself be regarded as too surprising, because the interpretation and enforcement of a new and far-reaching statute, such as the Sherman Act was considered to be in its early years, demand a certain amount of time. But, according to Thorelli, who has made an intensive study of that period, one of the major reasons for the early failure of antitrust policy against industrial monopolies must be sought in the lack of interest shown by the authorities in the enforcement of the Act. This attitude was especially

prevalent during the administrations of Benjamin Harrison, Grover Cleveland and William McKinley (that is, until 1901).²³ Other antitrust action could not stem the tide of rising concentration of economic power on its own. As already remarked, action by the several states on the basis of their own anti-trust laws proved sooner or later to constitute no threat to the monopolies (trusts) engaged in interstate commerce. Furthermore, suits brought by companies and private individuals seeking to recover damages sustained as a result of the acts of powerful competitors had not had the effect desired by the legislature (and presumably by the executive as well), so that the hoped-for self-enforcement of the statute never materialized. It was only by combating all forms of contract in restraint of competition that the state and federal authorities had any success.

Nor was the courts' interpretation of the Sherman Act very promising for the authorities. In the first case to come before it, in 1895, the Supreme Court of the United States rejected the government's request that the Sugar Trust, the American Sugar Refining Co., controlling 98 percent of the market in refined sugar, be required to dispose of its stock in the E. C. Knight Co. and three other competitors.²⁴ The Court agreed that the Sugar Trust had a monopoly, but the Sherman Act applied only to restraints of interstate *commerce* and the combination at issue was in manufacturing.²⁵ The Court therefore did not consider the question whether this monopoly position was in conflict with Sections 1 and 2 of the Sherman Act. Although the Court has never officially reversed this interpretation, in subsequent rulings it never again put the same view forward.

Great importance, perhaps even fundamental importance, for the development of antitrust legislation has attached to the problem of whether the word 'every' in Section 1 of the Sherman Act should be interpreted literally. A literal interpretation would mean the prohibition of all sorts of combination and also of all contracts comprising provisions likely to lessen competition. As we remarked above, the common law had long since abandoned this narrow view. The Supreme Court, however, originally refused to acknowledge a rule of reason in interpreting Section 1 in respect of loose-knit combinations, the decisions handed down in the *Trans-Missouri* case (involving rate-fixing agreements by a group of railroad companies) and in the *Addyston Pipe* case (market sharing by pipe manufacturers) having gained some notoriety in this connection.²⁶ In the first of these, the Court simply stated that the word 'every' in the Sherman Act did in fact relate to *all* contracts. Congress had by no means intended to codify the common law, so the provisions of the Sherman Act did not apply solely to agreements that were unreasonable. In *Addyston Pipe* a lower court followed a different line of reasoning but arrived

at the same conclusion. It held that while it was indeed the intention of Congress to codify the common law, only those conditions in restraint of trade that were not the main purpose of a contract (ancillary restraints) came under a rule of reason at common law. The contract at issue had been intended to restrict competition, and it must therefore be considered a *per se* violation of the law even if the alternative would be ruinous competition and even if the rates calculated were reasonable.²⁷

Not long after its *Trans-Missouri* ruling, however, the Supreme Court realized that the attitude it had then taken could hardly be maintained for any length of time. A year later, in its ruling on a case brought against another agreement between railroad companies, the Joint Traffic Association, the Supreme Court stated that

the Act of Congress must have a reasonable construction or else there would scarcely be an agreement or contract among businessmen that could not be said to have, indirectly or remotely, some bearing upon interstate commerce and possibly to restrain it.²⁸

All these cases were concerned with loose-knit associations. In 1904, however, the Supreme Court applied the same interpretation of Section 1 of the Sherman Act in declaring unlawful the consolidation of two large competing railroads (the *Northern Securities* case). In a close 5–4 decision, the Supreme Court gave voice to its dislike of concentrated economic power ('The mere existence of such a combination . . . constituted a menace to, and a restraint upon, that freedom of commerce which Congress intended to recognize and

²³ Of the cases that were brought during this period, five were against labor unions, despite the apparent wish of the Congress to exempt organized labor from antitrust legislation. For a complete survey of the enforcement and judicial interpretation of the Sherman Act until 1904, see Thorelli, *op. cit. supra* note 1, at 369–499.

²⁴ *US v. E. C. Knight Co.*, 156 US 1, 12 (1895). The government had already lost or withdrawn lower-court cases against the Whiskey Trust – *US v. Greenhut*, 50 Fed. 469 (DC Mass. 1892) – and National Cash Register Co. – *US v. Patterson*, 55 Fed. 605 and 59 Fed. 280 (CCD Mass. 1893).

²⁵ The Supreme Court's ruling drew forth comments from President Cleveland and his Attorney General, Richard Olney, to the effect that the Sherman Act was ineffectual and state action should be relied upon to combat the trusts. See Henry R. Seager and Charles A. Gulick, *Trust and Corporation Problems* 59 (New York: Harper, 1929).

²⁶ *US v. Trans-Missouri Freight Ass'n*, 166 US 290 (1897); *US v. Addyston Pipe & Steel Co.*, 85 Fed. 271 (6th Cir. 1898), *aff'd*, 175 US 211 (1899).

²⁷ 85 Fed. at 291, 293.

²⁸ *US v. Joint Traffic Ass'n*, 171 US 505, 568 (1898). Justice Rufus W. Peckham, delivering the opinion of the Court, is here repeating his own words in *Hopkins v. US*, 171 US 578, 600 (1898).

protect . . .'), holding that an economic assessment of the advantages and disadvantages of the merger for competition was irrelevant.²⁹ The validity of this ruling for mergers between industrial corporations was not quite certain, however: the companies involved in *Northern Securities* were in a services industry subject to government regulation.

It is interesting to note that it took the firms involved in this case more than seventy-five years to obtain a *de facto* reversal of the Court's judgment. In 1961, the Great Northern Railway Co. and the Northern Pacific Railway Co., together with their affiliated companies, sought permission to merge from the Interstate Commerce Commission; permission was finally granted in 1968 after a number of conditions had been fulfilled in order to protect the interests of competing railroads. However, in that same year the Antitrust Division applied to the courts for a reversal of the ICC's ruling, on the grounds that the Commission had not had due regard to the unfavorable effects on competition in the relevant market and had not proved that considerable advantages would result from the merger. On appeal from the district court the Supreme Court, relying principally upon the language of Section 5 of the Interstate Commerce Act, agreed with the findings of the ICC, holding that it had been sufficiently proved that economies would flow from the merger and that competition would not be diminished as a result.³⁰

4.2.1 Content and Meaning of the Rule of Reason

In the years immediately following 1904, the milestones in the development of the law were the Supreme Court's findings against the Standard Oil Co. of New Jersey and the American Tobacco Co. in 1911, when the rule of reason was established as the general rule by which the Sherman Act was to be construed in its application to close-knit combinations.³¹

In its *Standard Oil* ruling, the Supreme Court held that the general wording of the Sherman Act was open to the construction that congressional intent had been to make the statute applicable, where circumstances required, to all kinds of corporate agreement and merger but not to prohibit agreements or mergers that did not involve any undue restraint. Chief Justice Edward D. White, who delivered the majority opinion, had pointed out in earlier cases that a restraint of trade was inherent in any contract. The prohibition of all restraints of trade would make it impossible for business to be carried on. Consequently, Section 1 of the Sherman Act could not possibly be construed literally but had to be interpreted by way of a rule of reason. The only possible standard was the common-law standard of reason.³²

The Court expressed itself even more clearly on this point in *American Tobacco*:

[I]t was held not that acts which the statute prohibited could be removed from the control of its prohibitions by a finding that they were reasonable, but that the duty to interpret, which inevitably arose from the general character of the term 'restraint of trade,' required that the words 'restraint of trade' should be given a meaning which would not destroy the individual right to contract, and render difficult, if not impossible, any movement of trade in the channels of interstate commerce

[A]ll the difficulties suggested by the mere form in which the assailed transactions are clothed become of no moment. This follows because . . . it was held that, in view of the general language of the statute and the public policy which it manifested, there was no possibility of frustrating that policy by resorting to any disguise or subterfuge of form, since resort to reason rendered it impossible to escape, by any indirection, the prohibitions of the statute.³³

According to the Supreme Court, the same standard applied to Section 2 of the Sherman Act. The historical link between the concepts 'to monopolize' and 'restraint of trade' was based upon the view that certain acts of individual firms in a monopolistic position, particularly price increases, had the same harmful effects as restraint of trade resulting from agreements to that end and were intended to have them. For this reason, Section 2 was to supplement Section 1.

The rule of reason put the courts in a position, with regard to close-knit combinations, to investigate all the relevant aspects of each individual case before deciding whether there was a restraint of trade in the sense of the Sherman Act. For it was not considered that this type of combination was necessarily an impediment to competition, except when a monopoly would be created thereby (as was the case with the trusts). However, the courts did not feel free to discuss whether a restraint of competition might or might not be preferable to the prohibition of such restraints in the case of agreements between independent firms (loose-knit associations), whose effect will clearly be to lessen competition in nearly all circumstances. These agreements may not escape liability under the Sherman Act even if, say, some means of regulating competition between corporations is needed to prevent cutthroat competition or they have no injurious effects on customers. Consequently, the defense that the rates fixed by the members of an agreement are reasonable

²⁹ *Northern Sec. Co. v. US*, 193 US 197, 327 (1904).

³⁰ *US v. Northern Lines*, 396 US 491 (1970).

³¹ *Standard Oil Co. of NJ v. US*, *supra* note 17; *US v. American Tobacco Co.*, 221 US 106 (1911).

³² 221 US at 60. See also his dissenting opinion in the *Trans-Missouri* case, *supra* note 26.

³³ 221 US at 179-81.

is not acceptable to the courts. In later decisions, this interpretation was firmly established by the Supreme Court.³⁴ Agreements in nonancillary restraint of trade, then, are unreasonable *per se* and therefore prohibited *per se*.

4.2.2 The Law Applied to Trusts

It is difficult to categorize the suits brought against dominant firms under the Sherman Act since 1904 because each of them is unique. A certain classification, however, can be attempted by distinguishing between corporations originating in the formation of trusts and holding companies and those formed by internal growth. Before about 1945, the cases reaching the courts involved companies whose early power derived from merger or predatory conduct, while thereafter – beginning with *Alcoa* – most of the cases involved firms whose dominance was based on internal expansion and whose conduct was less typically predatory.

This classification is reflected in the choice of section under which suit was filed and in the construction put upon it. Whereas in the cases against trusts the administration concentrated on showing an infringement of Section 1, with Section 2 playing a supplementary role, the opposite procedure was followed in cases against dominant firms which had not grown out of trusts. In the early cases against trusts and holding companies the emphasis under Section 2 had fallen exclusively on the showing of abuse, and proof of abuse had been the determining factor in proving monopoly power and intent. (The only real exception to this was a lower court's ruling in 1916 in the *Corn Products* case, where market definition was indeed accorded thorough treatment.) The standards of proof of these two requisites of a Section 2 violation gradually evolved in the cases against dominant firms constituted otherwise than by some form of merger. The approach to proving that the defendant occupied a monopoly position was increasingly determined by structural factors, including the definition of the relevant market – especially after the Supreme Court's renowned analysis in its *Cellophane* ruling in 1956. It is not really so surprising that this concept was not given close attention in the early cases, for the defendants appearing before the courts prior to 1945 were supercombinations covering entire industries, so that market definition did not arise. Moreover, economists at that time had not yet begun to discuss the definition of the relevant market or to describe market power.

The Standard Oil Case (1911). Standard Oil Co. of New Jersey was a holding company, formed in 1899, which in 1911 controlled about 90 percent of the refining and sale of oil products in the United States and was consequently

making substantial monopoly profits. According to the government, the company was in violation of the Sherman Act because it had attained this position mainly through unfair trade practices and through abusing its monopoly of transportation (Standard had procured preferential rates from the railroads and also owned nearly all the pipelines in the country). The Supreme Court upheld the government, considering that the power vested in Standard Oil had not been built up 'as a result of normal methods of industrial development, but by new means of combination which were resorted to in order that greater power might be added . . .'.³⁵ It saw in the record of the company's course of action and policy as a whole evidence that the intent and purpose behind this industrial empire building was to exclude competitors in order to secure a dominant position. The Court ordered Standard dissolved, and the company was obliged to distribute to its stockholders its controlling shares in its thirty-three subsidiaries.

It is not clear from the Court's ruling whether the creation of Standard's monopoly position by way of acquisition of competing companies in the oil industry was regarded as sufficient proof in itself of violation of the Act or whether the finding of monopolization was also to be derived from the superabundant evidence of an intent to monopolize and the frequent use of unfair trade practices. Even Chief Justice White's writings do not give explicit support to one interpretation or the other.³⁶ However, the impression gained from the Supreme Court's ruling in *American Tobacco*, which followed immediately upon *Standard Oil*, is that the use of reprehensible means in industrial empire building is important to the success of a monopolization charge.

The American Tobacco Case (1911). Here, the antitrust authorities charged with violation of both sections of the Sherman Act a holding company constituted in 1890 by the five biggest cigarette manufacturers in the United States. American Tobacco, by resorting to a number of unfair trade practices, had come to control 96 percent of the country's total cigarette production. In its petition the government also pointed out that in the years since the formation of the trust American had attained an important position in other fields of

³⁴ See, e.g., *US v. Trenton Potteries Co.*, 273 US 392 (1927).

³⁵ 221 US at 75.

³⁶ 'Whether it was his [White's] view that monopoly combinations should be sustained where there was no abuse of power, or whether he would sanction the elimination of competition among the participants of a combine where there was no substantial impairment of competition in the market as a whole, or whether reason to him meant the subjective, intuitive, and unchartered judgment of the Court, his writings do not clearly reveal.' Milton Handler, *Antitrust in Perspective* 9 (New York: Columbia UP, 1957).

tobacco manufacture as well, often by employing similar methods.

The Supreme Court found evidence of an intent to monopolize and of monopolization in a whole series of acts: the first holding company had been formed to obviate a fierce trade war; competitors had been forced – usually by cutthroat practices – to sell out to the holding company; complete vertical integration enabled American to exclude new competitors effectively; millions of dollars had been spent on buying out new competitors, whose plant was then scrapped; and, finally, agreements were concluded with former competitors debarring them from beginning to manufacture cigarettes again. These practices were given prominence in the opinion of the Court. What was significant was not only American's dominant position as such but also its intention to monopolize by these indefensible means:

We say these conclusions are inevitable, not because of the vast amount of property aggregated by the combination, not because, alone, of the many corporations which the proof shows were united by resort to one device or another. Again, not alone because of the dominion and control over the tobacco trade which actually exists, but because we think the conclusion of wrongful purpose and illegal combination is overwhelmingly established³⁷

The Court, however, was lenient in its judgment: the dissolution of American Tobacco was to be effected with 'as little injury as possible to the interest of the general public.' The final decree stipulated that in industries where subsidiaries of American had a dominant position, these subsidiaries must be split up into at least two new corporations. Some of the firms originally belonging to American had to be shared out between two new competitors, P. Lorillard Co. and Liggett & Myers Tobacco Co. And American was ordered to divest itself of its holdings in foreign tobacco manufacturers.³⁸

The Shoe Machinery Case (1918). The government was less fortunate in its action against the United Shoe Machinery Co., which had been formed in 1899 by the amalgamation of the three leading shoe-machine manufacturers. Each of the three had specialized in producing certain types of machine, and since these complemented each other United Shoe as sole producer was able to offer a complete line of shoe machinery. By its subsequent policy of expansion and by refusing to sell its machines and insisting on leasing them subject to certain restrictions as regards the use of competitors' machines, United had been able to increase its share of the market appreciably, controlling 95 percent at the time of trial. In 1911 the Antitrust Division of the Department of Justice filed a complaint against United alleging violation of both sections of the Sherman Act and requested dissolution of the company. The government's

case was that United had been constituted as a combination between competitors with a view to securing a dominant position and that an attempt to monopolize and monopolization were proved by its leasing practices.

The Supreme Court, however, did not sustain this line of argument. Following its reasoning in its 1913 ruling in the criminal suit against the president of United,³⁷ the Court again in 1918 stressed that the companies amalgamated in United had not been competitors before the merger. Each of the original manufacturers had enjoyed monopoly power by virtue of its patents, but this could not be held to violate the Sherman Act. And there was no evidence of predatory conduct to support a finding of infringement of Sections 1 and 2. The Court did not find proof in the formation of United (the fact that this created a corporation controlling 95 percent of the market was regarded as irrelevant for Sherman Act purposes) nor in the leasing practices attacked by the government. On the contrary, the Court was convinced that this system stimulated competition: it was advantageous to United's customers because it saved them considerable outlay on expensive plant, and United could make a suitable profit by keeping its machines efficiently employed. As patent holder, moreover, United was entitled to make certain stipulations in the leases it granted to shoe manufacturers, so these conditions were not reached by the Sherman Act.⁴⁰

This ruling made it clear that a monopolist would come within the scope of Section 2 of the Sherman Act only if he had indulged in grossly unfair practices; the use of patents to the detriment of competitors and competition was not regarded as monopolization or abuse of a dominant position. However, as far as the applicability of Section 1 is concerned, this ruling should not lead us to conclude that horizontal mergers between competitors resulting in monopoly cannot therefore, in the absence of predatory and exclusionary

³⁷ 221 US at 182.

³⁸ The dissolution decree was issued by the circuit court that had found against American Tobacco in 1908 (164 Fed. 700). *US v. American Tobacco Co.*, 191 Fed. 371 (CC SD NY 1911). In 1912 a dissolution decree against the 'powder trust' was issued after the government suit had been sustained in *US v. E. I. du Pont de Nemours & Co.*, 188 Fed. 127 (CC Del. 1911).

³⁹ 'We can see no greater objection to one company manufacturing 70 percent of three noncompeting groups of patented machines collectively used for making a single product than to three corporations making the same proportion of one group each. The disintegration aimed at by the statute does not extend to reducing all manufacture to isolated units of the lowest degree.' *US v. Winslow*, 227 US 202, 217-18 (1913).

⁴⁰ *US v. United Shoe Mach. Co. of NJ*, 247 US 32 (1918). Subsequently, however, the courts did find various restrictive provisions in United's leases unlawful. *United Shoe Mach. Corp. v. US*, 258 US 451 (1922); *US v. United Shoe Mach. Corp.*, 110 F. Supp. 295 (D. Mass. 1953), *aff'd*, 347 US 521 (1954).

practices, be challenged under the Sherman Act since United was a combination between firms which were not direct competitors prior to the merger. In three interesting cases following closely upon *Shoe Machinery*, lower courts came to the conclusion that such mergers did fall under the ban of Section 1 of the Sherman Act.

The International Harvester, Corn Products and American Can Cases (1914-16). The first of these cases involved a corporation that had been formed in 1902 by the consolidation of five farm-machinery manufacturers. At the time of trial International Harvester's market share was 85 percent, and this constituted the main reason why the district court found against it. For International Harvester was recognized to be a progressive monopolist that had not been guilty of unfair competitive practices. The court ordered dissolution.⁴¹ The *International Harvester* decision seems to imply, then, that a corporate merger is prohibited *per se* if a dominant firm is formed as a result and there are no clear technical or economic reasons in defense of the combination. One writer has justly remarked that this decision was a major threat to big business in the United States.⁴²

A similar view was taken by District Judge Learned Hand in his decision in the *Corn Products Refining Co.* case in 1916. This company had been formed by mergers between competing glucose and starch manufacturers and had become a near monopolist on both markets. The government had charged the company with sporadic and selective use of violent price cutting to harm its competitors. In reviewing the evidence, Judge Hand did not take the position that these acts were in themselves proof of illegal monopolizing. According to him, evidence of intent was needed to show whether a firm's low prices were merely a tactical device and not likely to be of long-run benefit to consumers as long as the structure of the industry remained competitive. But when a firm of the size of Corn Products used such tactics, they constituted sufficient proof of an intent to monopolize. The ruling implies, then, that such a firm may be held *per se* to be in conflict with the Sherman Act:

If . . . 'public prejudice' be the test, it by no means follows that it is to be judged alone by price and quality. A given organization of industry may be thought to react to the public prejudice, regardless of its directly observable results It is the mere possession of an economic power, acquired by some form of combination, and capable, by its own variation in production, of changing and controlling price, that is illegal. It is not necessary in any view that the combination should exclude, or be able to exclude, all others⁴³

For the same reason the court did not regard as relevant the company's defense that it had a 'beneficent effect upon the industry.'⁴⁴

Judge Hand paid much more attention to a correct determination of the firm's position on the market than the courts in the preceding cases had done. His decision in this case has become famous as the first attempt of the courts to define the relevant market. The defendant had tried to convince the court that it did not occupy a monopoly position because the corn sirup it manufactured was in competition with sago, tapioca, potato starch and corn meal. Judge Hand, however, did not agree, basing his argument on two criteria:

- (1) Substitute products cannot be considered part of the relevant market if their production costs are substantially higher than those of the product in question. This rule holds good even if these substitute products cannot be distinguished by their nature, use or consumer acceptance from the product at issue.
- (2) Whether heterogeneous products must form part of the relevant market depends on consumer preference and the corresponding production costs.⁴⁵

There was no departure in principle from this line of reasoning in the decision of District Judge John C. Rose in the *American Can* case in 1916.⁴⁶ American Can Co. was the classic example of a trust established in the traditional manner. Initially, the company controlled practically the entire output of tin cans in the United States; its influence subsequently declined, which was evidence that even without specific government intervention a monopolist cannot enjoy his position undisturbed for very long if it has not been gained on merit. At the time of suit, American Can still had a relatively strong position on

⁴¹ *US v. International Harvester Co.*, 214 Fed. 987 (D. Minn. 1914). The company consented to divest itself of three lines of machinery, to sell two factories and to limit its dealers to one in each town. The disposal of the lines of machinery was said to involve 'no real loss to International' by Simon N. Whitney, *Antitrust Policies* Vol. 2, at 230 (New York: Twentieth Century Fund, 1958).

⁴² John D. Glover, *The Attack on Big Business* 70 (Boston: Division of Research, Graduate School of Business Administration, Harvard University, 1954).

⁴³ *US v. Corn Prods. Ref. Co.*, 234 Fed. 964, 1011 (SD NY 1916).

⁴⁴ *Id.* at 1012.

⁴⁵ *Id.* at 975-76. In the *Standard Oil* case of 1911 the Supreme Court had ruled that 'The commerce referred to by the words "any part" . . . has both a geographical and a distributive significance; that is, it includes any portion of the United States and any one of the classes of things forming a part of interstate or foreign commerce' (221 US 1, 61), but the point was not expanded.

⁴⁶ *US v. American Can Co.*, 230 Fed. 859 (D. Md. 1916).

the market (a share of about 50 percent), and the authorities considered this sufficient grounds for complaint under Section 2. Judge Rose, on the other hand, saw no reason for finding against American only because it occupied a powerful position on the relevant market. The firm was no longer a monopoly, and Judge Rose held that American had done 'nothing of which any competitor or consumer of cans complains or anything which strikes a disinterested outsider as unfair or unethical.'⁴⁷ He therefore refused to order dissolution of 'so finely adjusted an industrial machine.'⁴⁸ However, he did make the reservation that if American should ever achieve a monopoly position at some future date, the court might regard this as a reason for breaking up the company without requiring concrete proof of abuse of power.⁴⁹

From these lower-court decisions we may conclude that a firm that has obtained a monopoly position on a market as a result of a merger between competitors is in violation both of Section 1 and of Section 2 of the Sherman Act, because corporate growth to such a position of power must be regarded as 'monopolization.' It is then irrelevant whether or not the firm has used its position to restrict the freedom of action of its competitors. If a firm has no monopoly, even though it is much larger than its competitors, it cannot come into conflict with the Sherman Act through its normal market behavior.⁵⁰ Before Section 2 comes into play in cases such as this, the government must be able to prove that the corporation has engaged in unfair market practices, i.e. that there is a specific intent to monopolize.

The view that combinations which led to a monopoly were *prima facie* in violation of Sections 1 and 2 of the Sherman Act had in fact already been explicitly advanced by the Supreme Court in a number of rulings on combinations between railroad companies, both before the introduction of the rule of reason (e.g. in *Northern Securities*) and after 1911. The courts considered it to be in the general interest that a service industry should not be controlled by one firm. In its ruling in the *Union Pacific* case of 1912 the Supreme Court stated:

The consolidation of two great competing systems of railroad engaged in interstate commerce by a transfer to one of a dominating stock interest in the other creates a combination which restrains interstate commerce within the meaning of the statute, because, in destroying or greatly abridging the free operation of competition theretofore existing, it tends to higher rates Nor does it make any difference that rates for the time being may not be raised and much money be spent in improvements after the combination is effected.⁵¹

The Court handed down a similar decision in the *Southern Pacific* case of 1922.⁵²

The US Steel, International Harvester, Swift and Pullman Cases (1920-43). Though the Supreme Court was clearly convinced, then, that holding companies formed between railroads were unreasonable restraints of trade *per se* when they led to the creation of an actual or virtual monopoly, it was not yet clear if the Court, like the district courts in the decisions we have been discussing, would follow this reasoning in the case of combinations that had led to a monopoly position in manufacturing industry. Some indication that the Supreme Court would have endorsed such an interpretation of the Sherman Act is to be found in its *United States Steel, International Harvester* and *Swift* rulings. The companies involved in these cases had been formed by horizontal or vertical combination, but for a variety of reasons they no longer possessed complete monopoly on their respective markets at the time of trial. One of the most important rulings was in the *United States Steel* case (1920), brought against the huge United States Steel Corp. for violation of Sections 1 and 2 of the Sherman Act. The government's case was that the corporation had a monopoly, that this was obtained by financial merger and therefore illegal *per se*, irrespective of specific proof of intent, and that the corporation had monopolized the steel industry and had concluded price agreements with its customers and competitors. US Steel's market share, however, was more that of a dominant firm than of a monopolist. The corporation was set up in 1901 as a holding company controlling twelve large steel concerns, some of these having themselves resulted from numerous combinations of smaller competitors. Although the formation of the company prevented cutthroat

⁴⁷ *Id.* at 861.

⁴⁸ 'Its power is great but, as has already been pointed out, is limited by a large volume of actual competition and to a still greater extent by the potential competition, from the possibility of which in the present state of the industry it cannot escape. Those in the trade are satisfied with it. They do not want it dissolved. Whether its dissolution would profit anyone is doubtful. The first and immediate effect would almost certainly be the reverse, whatever larger good might in the end come from it.' *Id.* at 903.

⁴⁹ *Id.*, Supplemental Opinion, 234 Fed. 1019 (D. Md. 1916).

⁵⁰ See George W. Stocking, 'The Rule of Reason, Workable Competition and Monopoly', 64 *Yale LJ* 1107, 1147 (1955).

⁵¹ *US v. Union Pac. RR*, 226 US 61, 88 (1912).

⁵² 'Such combinations, not the result of normal and natural growth and development, but springing from the formation of holding companies, or stock purchases, resulting in the unified control of different roads or systems, naturally competitive, constitute "a menace to and a restraint upon that freedom of commerce which Congress intended to recognize and protect and which the public is entitled to have protected." *Northern Sec. Co. v. US*, 193 US 197, 327.' *US v. Southern Pac. Co.*, 259 US 214 (1922). However, as was pointed out above, in a recent decision (*supra* note 30) the Supreme Court allowed a horizontal merger between competing railroads under the Interstate Commerce Act, though no monopoly was created thereby.

competition, even after 1901 there was still so much active competition that US Steel proposed an informal agreement in the form of the 'Gary dinners.' Partly because of the government's attitude to trusts, no attempt was made to dominate the market absolutely. Small competitors were thus able to stay in business and to specialize, while US Steel secured a good profit margin for the whole steel industry by operating the 'Pittsburgh-plus delivered price system' as price leader.⁵³

In 1920, voting 4 to 3, the Supreme Court handed down its decision. The Court found that the organizers of US Steel had in fact intended to monopolize the industry by abuse in the past, but they had quickly realized that they would not succeed and had consequently given up the attempt. What had happened in the past was no longer relevant: '[T]he corporation did not achieve monopoly ... and it is against monopoly that the statute is directed; not against an expectation of it, but against its realization.'⁵⁴ And although 'the power attained was much greater than that possessed by any one competitor - it was not greater than that possessed by all of them.' The fact that prices had to be fixed with competitors by means of 'pools, associations, trade meetings, and through the social form of dinners' (though almost all of these had been terminated before 1911), was also considered proof that US Steel had no monopoly. The Court was apparently not interested in the fact that there was no competition under the corporation's price leadership and the Pittsburgh-plus system. As regards to government's objections to the size of US Steel, the majority answered in what has become a *locus classicus*: '[T]he law does not make mere size an offense or the existence of unexerted power an offense. It, we repeat, requires overt acts and trusts to its prohibition of them and its power to repress or punish them.'⁵⁵ And the Court, impressed by competitors' statements that their freedom was not restrained by the defendant, held that evidence of such overt acts was lacking:

The corporation ... did not at any time abuse the power ... it possessed. It resorted to none of the brutalities or tyrannies that the cases illustrate of other combinations. It did not secure freight rebates ...; it did not oppress or coerce its competitors - its competition, though vigorous, was fair⁵⁶

Consequently, the suit against the corporation was dismissed.

A construction could be put on the words 'the law does not make mere size an offense' whereby even a combination that had brought practically all the firms in an industry under central control (a real monopoly) need not be regarded *prima facie* as unlawful. However, the passage quoted earlier ('... it is against monopoly that the statute is directed') stands more or less to the contrary. The most that can be deduced from the ruling in *US Steel*, then,

is that dominant firms which have not yet gained complete (or near) monopoly on the market will not be condemned under the Sherman Act unless there is proof of predatory conduct toward competitors.

Seven years after *US Steel*, the Supreme Court handed down a similar decision in a comparable case. Whereas at the time of its constitution International Harvester Co. had had a market share of 85 percent, by 1927 this had fallen to 64 percent. So although there was no question of a monopolistic position, there was still dominance. The company was still price leader for the whole industry, but the majority of the Supreme Court regarded this as quite normal in that particular market situation: 'The fact that competitors may see proper, in the exercise of their own judgment, to follow the prices of another manufacturer does not establish any suppression of competition or show any sinister domination.'⁵⁷ International had not employed unfair methods of competition and was therefore a 'good trust.' Furthermore, the competitive situation in the relevant market had improved considerably since International had been established by the withdrawal of weak competitors and the entry of strong and efficient firms.⁵⁸ The Court consequently saw no grounds for ordering dissolution: 'The law . . . does not make the mere size of a corporation, however impressive, or the existence of unexercised power on its part, an offense, when unaccompanied by unlawful conduct in the exercise of its power,'⁵⁹ and the charge against International, in accordance with *US Steel*, was dismissed.

In 1932, in the suit brought against Swift and a number of other meat packers, the Court expressed itself in the same sense. Taken together, the meat packers enjoyed a dominant position, but for the most part they had achieved it by their efficient and technically highly developed organization.

⁵³ Nobody, of course, ventured to sell below *US Steel*'s price. See Seager and Gulick, *op. cit. supra* note 25, at 238-55.

⁵⁴ *US v. US Steel Corp.*, 251 US 417, 443-44 (1920). The Court appears to be ignoring the § 2 offense of attempting to monopolize, where no showing is required that monopoly power has in fact been attained.

⁵⁵ *Id.* at 451.

⁵⁶ *Id.* at 441.

⁵⁷ *US v. International Harvester Co.*, 274 US 693, 708-09 (1927).

⁵⁸ 'We further find that while several of the competitors of the International Company in harvesting machines have retired from business since 1911, some during the period of depression commencing in 1921, these retirements were not due to inability to compete with the International Company, but to other causes for which it was in no way responsible; that the place of these retiring competitors has been taken by other and stronger competitors; and that in 1923 it not only had as many competitors in harvesting machines as in 1911, but competitors of greater strength and competitive efficiency.' *Id.* at 708,

⁵⁹ *Ibid.*

In its ruling, the Court did not condemn market power as such.⁶⁰ However, it gave dominant firms to understand that they could easily lay themselves open to a charge of abuse of power at some future date. The Court expressed its opinion on the significance of size under the Sherman Act in the following words:

Mere size, according to the holding of this Court, is not an offense against the Sherman Act unless magnified to the point at which it amounts to a monopoly, but size carries with it an opportunity for abuse that is not to be ignored when the opportunity is proved to have been utilized in the past.⁶¹

The importance of proof of monopoly for the successful prosecution of a Section 2 suit comes out clearly in a decision by a lower court in the *Pullman* case. Pullman had used harsh methods to obtain a monopoly position in offering sleeping-car accommodation and reservations on the railroads, and in this way had ensured sales of its own sleeping cars. The Department of Justice brought suit in the district court, where Pullman's complete monopoly was held to be *per se* in conflict with the Sherman Act, so that there was no need to show evidence of intent in the form of a deliberate use of the monopoly. The court did consider Pullman's deliberate employment of predatory or abusive practices to the detriment of competitors in order to attain its monopoly but was unwilling to enter into an examination of performance since it believed irrelevant to a finding of infringement of the Act that passengers were satisfied with the services provided by the company – which was the defense put forward:

Monopoly being clearly established ... instances of its baleful practices need not be shown to prove that the statute is violated. Benevolent monopoly is no less a monopoly because it is benevolent. *A fortiori* evidence that defendants know their business and run it in an efficient manner or even that customers are not displeased is beside the legal point.⁶²

What was new about the *Pullman* dictum was that it concerned a firm which was not the product of merger. Since there was no complete monopoly at stake in *US Steel* and *International Harvester*, the *Pullman* ruling does not necessarily constitute a deviation from the views expressed by the Supreme Court in those cases. In 1946, in the second *American Tobacco* case, the Supreme Court officially confirmed the *Pullman* dictum in respect of monopolies.⁶³

The Case Law on Agreements. The American courts have applied a more

severe standard in judging agreements between competitors – loose-knit associations whose members retain their corporate identity. They have not adopted the approach of weighing the advantages and disadvantages of such agreements against each other, bearing in mind their origins and *raison d'être*: the courts have always held that they are proscribed *per se* because they always involve an unreasonable restraint of trade, so that analysis of the pros and cons of each agreement is beside the point. The proscription holds good even if the firms involved are by no means dominant on their market. Ruling in the *Northern Pacific* case, the Supreme Court again stated its reasons for this:

[T]here are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use. This principle of *per se* unreasonableness not only makes the type of restraints which are proscribed by the Sherman Act more certain to the benefit of everyone concerned, but it also avoids the necessity for an incredibly complicated and prolonged economic investigation into the entire history of the industry involved, as well as related industries, in an effort to determine at large whether a particular restraint has been unreasonable . . .⁶⁴

The most recent expression of the Court's unwillingness to discuss the possible merits of such agreements has been in its *Topco* ruling.⁶⁵ The defendant was a cooperative association of about twenty-five small and medium-sized regional supermarket chains operating independently in some thirty-three states. The combined retail sales of Topco's members totaled more than \$2300 million in 1967 (a figure exceeded by only three national grocery chains), and the members' shares of the market in their respective areas averaged about 6 percent. The Justice Department brought suit under Section 1 of the Sherman Act, alleging that Topco allocated 'exclusive,' 'nonexclusive' and 'co-extensive' territories to its members and prohibited them from selling Topco brand products outside their territory without first receiving permission from the association. The district court applied a rule of reason, finding that on

⁶⁰ *US v. Swift & Co.*, 286 US 106 (1932). This case is discussed further in subsection 2.4 of this chapter.

⁶¹ *Id.* at 116.

⁶² *US v. Pullman Co.*, 50 F. Supp. 123, 134 (ED Pa. 1943).

⁶³ *American Tobacco Co. v. US*, 328 US 781 (1946). This case is discussed in subsection 2.3 of this chapter.

⁶⁴ *Northern Pac. Ry. v. US*, 356 US 1, 5 (1958). See also *US v. Socony-Vacuum Oil Co.*, 310 US 150 (1940); *US v. Trenton Potteries Co.*, *supra* note 34.

⁶⁵ *US v. Topco Associates*, 405 US 596 (1972).

the whole Topco's practice stimulated competition.⁶⁶ But on appeal the Supreme Court reversed, reiterating its reasoning in *White Motor Co. v. US* that certain business relationships, such as the horizontal territorial limitations involved in this case, constitute *per se* violations of Section 1 because they are 'naked restraints of trade with no purpose except stifling of competition.'⁶⁷ The essence of the Court's view of restrictive agreements can be seen from the following passage:

Antitrust laws in general, and the Sherman Act in particular, are the Magna Carta of free enterprise. They are as important to the preservation of economic freedom and our free-enterprise system as the Bill of Rights is to the protection of our fundamental personal freedoms. And the freedom guaranteed each and every business, no matter how small, is the freedom to compete Implicit in such freedom is the notion that it cannot be foreclosed with respect to one sector of the economy because certain private citizens or groups believe that such foreclosure might promote greater competition in a more important sector of the economy.⁶⁸

The only time the Court held otherwise was in *Appalachian Coals*, in which an agreement between a small number of manufacturers in an industry seriously affected by the economic crisis was not condemned.⁶⁹

4.2.3 The Case Law on Monopolies since 1945

The cases we have reviewed so far concerned monopolies and dominant firms which had derived their power from early horizontal mergers and from abusive and predatory tactics. Beginning with the celebrated *Alcoa* case of 1945, in which the government brought suit against the Aluminum Co. of America for infringement of Sections 1 and 2 of the Sherman Act, cases relating to corporations that had gained their dominant position on the market by internal expansion and whose conduct in constructing or holding their position had not been typically predatory became prevalent. As well as challenging firms that had built up a dominant position on a single market, since 1945 the government has also instituted proceedings against vertical integration by major corporations and against companies jointly occupying a dominant position on a single market. The case law on vertical integration will be discussed in subsection 2.4 of this chapter, the decisions on oligopoly in section 3.

The First Alcoa Case (1945). The foundations of the aluminum industry in the United States were laid between 1880 and 1890, when two American firms acquired foreign patents for the production process. One of these sold its patent to the other – the Pittsburgh Reduction Co., set up in 1888. This firm

was renamed Aluminum Co. of America (commonly called Alcoa) in 1907. Until 1945 Alcoa was the sole manufacturer of aluminum. It had succeeded in popularizing this new metal, had developed into a big, powerful, fully integrated producer of aluminum as a result, and had also managed to gain control of various deposits of bauxite, the raw material of aluminum. It was only after 1945 that the structure of the industry was drastically changed – when the Surplus Property Administration disposed of plants built by the government during World War II and other firms were enabled to start operating.

It was not long after its foundation that Alcoa had its first encounter with the antitrust laws. In 1912 it was obliged to sign a consent decree enjoining it from participating in an international aluminum cartel or abusing the advantages of its fully integrated production process to the detriment of non-integrated competitors. In 1937 the government again filed suit against Alcoa for monopolizing the manufacture of virgin aluminum ingot and for having abused its monopoly, but the district court ruled in favor of the defendants.⁷⁰ The government appealed to the Supreme Court, but four justices disqualified themselves on account of earlier participation in the case and special legislation had to be enacted giving final authority to the three senior judges of the circuit court of appeals which had territorial jurisdiction. Judge Learned Hand, who wrote the opinion for the court, ruled that it was not essential for a firm to have acted unfairly toward its competitors in order to be judged guilty of violating Section 2 of the Sherman Act.⁷¹ The fact that a firm enjoys a monopoly position and has demonstrated its intention to use it is sufficient to show an infringement of Section 2. This intention may be shown by the retention of such economic power for a long time, without the corporation in question necessarily having effected ‘manoeuvres not honestly industrial,

⁶⁶ 319 F. Supp. 1031, 1043 (ND Ill. 1970).

⁶⁷ 372 US 253, 263 (1963).

⁶⁸ 405 US at 610.

⁶⁹ *Appalachian Coals, Inc. v. US*, 288 US 344 (1933).

⁷⁰ *US v. Aluminum Co. of America*, 44 F. Supp. 97 (SD NY 1942).

⁷¹ Another aspect of the case is the doctrine of the extraterritorial jurisdiction of the American antitrust laws developed by Judge Hand in his decision. The central issue was whether the acts resulting from an agreement that was concluded between foreign corporations outside the United States, that was valid under foreign law, and that regulated imports of aluminum into the United States, were in conflict with § 1 of the Sherman Act. 148 F. 2d 416, 443–44 (2d Cir. 1945). On this and other cases of extraterritorial application the reader is referred to the standard works of Kingman Brewster Jr., *Antitrust and American Business Abroad* (New York: McGraw-Hill, 1958), and Wilbur L. Fugate, *Foreign Commerce and the Antitrust Laws* (Boston: Little, Brown, 1958), and to Roger W. Rosendahl (ed.), *Legal Environment for Foreign Direct Investment in the United States* Ch. 9.8 (Washington, DC: Institute for International and Foreign Trade Law, Georgetown University Law Center, 1972).

but actuated solely by a desire to prevent competition.' Any other interpretation of Section 2 of the Sherman Act 'would in our judgment emasculate the Act; would permit just such consolidations as it was designed to prevent.'⁷²

Judge Hand found that Alcoa had a monopoly position in aluminum manufacturing in the United States because of its high market share of 90 percent. 'That percentage is enough to constitute a monopoly; it is doubtful whether sixty or sixty-four percent would be enough; and certainly thirty-three percent is not.'⁷³ Judge Hand arrived at this high figure on the basis of a number of considerations. Alcoa's entire aluminum production, including what was not sold to outsiders but subjected to further processing by Alcoa, was counted part of the relevant market. Further, secondary aluminum was not regarded as a direct competitor of the virgin metal since Alcoa – being by far the biggest aluminum manufacturer in terms of output and sales – could take into account the future supply of secondary aluminum. The same reasoning was applied to scrap. Finally, aluminum imports (accounting for approximately 10 percent of the virgin ingot offered at the time of trial) did not put an effective ceiling on Alcoa's monopoly power: '[S]ubstitutes are available for almost all commodities, and to raise the price enough is to evoke them. . . . [W]ithin the limits afforded by the tariff and the sort of transportation, Alcoa was free to raise prices as it chose. . . .'⁷⁴

The fact that in his definition of the market Judge Hand took no account of substitutes for virgin aluminum ingot has given rise to criticism – especially in respect of secondary aluminum and scrap, which were in active price competition with the basic metal. If he had taken the total supply of aluminum on the domestic market as his criterion (including secondary and scrap), then Alcoa's share of the market would have dropped to about 66 percent, and the Judge had stated that it was doubtful whether such a share of the market was enough to constitute a monopoly. If that part of Alcoa's output of virgin ingot that Alcoa itself processed to end products and consequently was not offered on the market were not included and imports were, then the company's share of the market thus defined would have dropped as low as 33 percent. Then there is the point of competition from substitute products other than aluminum, which the court entirely ignored. For aluminum can substitute for a great number of metals in industrial use, and in turn it can also be replaced by other metals. For example, in 1909 the transportation industry consumed less than one fifth of total output of aluminum. By 1920 its consumption had risen to 50 percent before declining again to 37 percent in 1939 and to 21 percent in 1949. This was chiefly because aluminum was being ousted by steel in the construction of automobile bodies.⁷⁵ However, it is doubtful whether this instance alone would have been sufficient to extend

the relevant market to cover these substitute products in this particular case.

Monopoly being established, Judge Hand considered that an infringement of Section 2 of the Sherman Act was also established – because *any* behavior by a corporation that has a monopoly position on a market is a form of monopolistic market behavior and as such is forbidden, even if it cannot be termed abuse of power. '[T]he [monopoly] power and its exercise must needs coalesce [N]o monopolist monopolizes unconscious of what he is doing.'⁷⁶ The court rejected Alcoa's defense that secondary and imported ingot set limits to Alcoa's pricing power and that this was reflected in the fact that over the whole lifetime of the company the net return on capital invested had been only about 10 percent. Judge Hand agreed that this was not exorbitant but held that it was inconclusive because the profit on ingot alone was unknown. However, he stressed that as a matter of law the reasonableness of Alcoa's prices and profits was irrelevant to the charge of monopolization. He rejected the idea that its market behavior could not be termed an abuse of a monopoly position because it had never taken excessive profits:

[P]ossession of unchallenged economic power deadens initiative, discourages thrift and depresses energy; . . . immunity from competition is a narcotic, and rivalry is a stimulant, to industrial progress; . . . the spur of constant stress is necessary to counteract an inevitable disposition to let well enough alone. . . . [T]he mere fact that a producer . . . has not been able to make more than a 'fair' profit is no evidence that a 'fair' profit could not have been made at lower prices.⁷⁷

Does this construction signify a *per se* prohibition of firms in a monopoly position? Not altogether, for Judge Hand also provides monopolists with a possible way out – where technical and economic progress leads to such big

⁷² 148 F. 2d at 431.

⁷³ *Id.* at 424.

⁷⁴ *Id.* at 424–26.

⁷⁵ A. D. H. Kaplan, *Big Enterprise in a Competitive System* 97 (Washington, DC: Brookings Institution, 1954). 'The market for aluminum has been largely determined in almost every case by the success of the metal in its struggle for preference over established materials and in withstanding competition of new ones.' *Ibid.*

⁷⁶ 148 F. 2d at 428, 432.

⁷⁷ *Id.* at 427. Judge Hand continued with the following much-quoted passage: 'It is possible, because of its indirect social or moral effect, to prefer a system of small producers, each dependent for his success upon his own skill and character, to one in which the great mass of those engaged must accept the direction of a few.' *Ibid.* This he believed to be in some measure the Congress's creed. What he is advocating is the ideal of perfect competition, but he draws no further conclusion from this dictum in the rest of his ruling.

plants and firms that only a single firm could profitably operate if the production process in a given industry is organized for optimum efficiency:

It does not follow because 'Alcoa' had such a monopoly, that it 'monopolized' the ingot market: it may not have achieved monopoly; monopoly may have been thrust upon it. . . . A single producer may be the survivor out of a group of active competitors, merely by virtue of his superior skill, foresight and industry. . . . The successful competitor, having been urged to compete, must not be turned upon when he wins.⁷⁸

Judge Hand considered, however, that Alcoa did not qualify for this exception, because there was evidence of a deliberate purpose to attain a monopoly position, not only prior to 1912, when Alcoa had sought to strengthen its position by unlawful practices, but also thereafter, when it stimulated new applications for aluminum but always put sufficient reserve capacity to use in order to satisfy the expected rise in demand for these products:

'Alcoa' avows it as evidence of the skill, energy and initiative with which it has always conducted its business We need charge it with no moral derelictions after 1912; we may assume that all it claims for itself is true. The only question is whether it falls within the exception established in favor of those who do not seek, but cannot avoid, the control of a market. It seems to us that that question scarcely survives its statement. It was not inevitable that it should always anticipate increases in the demand for ingot and be prepared to supply them. Nothing compelled it to keep doubling and redoubling its capacity before others entered the field. It insists that it never excluded competitors; but we can think of no more effective exclusion than progressively to embrace each new opportunity as it opened, and to face every newcomer with the new capacity already geared into a great organization, having the advantage of experience, trade connections and the elite of personnel. Only in case we interpret 'exclusion' as limited to manoeuvres not honestly industrial, but actuated solely by a desire to prevent competition, can such a course, indefatigably pursued, be deemed not 'exclusionary.' So to limit it would in our judgment emasculate the Act; would permit just such consolidations as it was designed to prevent.⁷⁹

Judge Hand's view that any action by a firm without competitors is generally undesirable, unless this lack of competition is due to some reason other than the firm's own economic superiority, is acceptable to the economist's way of thinking. However, to see proof of deliberateness in an alleged expansion in anticipation of demand appears to be too sweeping a conclusion. Although Alcoa took pains to ensure that it kept ahead of potential competitors, its policy of developing new products and then expanding its capacity in order to maintain its lead over potential competitors in meeting future demand can hardly be regarded as anything but an expression of dynamic corporate be-

havior – and, what is more, behavior under pressure from potential competitors producing substitute metals. Alcoa's position of power was much more vulnerable than that of a monopolist with no potential competitors in its field. This reproach of Alcoa's market behavior therefore amounted to censure of business conduct influenced by competitive impulses, and Judge Hand would have done better to investigate more closely one of the major charges brought by the government – that Alcoa had retarded the development of new uses for the metal. For the court's ruling could be taken to mean that for corporations having a monopoly position the only way to behave so as not to come into conflict with the Sherman Act was to follow a business policy of passivity, of stagnation.⁸⁰ However, this construction was rejected by the Attorney General's National Committee.⁸¹ The Committee felt that Alcoa lost its case not because of its dynamism but because its deliberate policy was to prevent the rise of potential competition. Here we enter the realm of subjective judgment of what is permissible and what is no longer permissible action, and on dubious points such as the acts denounced by the court no clear guides to judgment can be developed.

Finally, a difficult problem arose as to the remedies to be applied in this case. It is clear that Judge Hand hesitated over the best course of action. It may be for this reason that his decision was lenient. He pointed out that the answer to the question how the performance of the aluminum industry could be improved was conditional upon an improvement in Alcoa's performance. Dissolution of Alcoa in order to produce a market consisting of several small firms should be rejected if this would endanger the industry's efficiency. Judge Hand therefore proposed waiting for the implementation of the Surplus Property Act of 1944 and its effect on the pattern of competition in the aluminum industry before a final decision was made.⁸² In pursu-

⁷⁸ *Id.* at 429. Even before 1945 certain monopoly positions were held not to be *per se* violative of the Sherman Act because of particular economic circumstances. The classic case is *US v. Terminal RR Ass'n of St. Louis*, 224 US 383 (1912), in which the Supreme Court ruled on a 'bottleneck' monopoly (natural barriers prevented any one of the railroads converging on St. Louis from having a separate terminal system).

⁷⁹ 148 F. 2d at 431.

⁸⁰ A similar interpretation of Judge Hand's ruling is to be found in Joseph W. Burns, 'Antitrust and Robinson-Patman Act Problems: Intracorporate Problems', 7 *Antitrust Bull.* 689 (1962).

⁸¹ *Op. cit. supra* note 22, at 60.

⁸² Two small companies had entered the aluminum industry in recent years, and Judge Hand presumably expected that they would grow under Alcoa's 'protection' and with a great deal of government assistance. Alcoa's annual output during the war was about 828 million pounds, compared with the 202 million of these two competitors together. In addition, Alcoa produced 1293 million pounds in plants leased from the government. 148 F. 2d at 446.

ance of this Act, most of the government plants were sold to two new competitors of Alcoa – Reynolds Metals Co. and Kaiser Aluminum and Chemical Co. – which thus became fully integrated corporations. Alcoa was only allowed to take over a few small processing plants.⁸³

The Second Alcoa Case (1950). In 1947 Alcoa petitioned the district court to be cleared of the monopoly charge, since effective competition had been restored in the aluminum industry and Alcoa no longer occupied a monopoly position. In turn, the government requested the same court in the following year to divest Alcoa of sufficient plants to enable effective competition to be established. In the ensuing case District Judge John C. Knox handed down a decision granting neither Alcoa's petition nor the government's but retaining jurisdiction of the case for five years. The Judge did consider, however, that competition in the aluminum industry would be stimulated further if Aluminium Limited (Alted), Alcoa's Canadian subsidiary, were to enter the American market as an independent competitor. He therefore ordered a number of major Alcoa stockholders who also held stock in Alted to sell their holdings in either of the two within ten years.⁸⁴

The decision of Judge Knox in this second *Alcoa* case is evidence of sound economic insight into the problems raised by the existence of market dominance. Considerations of a purely economic nature were more important in Knox's judgment than in that of Judge Hand; this comes out clearly not only in the determination of the relevant market, in which the court included products substitutable for aluminum, but principally in its treatment of the statutory test of Section 2 of the Sherman Act. Following the reasoning of Judge Hand, Judge Knox remarked, quite rightly, that a serious discrepancy in the law would ensue if price agreements were forbidden *per se* (as had hitherto been the case) while explicit abuse had to be shown in the case of dominant firms, which have a much greater influence on the market. If price agreements were prohibited, so also should single-firm monopoly be prohibited:

If Alcoa should be found in this proceeding to possess monopoly power as above defined, it is not necessary that a purpose or intent to exercise such power also be found to exist in order to justify this court in granting relief to the government The power itself, and not the specific elements thereof, must sometimes be viewed as the 'fruit'⁸⁵

In order to determine whether a firm does or does not have a monopoly under this interpretation, Judge Knox laid down these criteria:

The number and strength of the firms in the market; their effective size from the standpoint of technological development, and from the standpoint of competition with substitute materials and foreign trade; national security interests in the maintenance of strong productive facilities, and maximum scientific research and development; together with the public interest in lowered costs and uninterrupted production.⁸⁶

In assessing whether Section 2 of the Sherman Act had been violated, Judge Knox gave the element of monopoly, which is central to the notion of monopolization, a much fuller content than it had previously been accorded, not only incorporating essential considerations of market structure and market performance but evaluating the firm's position in the national economy as well. This more comprehensive approach also included a more elaborate definition of the relevant market than had been applied hitherto. Judge Knox took a broader view of this concept than Judge Hand had done in 1945, stressing that market definition must be established case by case. His comments on secondary aluminum, for instance, are interesting: 'The question as to whether secondary aluminum should be treated as a competitive element in the market for primary is one of fact, and not of law.'⁸⁷ He accordingly included secondary aluminum and scrap in the relevant market, holding that the market consisted of 'the entire range of aluminum products,' including those made at later stages of the manufacturing process.⁸⁸ Although in other parts of his decision Judge Knox did keep in mind the fact that aluminum and other metals were interchangeable for certain industrial purposes, he took aluminum alone into account in determining the relevant market.

On the basis of this market definition, Judge Knox came to the conclusion that in 1950 Alcoa accounted for only 50 percent of the primary aluminum processed in the United States; the other 50 percent was shared between its

⁸³ As Judge Hand noted, quoting the Surplus Property Act: 'So far as consistent "with the usual and customary commercial practice" preference is to be given to smaller purchasers, § 18(b); to whom, when proper, money may be lent, § 18(f). Finally, no "disposal agency" shall even "begin negotiations" to sell a plant which has cost over a million dollars without advising the Attorney General of "the probable terms or conditions" of the sale; and he in turn must tell the "agency" whether "the proposed disposition will violate the antitrust laws." The act must not be read to "impair, amend, or modify" those laws, or to "prevent their application" to purchasers of surplus property.' *Ibid.* See also Walter Adams and Horace M. Gray, *Monopoly in America* 117-42 (New York: Macmillan, 1955).

⁸⁴ *US v. Aluminum Co. of America*, 91 F. Supp. 333 (SD NY 1950).

⁸⁵ *Id.* at 346.

⁸⁶ *Id.* at 346-47.

⁸⁷ *Id.* at 358.

⁸⁸ *Ibid.*

two new competitors, Reynolds and Kaiser. Although the judge found that Alcoa no longer had a monopoly, he considered the corporation still financially powerful enough to obstruct the growth of its competitors. Nevertheless, he denied the government's request for dissolution. Apart from the fact that since 1945 Alcoa had not abused its power, Judge Knox found particular relevance in considerations of military and economic policy, the company having played an important part in the American economy.⁸⁹ He held that a 'strong and resourceful domestic aluminum industry' was essential to 'national security and the peacetime welfare of the general public.' And in the possibility of competition between the aluminum industry and industries producing substitute metals and including firms that were about the same size as or even bigger than Alcoa, Judge Knox saw another argument for not ordering the dissolution of Alcoa for the time being:

The industry . . . must carry on a continuous process of encroachment upon the preserves of other industries The success of any such effort to encroach upon fields of endeavor that are now occupied by strongly entrenched competitors can be achieved only by companies that are rich in resources, and which are capable of undertaking expensive scientific and market experiments. At the present juncture, the weakening of any aluminum producer would lessen the buoyancy of the industry as a whole. From the economic and social standpoint, big business in many industries is an actuality, and if such enterprises are to be subjected to effective competition, their trade rivals must be of somewhat comparable strength. This situation imposes a minimum effective size on any aluminum producer if it be a real contributor to the growth of the industry, and be, as well, a lively competitor with the producers of other metals.⁹⁰

Finally, the dissolution of a fully integrated company such as Alcoa would involve major technical difficulties.⁹¹

The American Tobacco Case (1946). Ruling on the status of monopolies under the Sherman Act in a case brought against the three leading cigarette manufacturers in the United States, the Supreme Court in 1946 endorsed the findings of lower courts before 1945 and Judge Hand's construction in the first *Alcoa* case by stating:

Neither proof of exertion of the power to exclude nor proof of actual exclusion of existing or potential competitors is essential to sustain a charge of monopolization [T]he material consideration in determining whether a monopoly exists is not that prices are raised and that competition actually is excluded but that power exists to raise prices or to exclude competition when it is desired to do so.⁹²

The Court also made it clear that whereas in the case of corporations that had obtained a monopoly on the market through internal growth it was also necessary to show an intent to monopolize in the form of predatory conduct in order to establish infringement of the Sherman Act, this was not required in the case of combinations between former competitors. The mere fact that formerly competing firms had joined together into a single monopolistic firm was clear evidence of such an intent. This marked a further step forward by the courts toward bringing the case law on agreements and combinations under Sections 1 and 2 of the Sherman Act into line.

In three rulings on regional monopolies on the exhibition side of the motion-picture industry the Supreme Court confirmed its holdings in *American Tobacco*. These exhibition monopolies, born out of the horizontal combination of exhibitors into circuits in order to provide countervailing power against the integrated major producers, involved preferential treatment to the detriment of independent theater operators. In this way the circuits were in a position to reserve the first-run rights of new films to themselves. The 'clearance' – the number of days between the first run of a film and the second – was often unreasonably long. Finally, there were numerous devices by which

⁸⁹ 'Alcoa is a company whose efficiency is creditable, and its service to the American people in many ways has been outstanding.' The company's growth could be compared with that of the aluminum industry itself – an industry of vital importance to the country's defense. 91 F. Supp. at 401. 'The most that can be said is that Alcoa yielded its unlawful market position reluctantly.' *Id.* at 415.

⁹⁰ *Id.* at 417.

⁹¹ Judge Knox decided to retain jurisdiction and await developments over the next five years. This five-year trial period elapsed, and the Department of Justice petitioned the district court for extension. In the course of the first trial period, in April 1954, a consent decree was issued providing for sales of Canadian aluminum to nonintegrated fabricators. In time of shortage these smaller companies were to have priority over Alcoa. The government's petition for a second five-year trial period during which it would still be entitled to ask for dissolution was denied. The court observed that Reynolds and Kaiser had become vigorous competitors and rejected the contention that size *per se* was violative of the Sherman Act, referring to Judge Knox's Opinion. *CCH 1957 Trade Cas.* ¶ 68 755, at 73 081, 73 083. Clearly, Alcoa would do nothing to reinforce its market position during the trial period, and to that extent the usefulness of such a period was probably slight. Booming demand for aluminum made it unlikely that Alcoa would suffer substantial losses by refraining from aggressive competition.

⁹² *American Tobacco Co. v. US*, 328 US 781, 811 (1946), *affirming* 147 F. 2d 93 (6th Cir. 1944). In an earlier case, involving a price-fixing agreement between competitors, the Supreme Court had already expounded comparable ideas: 'The power to fix prices, whether reasonably exercised or not, involves power to control the market and to fix arbitrary and unreasonable prices. The reasonable price fixed today may, through economic and business changes, become the unreasonable price of tomorrow. Once established, it may be maintained unchanged because of the absence of competition' *US v. Trenton Potteries Co.*, 273 US 392, 397–98 (1927).

profitable films could be kept running longer, and the independents were often obliged to take a whole year's releases. In the first case, against the Crescent Amusement Co., the Supreme Court had no difficulty in finding a violation of Section 2 of the Sherman Act, because the defendants (a powerful group of exhibitors) had insisted that distributors should give them monopoly rights in 'open' towns where they faced competition, threatening that they would not give the distributors any business in the 'closed' towns where they had no competition.⁹³ The same issue arose in the cases against the Griffith and Schine theater circuits. As it had done in *Crescent*, the Supreme Court held that the circuits' use of the leverage of their monopoly power in order to secure advantages in open towns constituted evidence enough of intent to monopolize those markets. In its *Griffith* ruling the Court stated:

It is sufficient that a restraint of trade or monopoly results as the consequence of a defendant's conduct or business arrangements. . . . To require a greater showing would cripple the Act. . . . And even if we assume that a specific intent to accomplish that result [to get a monopoly in the open towns] is absent, he is chargeable . . . with that purpose since the end result is the necessary and direct consequence of what he did.⁹⁴

[M]onopoly power, whether lawfully or unlawfully acquired, may itself constitute an evil and stand condemned under Section 2 even though it remains unexercised.⁹⁵

Since this was a case of conspiracy between oligopolists, the Court's conclusions from the facts will be discussed in detail in section 3 of this chapter. The law since *Griffith* has further elaborated on the bounds under Section 2 to the use of the market power of large concerns. In this respect, Judge Wyzanski's *Shoe Machinery* ruling is highly important.

The Shoe Machinery Case (1953). One of the reasons for the significance to be attached to the case against the United Shoe Machinery Corp. is that District Judge Charles E. Wyzanski's 1953 ruling included a perceptive analysis of the problems surrounding the test of Section 2 where there is no question of gross abuse of power. In its complaint the Department of Justice had alleged that United's dominance was not a result of economies of scale but of a deliberate policy of taking out patents on as many new inventions as possible and artificially increasing its consequent influence on the market by a system of leasing involving all manner of restrictions on the use of competitors' machines. The government requested dissolution of United into three separate units.

As long ago as 1913 and 1918 the government had already taken similar

allegations to the Supreme Court in an attempt to obtain conviction of United under Sections 1 and 2 of the Sherman Act. It had not been successful, however: the Supreme Court had declined to view the formation of the company as an infringement of Section 1 or the leasing practices as evidence of an intent to monopolize.⁹⁶

Since the early trials United had been able to maintain practically complete dominance in the shoe-machinery industry by leasing rather than selling its machines to shoe manufacturers. Because United still held valid patents on only a few of the machines it manufactured and machines of this kind could not be ordered from competitors (as they did not offer a full line of machinery for all types of shoes and boots), United was able to ensure, by including in its lease contracts restrictions on the use of certain competitors' machines, that machines that were no longer protected by patents still had to be leased by the shoe manufacturers. Some of the restrictive provisions United included in its contracts were that shoes made on its machines could not be finished on machines of its competitors or vice versa; that so long as work was available all United machines always had to be operated at full capacity; that all supplies and parts must be bought from United; and its long lease terms (between ten and twenty years). Its system of leasing was advantageous to small manufacturers because they did not need to buy the costly machines, regular service was assured, and they only had to pay the same rental per pair of manufactured shoes as their bigger competitors. Since there was an inverse ratio between productivity and servicing of the machines, this amounted to discrimination against large manufacturers.⁹⁷ Competition in the American shoe industry was thus artificially distorted. United's much smaller competitors, however, could not offer an expensive repair service, and it was this that put them also at a disadvantage.⁹⁸ Finally, United was able to avoid competition from the secondhand machinery market by its leasing policy.⁹⁹ Apart from its leasing policy, there was additional evidence of United's mo-

⁹³ *US v. Crescent Amusement Co.*, 323 US 173 (1944).

⁹⁴ *US v. Griffith*, 334 US 100, 105 (1948).

⁹⁵ *Id.* at 107. See also *Schine Chain Theatres, Inc. v. US*, 334 US 110 (1948); *Times-Picayune Publishing Co. v. US*, 345 US 594 (1953).

⁹⁶ *US v. Winslow*, 227 US 202 (1913); *US v. United Shoe Mach. Co. of NJ*, 247 US 32 (1918).

⁹⁷ See Carl Kaysen, *United States v. United Shoe Machinery Corporation* 140 (Cambridge, Mass.: Harvard UP, 1956); Lucile S. Keyes, 'The Shoe Machinery Case and the Problem of the Good Trust', 68 *QJ Econ.* 287 (1954). Whitney, however, notes that the system did have bookkeeping advantages for United (*op. cit. supra* note 41, Vol. 2, at 129).

⁹⁸ See the detailed treatment of United's leasing policy in Kaysen, *op. cit. supra* note 97.

⁹⁹ Kaysen sees this as one of the major reasons for United's success (*op. cit. supra* note 97, at 73).

nopoly position on the shoe-machinery market in some of its other trade practices. For instance, United usually put off bringing new machines onto the market until its competitors forced it to do so. The government also cited cases of price discrimination in favor of those machines that were also manufactured by competitors and United's attempts to get in first with patents on new technical discoveries in its field.

In his ruling, Judge Wyzanski assumed that United occupied a monopoly position on the market,¹⁰⁰ and this had to be considered unlawful unless its possessor could prove

that it owes its monopoly *solely* to superior skill, superior products, natural advantages (including accessibility to raw materials or markets), economic or technological efficiency (including scientific research), low margins of profit maintained permanently and without discrimination, or licenses conferred by, and used within, the limits of law (including patents on one's own inventions, or franchises granted directly to the enterprise by a public authority).¹⁰¹ [Emphasis supplied.]

In considering whether United could benefit from this more precise and refined formulation of Judge Hand's 'escape' clause, Judge Wyzanski examined the reasons for the growth and success of United.¹⁰² He praised United's 'research organization of efficiency, intelligence, and vision' and its excellent repair service. The shoe manufacturers derived considerable benefit from United's service, partly because it reduced overheads on the machines.¹⁰³ But though United's expenditure on research, amounting to a good \$4 million a year (about 5 percent of gross income), ensured that it kept its head start on its competitors even after certain patents had expired, Judge Wyzanski was not impressed by the results of this investment: every two and a half years an important new machine was brought onto the market; the median age of models used by the shoe manufacturers in 1950 was twenty-five years and the weighted average age thirty-two. Furthermore, the increase in labor productivity in the shoe industry had remained below the rate in industry as a whole.¹⁰⁴ On the other hand, certain restrictive trade practices had, in the view of the court, also played an effective part in the maintenance of United's share of the market – particularly some of the provisions in United's long-term (ten-year) lease contracts. The most important of these was the obligation of a shoe manufacturer who used certain of United's machines (of which United was the sole supplier) to lease all its other machines from United, even if he would have been better served by competing machines. This policy of 'full-line forcing' was the stumbling block for Judge Wyzanski. While recognizing that these practices were in a way 'normal methods of industrial

development' and therefore not in themselves illegal restraints of trade, they were 'business policies that are not the inevitable consequences of its capacities or its natural advantages' when employed by a dominant firm because they furthered its dominance. And 'while the law allows many enterprises to use such practices, the Sherman Act is now construed by superior courts to forbid the continuance of effective market control based in part upon such practices.'¹⁰⁵ For that reason, United's defense that its dominance was unavoidable and that shoe manufacturers benefited from it was not accepted.

In an economic analysis of this case, Judge Wyzanski's law clerk, the economist Carl Kaysen, furnished some additional information which throws more light on the performance of United. Kaysen found little evidence of economies of scale to support the assertion that big firms were essential. In his view the optimum plant size in the shoe-machinery industry was not very large. Only in some instances were fifty or more machines of a single type produced, because the differing needs of the shoe manufacturers required a fairly individual operation. According to one of United's managers, 'Beverly [the corporation's headquarters] is essentially a large "job shop" with a wide variety of products and small orders.' This evidence, together with an analysis of the structure of United's research and service departments, led Kaysen to the conclusion that firms smaller than United would have been just as efficient. The growth of Compo Shoe Machinery Corp. (United's only important competitor) provides some evidence of this.¹⁰⁶ It should not be overlooked, however, that clear justification in favor of a big firm in this industry may be provided by reasons of business continuity, for the existence of a corporation manufacturing shoe machinery would be in constant jeopardy if it were to concentrate on a single type of machine. Nevertheless, this should not detract from the fact that United's position of near monopoly was in fact undesirable because it was based in large part on the leasing practices. More evidence in this respect can be derived from Kaysen's comment that the profit margins on machines for which United had no competition at all were ap-

¹⁰⁰ The court gave little attention to definition of the market, taking the competitiveness of machinery for similar purposes as its criterion for distinguishing the shoe-machinery market. Without giving reasons, Judge Wyzanski excluded dry-thread sewing machines used in making uppers. See Keyes, *supra* note 97.

¹⁰¹ *US v. United Shoe Mach. Corp.*, 110 F. Supp. 295, 342 (D. Mass. 1953).

¹⁰² *Id.* at 344.

¹⁰³ *Id.* at 330, 340.

¹⁰⁴ *Id.* at 331.

¹⁰⁵ *Id.* at 345.

¹⁰⁶ Kaysen, *op. cit. supra* note 97, at 92-99.

precipitously higher than on machines also offered by competitors.¹⁰⁷

Judge Wyzanski's decree was determined by economic and technical realities in the industry concerned. He decided against dissolution: first, this would be technically impracticable because the whole of United's production originated in a single factory; second, more generally, dissolution is a big step, and the risks incurred in taking this step on the basis of an erroneous economic forecast are enormous. Wyzanski notes that he as judge has to take a decision with the aid of a minimum of factual material in a field in which he is not expert. Since only the principal officers of a company are likely to have enough information to assess the consequences of dissolution, Judge Wyzanski refused to assume responsibility for such an action. He did order United to sell its production and distribution facilities for certain supplies and to offer to license all its patents. One of his most important directives was that United must eliminate a large number of restrictive clauses in its leases so that its competitors should no longer be at a disadvantage and efficient manufacturers should no longer be penalized.¹⁰⁸ Judge Wyzanski hoped to help achieve this result in another way by enjoining United from buying back its own used machines from shoe factories. The judgment provided for a review of the competitive situation in the shoe-machinery market in January 1965 in order to establish whether the decree had achieved its purpose of restoring competitive conditions.

The case was duly brought before the courts again, and both district court and Supreme Court gave rulings in 1967 and 1968 respectively.¹⁰⁹ The lower court held that the 1953 decree was operating as intended and that it consequently had no power to change it, but on appeal the Supreme Court reversed, finding that if the decree had not yet fully achieved what it had set out to do the time had come to consider other remedies. The trial court then entered a supplemental judgment – eventually agreed to by both parties – giving United Shoe two years in which to divest itself of sufficient assets to reduce its share of the market to 33 percent at most.

The Increased Importance of Determination of the Relevant Market and Other Economic Evidence: Cellophane and Other Cases. In the antitrust cases discussed so far, the relevant market was considered only incidentally as certain elements of the market position of the firm in question were examined. The monopoly position of the defendant in one or other industry was taken more or less for granted; this could be done with relative impunity because generally the firm exercised economic power throughout the industry and there were instances of clear abuse whose consequences were such that they could only be the acts of a monopolist. As later cases that were prosecuted by the anti-

trust agencies under the Sherman Act were not concerned with industrywide monopolies nor even with monopolies at all in the strict sense of the term, the agencies and the courts had to give more attention to market definition in order to establish whether these cases did fall under Section 2 of the Sherman Act. In 1953, in a Sherman Act suit against a newspaper monopoly, the Supreme Court developed the market issue in some detail. It noted:

For every product, substitutes exist. But a relevant market cannot meaningfully encompass that infinite range. The circle must be drawn narrowly to exclude any other product to which within reasonable variations in price, only a limited number of buyers will turn; in technical terms, products whose 'cross elasticities of demand' are small.¹⁰⁷

This was the first time that the Supreme Court admitted that the relevant market was not made up exclusively of physically identical products but that differentiated products answering the same purpose from the customer's point of view must also be included. The market thus had to be defined anew for each individual case. The Supreme Court enlarged on this in its 1956 ruling in the important *Cellophane* case. The government had charged E. I. du Pont de Nemours & Co. with monopolizing the manufacture and sale of cellophane in the United States and demanded divestiture of some of du Pont's factories. In 1953 a lower court had rejected the government's petition, holding that du Pont did not have a monopoly position on the market.¹⁰⁸ The relevant market was not the market in cellophane but that in flexible packaging materials, so that a monopoly in the production of cellophane alone could not give du Pont any great influence on the latter market. This was proved by the facts that du Pont's prices had to respond to competitive pressures from these other products and that the company possessed no exclusive patents or other means of excluding competitors from the manufacture of cellophane. The court even found signs of active competition in the packaging-materials

¹⁰⁷ *Id.* at 114-28.

¹⁰⁸ The opinion on remedy is to be found in 110 F. Supp. at 346-51. The court agreed that the maximum term of lease should be shortened to five years, that charges for machines should be segregated from charges for repair service, that lessees should be able to cancel a lease without thereby incurring undue penalties, and that the full-capacity clause should be eliminated. The economic effects of the decree on the competitive situation will be discussed in Chapter 6 *infra*.

¹⁰⁹ *US v. United Shoe Mach. Corp.*, 266 F. Supp. 328 (D. Mass. 1967), *rev'd*, 391 US 244 (1968).

¹¹⁰ *Times-Picayune Publishing Co. v. US*, *supra* note 95, at 612 n.31.

¹¹¹ *US v. E. I. du Pont de Nemours & Co.*, 118 F. Supp. 41 (D. Del. 1953).

market, including declining prices, expanding production, research and the development of new products.¹¹² The Supreme Court sustained this ruling, going into extensive detail on the definition of the market:

In considering what is the relevant market for determining the control of price and competition, no more definite rule can be declared than that commodities reasonably interchangeable by consumers for the same purposes make up that 'part of the trade or commerce,' monopolization of which may be illegal. . . . In determining the market under the Sherman Act, it is the use or uses to which the commodity is put that control. . . . An element for consideration as to cross elasticity of demand between products is the responsiveness of the sales of one product to price changes of the other [footnote omitted] The court below held that the 'great sensitivity of customers in the flexible packaging markets to price or quality changes' prevented du Pont from possessing monopoly control over price. 118 F. Supp., at 207. The record sustains these findings.¹¹³

The majority opinion considered at some length the share of cellophane in the packaging of certain products – a share which fluctuated over time and from one product to another. The Court found that there was 'a very considerable degree of functional interchangeability' between cellophane and other flexible packaging materials. This was evidenced by the marked sensitivity to price and quality of the consumers of these materials. On the basis of this information, the majority concluded that the relevant market was the market for flexible packaging materials. Although du Pont occupied a strong position in the cellophane industry, its share of the market in flexible packaging materials was only small. Moreover, du Pont's profits from cellophane manufacture had been no higher than those of its competitors.¹¹⁴ As no monopoly power could be shown, then, the charges against du Pont were dismissed.

This reasoning of the Court's was undoubtedly a step in the direction of a realistic and economically defensible market definition. But the analysis of the majority contained important gaps, and the three dissenting justices emphasized this in their opinion. In the first place, the minority laid stress on the fact that other packaging materials, though often appreciably cheaper, were nevertheless regarded by the majority as direct competitors of cellophane.¹¹⁵ Secondly, the only other cellophane producer, Sylvania Industrial Corp., was the only firm to follow du Pont's pricing policy closely; the manufacturers of other packaging materials did not do so.¹¹⁶ Thirdly, the minority rejected as unrealistic the theory of the lower court that du Pont could not arbitrarily increase its prices without suffering a reduction in sales: 'A monopolist seeking to maximize profits cannot raise prices "arbitrarily."' In support of its view the minority cited the advice of du Pont's division manager

in 1948 that prices should be revised upwards if operative earnings of 31 percent should be considered inadequate:

The trial judge thought that, if du Pont raised its price, the market would 'penalize' it with smaller profits as well as lower sales. Du Pont proved him wrong. When 1947 operating earnings dropped below 26 percent for the first time in ten years, it increased cellophane's price 7 percent and boosted its earnings in 1948. . . . It is this latitude with respect to price, this broad power of choice, that the antitrust laws forbid. Du Pont's independent pricing policy and the great profits consistently yielded by that policy leave no room for doubt that it had power to control the price of cellophane.¹¹⁷

On the whole, subsequent writers have defended the minority's view of the facts.¹¹⁸ For instance, commentators have pointed out – quite correctly – that the heavy demand for cellophane despite its high price was evidence of the peculiar characteristics of this material.¹¹⁹ For cellophane had so many excellent qualities that a large number of customers were influenced in their choice by these qualities rather than by price. This conclusion is further confirmed by the relatively high profits obtained by du Pont on its cellophane operation. From the beginning of the Great Depression of 1929 through the subsequent period of recovery and the 1938 recession, du Pont's rate of earnings before taxes was 29.6 percent. If we compare this with the 6.3 percent earned, for instance, on the manufacture of rayon, in which du Pont had long

¹¹² *Id.* at 233.

¹¹³ *US v. E. I. du Pont de Nemours & Co.*, 351 US 377, 395–96 (1956).

¹¹⁴ *Id.* at 404.

¹¹⁵ 'We cannot believe that buyers, practical businessmen, would have bought cellophane in increasing amounts over a quarter of a century if close substitutes were available at from one seventh to one half cellophane's price. That they did so is testimony to cellophane's distinctiveness.' *Id.* at 417.

¹¹⁶ 'Certainly du Pont itself shared our view. From the first, du Pont recognized that it need not concern itself with competition from other packaging materials.' *Id.* at 418.

¹¹⁷ *Id.* at 422–23.

¹¹⁸ The major contributions to the literature are George W. Stocking and Willard F. Mueller, 'The Cellophane Case and the New Competition', 45 *Am. Econ. Rev.* 29 (1955); George W. Stocking, 'The Rule of Reason, Workable Competition and Monopoly', 64 *Yale LJ* 1107 (1955); Donald F. Turner, 'Antitrust Policy and the Cellophane Case', 70 *Harv. L. Rev.* 281 (1956); Frank J. Kottke, 'Simultaneous Price Fluctuations as a Test of the Significance of Product Substitution', 5 *Antitrust Bull.* 627 (1960). Criticism of these articles, particularly of Stocking and Mueller, can be found in Joel B. Dirlam and Irwin M. Stelzer, 'The Cellophane Labyrinth', 1 *Antitrust Bull.* 633 (1956); John M. Lishan, 'The Cellophane Case and the Cross Elasticity of Demand', 4 *Antitrust Bull.* 593 (1959).

¹¹⁹ Stocking and Mueller, *supra* note 118, at 144.

had a number of formidable competitors, the difference is clear as day.¹²⁰ Judge Irston R. Barnes, who was then Assistant Attorney General in charge of the Antitrust Division, later recalled that the *Cellophane* ruling had caused considerable dismay among enforcement agencies, not because of the standard adopted by the majority for definition of the relevant market but because it was applied far too loosely.¹²¹

One year after *Cellophane*, a company that published several daily newspapers in metropolitan Kansas City relied on the Supreme Court's ruling in this case in order to show that it did not occupy a dominant position. The Kansas City Star Co. had originally been charged by the Antitrust Division in a suit brought under Section 2 of the Sherman Act with attempting to monopolize by unfair trade practices and, once it had become a monopolist, with monopolizing the newspaper industry in Kansas City (with 95 percent of all subscribers to morning, evening and Sunday newspapers in the metropolitan area). In its ruling in 1955, the district court had upheld the Antitrust Division and imposed fines.¹²² The Star then appealed. In 1957 the circuit court of appeals handed down its decision, this time in a civil case.

Although his newspaper practically held a monopoly in the Kansas City area, the owner of the Star nevertheless insisted that in his advertising policy he had to take seventy-eight weeklies into account. Moreover, his newspaper had to meet competition from radio and television stations, periodicals, and so on. The court rejected this argument, however, repeating a point made by the district court and quoted approvingly by the Supreme Court in *Associated Press*:

most monopolies, like most patents, give control over only some means of production for which there is a substitute; the possessor enjoys an advantage over his competitors, but he can seldom shut them out altogether; his monopoly is measured by the handicap he can impose.¹²³

Basing itself on trade literature on advertising, which made a distinction between advertisements in dailies and those in other mass communications media (weeklies, radio, television), the court concluded that the relevant market was that in daily newspapers in metropolitan Kansas City.¹²⁴

In the view of the court the monopoly position of the Kansas City Star Co. was not the result of 'superior skill, foresight and industry' but of harsh methods that forced advertisers to take space only in the Star. Now since the vast majority of Kansas City families subscribed to the Star, the company could boycott advertisers that also bought space in other newspapers or did not use the Star's own television station. Subscribers, moreover, were obliged to take both the morning and the evening paper. By practices such as these,

the Star was able effectively to exclude its competitors. On the basis of these facts the court declared that a violation of Section 2 of the Sherman Act was shown. The circuit court then remanded the case to the district court for remedy. The district court ordered divestiture of the Star's radio and television stations, forbade the company to acquire them again and enjoined it from forcing advertisers to refrain from using other media.¹²⁵ This decision was in line with Supreme Court rulings in the *Lorain Journal* and *Times-Picayune* cases, involving comparable situations.¹²⁶

We find a logical application of the *Cellophane* standard of market definition in the Supreme Court's ruling of 1959 in *International Boxing Club*. In this case, the two defendants were promoters of championship fights accused by the government of conspiracy in restraint of trade and monopolization in conflict with Sections 1 and 2 of the Sherman Act. By buying out competitors, tying the best boxers by exclusive contracts, and by controlling the best arenas and stadiums and holding exclusive film and television rights, these promoters together had attained dominance in the business of professional championship contests. The district court rejected the defense that the relevant market consisted in the promotion of *all* boxing contests, if not the whole entertainments industry, remarking upon the criteria of the *Cellophane* case, but stated that there was a particular demand for championship fights and that the relevant market should be restricted to them.¹²⁷ In the Supreme Court's ruling the criteria of the *Cellophane* case were applied. The Court agreed with the district court that 'nonchampionship fights are not "reasonably interchangeable for the same purpose" as championship contests,' mainly because the receipts of a championship fight were substantially higher than those of ordinary contests. Admittedly, the Court was unable to prove abuse or unfair competitive practices, but it had become clear that the defendants were practically the sole successful promoters of championship fights.¹²⁸ The Supreme

¹²⁰ See Jesse W. Markham, *Competition in the Rayon Industry* 181, 206, 208 (Cambridge, Mass.: Harvard UP, 1952).

¹²¹ Irston R. Barnes, 'Legal Issues and Economic Evidence in Cartel Law', in International Conference on Restraints of Competition (Frankfurt on Main, June 1960), *Cartel and Monopoly in Modern Law* 827 (Karlsruhe: Müller, 1961).

¹²² *US v. Kansas City Star Co.*, CCH 1955 Trade Cas. ¶ 68 117 (WD Mo. 1955).

¹²³ *US v. Associated Press*, 52 F. Supp. 362, 371 (SD NY 1943), *aff'd*, 326 US 1 (1945).

¹²⁴ *Kansas City Star Co. v. US*, 240 F. 2d 643, 659-60 (8th Cir. 1957), *cert. denied*, 354 US 923 (1957).

¹²⁵ *US v. Kansas City Star Co.*, CCH 1957 Trade Cas. ¶ 68 857 (WD Mo. 1957).

¹²⁶ *Lorain Journal Co. v. US*, 342 US 143 (1951); *Times-Picayune Publishing Co. v. US*, *supra* note 95.

¹²⁷ *US v. International Boxing Club of NY, Inc.*, 150 F. Supp. 397, 419-20 (SD NY 1957).

¹²⁸ *International Boxing Club of NY, Inc. v. US*, 358 US 242 (1959).

Court therefore affirmed the decree of the court below ordering them to divest themselves of Madison Square Garden – the foremost of the arenas they owned.

Another case that should be considered in this survey of the legal status of horizontal market power under the Sherman Act involved a complaint against a dominant firm in the automatic alarm systems industry, the Grinnell Corp. In the civil action brought by the Antitrust Division, Grinnell and three affiliated companies were accused of (1) concluding premerger market-sharing agreements in conflict with Section 1 of the Sherman Act, (2) subsequently attempting to monopolize the market by other means in violation of Section 2 of the Sherman Act and (3) monopolizing interstate commerce.¹²⁹ The Grinnell Corp., a manufacturer of alarm installations, originally had exclusive-dealing agreements with a number of large central station protective services (CSPS) companies in which it later obtained a majority interest. These companies have central stations in various cities; the stations are connected by wires to hazard-detecting devices located on subscribers' premises, and in case of fire or burglary they are automatically alerted so that appropriate action can be taken. Installation of these systems is paid for by the subscribers. Apart from these automatic alarm systems, simpler services (watchmen, nonautomatic alarms) are also used ('ordinary alarm systems').

Determination of the relevant market was an important element in the rulings of both district court and Supreme Court. Although substitutes for the accredited central station service provided by the defendants were considered, the Supreme Court reasoned that there were marked differences in quality so that the interchangeability test of the *Cellophane* decision was not met.¹³⁰ Its reasoning followed that of the lower court, which on the basis of testimony by expert witness had come to the conclusion that 'nonautomatic systems differ not merely in technology but in utility, efficiency, reliability, responsiveness, and continuity from all automatic arrangements'. The district court had also pointed out that insurance companies charged lower premiums for clients who were subscribers to an automatic alarm system.¹³¹ Both courts rejected the defendants' argument that the different services offered by the central station business were so diverse that they could not be considered part of a single market. The Supreme Court found their argument to be irrelevant since CSPS companies had to offer the full cluster of services in order to compete effectively. Here, the majority relied on the Court's opinion in a merger case, *US v. Philadelphia Nat'l Bank*, 374 US 321 (1963), stating: 'We see no reason to differentiate between the "line of commerce" in the context of the Clayton Act and "part" of commerce for purposes of the Sherman Act.'¹³²

Both courts found that the market was national in character because Grinnell and its associates were active throughout the country. In the market so defined, Grinnell had a share of approximately 90 percent. A minority of two Supreme Court justices pointed out that on a number of local markets customers did regard ordinary systems as substitutable for automatic systems and that Grinnell sold at a loss in some of these markets; hence, not only was it impossible to consider the relevant market to be national, but these substitutes should be taken into account as well.¹³³

Ruling on the applicability of Section 2 of the Sherman Act to the facts in this case, both courts applied the ideas already advanced in *Alcoa* and *United Shoe Machinery*. In the language of the district court:

[O]nce the government has borne the burden of proving what is the relevant market and how predominant a share of that market defendant has, it follows that there are rebuttable presumptions that defendant has monopoly power and has monopolized in violation of Section 2. The government need not . . . consume time in needlessly proving defendant's predatory tactics, if any, or defendant's pricing, or production, or selling, or leasing, or marketing, or financial policies while in this predominant role.¹³⁴

Like the lower court before it, the Supreme Court saw evidence of intent to monopolize in Grinnell's absorption of the three biggest alarm systems services in the United States.¹³⁵

The Supreme Court's opinion on remedy in this case provided first of all for divestiture of Grinnell's holdings in the three alarm company defendants. The Supreme Court also confirmed the requirement in the decree of the lower court that forbade the Grinnell group from acquiring interests in firms in the accredited central station business since 'acquisition was one of the methods by which the defendants acquired their market power and was the method by which Grinnell put the combination together.'¹³⁶ Further, American District Telegraph Co., a member of the Grinnell group and the biggest accredited

¹²⁹ *US v. Grinnell Corp.*, CCH 1964 Trade Cas. ¶ 71 298 (D. RI 1964).

¹³⁰ CCH 1966 Trade Cas. ¶ 71 789, at 82 649-50.

¹³⁷ CCH 1964 Trade Cas. ¶ 71 298, at 80 250. See also CCH 1966 Trade Cas. ¶ 71 789, at 82 650.

¹³² CCH 1966 Trade Cas. ¶ 71 789, at 82 649. The *Philadelphia Nat'l Bank* case will be discussed in Chapter 5 *infra*.

¹³³ CCH 1966 Trade Cas. ¶ 71 789, at 82 656. The court below had seen in this practice of selling at a loss an indicium of monopoly power. CCH 1964 Trade Cas. ¶ 71 298, at 80 249.

¹³⁴ CCH 1964 Trade Cas. ¶ 71 298, at 80 246.

¹³⁵ *Id.* at 80 249, and CCH 1966 Trade Cas. ¶ 71 789, at 82 650-51.

¹³⁶ CCH 1966 Trade Cas. ¶ 71 789, at 82 651-52.

company in the central station service business, with a market share of 73 percent in 1961, had to be dissolved; the details of the dissolution had to be worked out by the court of first instance.¹³⁷

Finally, mention should be made of a civil suit filed by the Department of Justice on 17 January 1969 charging International Business Machines Corp. with monopolization of the computer industry and seeking divorcement, divestiture and reorganization. The government alleged that IBM's market share ranged up to 80 percent of total shipments of all general-purpose digital computers and that the corporation had pushed out competitors in several parts of the market by setting inclusive prices for packages comprising hardware, software and related support services, and had offered computers for sale at only a slight markup in markets where it was exposed to fierce competition. IBM had also shut out smaller companies by announcing to prospective customers that it would produce new models within an unrealistically short time. Problems have arisen in the prosecution of this case because the Department of Justice relied on evidence that had been obtained from IBM and indexed by another computer firm, Control Data. A private antitrust suit that Control Data filed against IBM in 1968 ended in a consent settlement early in 1973 whereby IBM agreed to pay substantial compensation to Control Data and to sell to it its subsidiary Service Bureau Corp. It later emerged that Control Data had undertaken to destroy the computerized index (the 'data base') that its lawyers had compiled to the several million pages of evidence it had acquired from IBM. Without the data base, it is virtually impossible to find one's way about the material, and that is a major handicap for the government. This is further demonstration of how difficult it is for the government to proceed with basic Section 2 actions against very large firms with a view to a structural reorganization of the industry, particularly because of the time-consuming element involved.¹³⁸

4.2.4 The Case Law on Vertical Integration

There is nothing in the antitrust laws which specifically bars a dominant firm from vertical expansion. However, the conduct of a vertically integrated corporation can bring it into conflict with the Sherman Act, and certain recent developments in the law go even so far as to regard vertical integration by a firm having a monopoly position on the market as a monopolistic practice under certain circumstances and to regard such vertically integrated firms as *per se* violative of the Sherman Act. Vertical integration may also be held to violate Section 7 of the Clayton Act. Since the Celler-Kefauver amendment to the Clayton Act was adopted in 1950, in fact, all actions against vertical mergers by the enforcement agencies have been brought under the Clayton

Act. Lastly, any abuses attendant upon vertical integration may themselves be the ground of an action under Section 2 of the Clayton Act, say, or Section 5 of the Federal Trade Commission Act. This subsection will be limited to a discussion of the case law under the Sherman Act. Suits brought under Section 7 of the Clayton Act will be reviewed in the following chapter.

Nearly all the big corporate combinations involved in antitrust lawsuits before 1945 were integrated vertically as well as horizontally. If the courts found that a given corporation was a combination in unreasonable restraint of trade and thus had to be broken up, this meant not only horizontal but also vertical dissolution. The standpoint adopted by the courts toward vertical integration was much the same as the attitude they had taken toward horizontal combinations after 1911: two main factors were adduced to judge integrated corporations under the Sherman Act, namely the extent to which the corporation concerned dominated the relevant market and the consequences of integration for its competitors.

This was how the law was construed, for instance, in the *Reading* and *Lehigh Valley* rulings in 1920, the *Swift* ruling in 1932 and the *Pullman* ruling in 1943. The first two of these involved railroad companies that had bought up coal mines in order to ensure sources of traffic. As the government succeeded in showing that the two companies had applied discriminatory rates against competing mining companies that were obliged to use their roads, the Supreme Court found that there was sufficient evidence of deliberate strategy designed to maintain a monopoly position on the part of Reading and Lehigh and ordered both companies to dispose of their mining interests.¹³⁹

In the *Swift* case, the horizontal aspects of which have already been discussed, the fear that vertical integration might give a dominant firm still more influence over its nonintegrated competitors seems to have led the Supreme Court in 1932 to refuse a petition by a number of major meat packers to be allowed to distribute other food products. Earlier, the packers had already ventured into distribution, but in 1920 they had been obliged to accept a con-

¹³⁷ *Id.* at 82 651.

¹³⁸ The Department of Justice then applied for a court order to oblige IBM to replace the data base or pay for a new one to be made. On 6 March 1973 the district court ruled that IBM had acted unlawfully in destroying the data base but declined to order the company to pay the cost of replacing it: the original court order had referred only to the preservation of the index, not to its production or reconstruction. IBM was ordered to deliver the evidence required by the government direct to the district court. *US v. International Business Machines Corp.*, CCH 1973-1 Trade Cas. ¶ 74 392 (SD NY 1973). The government has two other major § 2 cases pending: *US v. Firestone Tire & Rubber Co.*, Civ. C-73-836 (ND Ohio); *US v. Goodyear Tire & Rubber Co.*, Civ. C-73-835 (ND Ohio).

¹³⁹ *US v. Reading Co.*, 253 US 26 (1920); *US v. Lehigh Valley RR*, 254 US 255 (1920).

sent decree ordering them to cease. At the same time they had had to undo much of their forward integration by selling their holdings in cold-storage plants, railroads and stockyards. When the packers petitioned to have the decree modified, they were denied by the Supreme Court on the grounds stated above. The meat packers had insisted that economic conditions had changed completely since 1920: the industry was in a depressed state, integrated grocery chains had entered the meat-packing business, competition was on the increase, and government regulation was stringent, which made it impossible to comply with the provisions of the consent decree. However, the majority of the Supreme Court feared that

through the ownership of refrigerator cars and branch houses as well as other facilities, the defendants were in a position to distribute ... other ... commodities with substantially no increase of overhead [This] would ... put them in a position to starve out weaker rivals.¹⁴⁰

The essence of the Supreme Court's argument, then, is that if integration gives an already dominant firm a stronger position on its own market and on other markets, even if it is economically justifiable and could benefit the consumer, it must be forbidden because nonintegrated competitors are no longer on an equal footing.

In 1956 the meat packers made a further attempt to have the 1932 decree modified. But again they were refused, the district court noting that the dominance of the packers had not diminished and that the 1932 decree would have to remain in force. Although Swift and the others had shown that in the intervening period they had obtained only modest profits while other companies had earned much more and had grown more rapidly, the court found this defense insufficient to warrant reversal of the ban on integration imposed thirty years before.¹⁴¹ The last page in the meat packers consent decree story was finally written in 1971 after the Supreme Court allowed Greyhound to take a controlling interest in Armour, one of the packers, despite the fact that two of Greyhound's wholly-owned subsidiaries traded in some of the products that Armour had been prohibited from dealing in by the consent decree. The Court thus rejected the government's view that by permitting Greyhound's acquisition, the complete structural separation of the meat-packing and the retail food industries would be nullified. The Court found that the 1920 decree did not envisage a complete separation of Armour from the reserved food products concerned but merely prohibited certain actions and relationships 'not including the one here in question.'¹⁴²

The *Pullman* case originated in a civil suit filed by the Department of Justice against the Pullman Co. in 1940. As was pointed out earlier in this chapter,

this company had built up a monopoly position in the operation of sleeping cars. It was not profitable for the railroad companies themselves to organize a sleeping-car service. Pullman, however, had not confined its business activities to providing this service but had also gone into building freight cars, sleeping cars and passenger coaches. Through acquisition of a number of car builders, Pullman by 1930 had become the biggest railroad-car manufacturer in the United States. (The manufacturing unit was the Pullman-Standard Car Manufacturing Co.) The government charged that Pullman had moved into car building with a view to extending its monopoly. Pullman refused to operate sleeping cars that had not been built by Pullman-Standard, thus gaining an effective means of compelling the railroads to buy Pullman-Standard cars. Pullman also subsidized Pullman-Standard, according to the government, from the high profits on its sleeping-car operation, thus enabling Pullman-Standard to sell passenger coaches and freight cars more cheaply. Both of these practices put other car builders at a serious disadvantage. The district court did not pass upon these alleged abuses because it held that they were not needed to show an infringement of the Sherman Act.¹⁴³ It did believe, however, that vertical integration in this case gave appreciable support to the market position of Pullman's car-building unit because Pullman had an absolute monopoly as a sleeping-car operator. The court therefore ordered disintegration into two separate companies. Pullman chose to retain its car-building company. A group of fifty-six railroads then purchased the sleeping-car business.¹⁴⁴ The court's ruling means, then, that a monopoly, in entering another market, may not make use of its key position in the first market in order to attain a similar position in the second. So the main issue is whether such a company is abusing its position; if it is, the courts are correct in prohibiting vertical integration.¹⁴⁵

¹⁴⁰ *US v. Swift & Co.*, 286 US 106, 115-16 (1932).

¹⁴¹ 189 F. Supp. 885 (ND Ill. 1960), *aff'd per curiam*, 367 US 909 (1961).

¹⁴² *US v. Armour & Co.*, 402 US 673, 678 (1971). The Court's exposition on the nature of consent decrees in this decision modifies its views as set out in the 1932 opinion. The consent-decree issue is amply discussed in Milton Handler, 'Twenty-Fourth Annual Antitrust Review', 72 *Colum. L. Rev.* 1, 19-29 (1972).

¹⁴³ *US v. Pullman Co.*, 50 F. Supp. 123 (ED Pa. 1943). This aspect of the ruling is discussed in subsection 2.2 of this chapter.

¹⁴⁴ The district court's supplementary opinions on remedy and its approval of the sleeping-car transaction are contained in 53 F. Supp. 908 (1944), 55 F. Supp. 985 (1944) and 64 F. Supp. 108 (1945). The Supreme Court rejected the government's appeal, 330 US 806 (1947), *rehearing denied*, 331 US 865 (1947).

¹⁴⁵ Simon N. Whitney, *Antitrust Policies* Vol. 2, at 333-34 (New York: Twentieth Century Fund, 1958), who examines this case in detail, doubts whether there was any 'subsidization' of Pullman's car-building operation by its sleeping-car service.

In the cases on vertical integration under the Sherman Act since 1945 the central issue has been the legality of vertical integration by a firm in a dominant position in the absence of clear evidence of intent to monopolize. In 1947 the Supreme Court handed down its decision in the *Yellow Cab* case, which made it clear that vertical integration was not prohibited *per se* under the Sherman Act and that intent to monopolize had to be proved for a finding against the defendants. The Antitrust Division had charged the Checker Cab Manufacturing Corp., a firm that built taxicabs but was very small in comparison with competitors such as General Motors, Ford and Chrysler, with combination and conspiracy with specific intent to violate the first two sections of the Sherman Act. The complaint was directed against Checker's acquisition of a controlling interest in six companies operating cabs, including the well-known Yellow Cab Co. This had been the only means available to Checker of securing a market in the face of competition from the big automobile manufacturers. When suit was filed in 1946, the companies under Checker's control owned most of the licensed cabs in Chicago, Minneapolis and Pittsburgh, and a smaller proportion of those in New York. All in all, the Checker companies operated about 5 000 cabs. When *Yellow Cab* came before the Supreme Court, it was held that this number of cabs certainly constituted a relevant product market within the meaning of the Sherman Act. Geographically, the market was defined as cab transportation between a number of railroad terminals in Chicago.¹⁴⁶ Since roads from various states converged at these terminals, interstate commerce was involved.¹⁴⁷ The Antitrust Division's lawyers contended that Checker's monopoly position in this market 'was not obtained by normal expansion to meet the demands of a business growing as a result of superior and enterprising management, but by deliberate calculated purchase for control'. The Court, however, found that the government had not proved that Checker's acquisition of control of cab companies in Chicago had also led to an *undue* restraint of interstate commerce. Only if this could be proved would the government have won its case.¹⁴⁸ The Supreme Court refused to impose a *per se* prohibition of vertical integration and remanded the case for trial on the facts. The trial court held that the government had too little evidence to show an infringement of the Sherman Act, and its decision was sustained on appeal.¹⁴⁹

The Supreme Court's ruling in *Yellow Cab* is also of interest because of its treatment of conspiracy between a parent and its subsidiary. The Antitrust Division had charged that the link between Checker and its subsidiaries (the cab companies) was a combination and conspiracy to monopolize and had requested a *per se* prohibition of this parent/subsidiary link because it excluded Checker's competitors from the market constituted by the subsidiaries.

The view expressed by the Court was that the Sherman Act is indeed applicable to 'intra-enterprise conspiracy'.¹⁵⁰

The test of illegality under the Act is the presence or absence of an unreasonable restraint on interstate commerce. Such a restraint may result as readily from a conspiracy among those who are affiliated or integrated under common ownership as from a conspiracy among those who are otherwise independent. Similarly, an affiliation or integration flowing from an illegal conspiracy cannot insulate the conspirators from the sanctions which Congress has imposed. The corporate interrelationships of the conspirators, in other words, are not determinative of the applicability of the Sherman Act.¹⁵¹

In two further suits brought before the Supreme Court shortly after *Yellow Cab*, the government again tried to obtain a declaration that vertical integration practiced by a dominant firm was *per se* in conflict with the provisions of the Sherman Act. These were cases of vertical integration between motion-picture producers and exhibitors (*Paramount Pictures*) and of further integration by US Steel (*Columbia Steel*).

In the motion-picture industry, the major producers had long since integrated forward by purchasing theater companies that operated the best houses in the major cities of the United States. This assured them of an excellent market for their products. As the producers could decide which films they would exhibit, the smaller, nonintegrated companies were virtually unable to show their films in any of the big theaters. Apart from this vertical integration, there had also been horizontal combination of exhibitors into circuits. The independent theater operator found it particularly difficult to exhibit profitable films because of the policy of the producers and circuits, which stipulated preferential treatment to his disadvantage. The Department of Justice acted against both circuits and producers engaging in these trade practices. Its complaints against the circuits were sustained a number of times by the Supreme Court. The most celebrated rulings were handed down in the *Crescent*, *Griffith*

¹⁴⁶ *US v. Yellow Cab Co.*, 332 US 218, 225-27 (1947).

¹⁴⁷ The extensive case law on the distinction between interstate and intrastate commerce is not discussed in the present study.

¹⁴⁸ 332 US at 228.

¹⁴⁹ 80 F. Supp. 936 (ND Ill. 1948), *aff'd*, 338 US 338 (1949).

¹⁵⁰ The question of intra-enterprise conspiracy was also considered by the Supreme Court in *US v. Griffith*, 334 US 100 (1948); *Kiefer-Stewart Co. v. Joseph E. Seagram & Sons*, 340 US 211 (1951); *Timken Roller Bearing Co. v. US*, 341 US 593 (1951). The facts of these cases were quite distinct from what we are considering here, and the doctrine is not further discussed.

¹⁵¹ 332 US at 227.

and *Schine* cases (discussed in the preceding subsection).¹⁵² In 1940 the five major producers accepted a consent decree prohibiting certain of their practices but not affecting their integrated structure. This decree gave little satisfaction, and in 1944 the government asked the district court to order divorcement of production and distribution from exhibition.

In its 1946 ruling in the *Paramount* case the district court held that since the five majors together owned only a sixth of all motion-picture theaters in the United States, the government's petition could not be granted. However, the court did agree that defendants engaged in unfair trade practices. It prohibited some of these practices and proposed competitive bidding as a remedy for the obligation of block booking.¹⁵³ On appeal, the Supreme Court unanimously rejected the reasoning of the trial court. The relevant market consisted not of all motion-picture theaters but only of first-run theaters – a distinction that was also made by the public. (The Court did not consider other forms of mass entertainment such as theaters, television and sport.) The Supreme Court found that the court below had also failed to examine whether vertical integration by the producers and the powerful position gained as a consequence were intended to give them a monopoly in the exhibition of their films. In answer to the question when vertical integration comes into conflict with the law, the Supreme Court stated:

[I]t runs afoul of the Sherman Act if it was a calculated scheme to gain control over an appreciable segment of the market and to restrain or suppress competition, rather than an expansion to meet legitimate business needs. . . . Second, a vertically integrated enterprise, like other aggregations of business units . . . will constitute monopoly which, though unexercised, violates the Sherman Act provided a power to exclude competition is coupled with a purpose or intent to do so. . . . Likewise bearing on the question whether monopoly power is created by the vertical integration, is the nature of the market to be served . . . and the leverage on the market which the particular vertical integration creates or makes possible.¹⁵⁴

The Supreme Court rejected the competitive bidding suggested by the district court as a remedy that might well harm the small theater owners it was intended to protect.¹⁵⁵ On the desirability of theater divestiture, however, the Court refused to rule and referred the matter back to the district court. On remand, the district court found that the five majors owned more than 70 percent of the first-run theaters in the ninety-two biggest cities of the country and 60 percent of these theaters in cities between 25 000 and 100 000 in population. They also received 73 percent of domestic film rentals. The Court held that these figures proved that the producers had power to make any form of competition impossible. Although there was no further proof of a

market-sharing agreement, the fact that the film producers did not each have a theater of their own in all cities and therefore relied on each other for exhibition to a considerable extent indicated a restraint of competition between them.¹⁵⁶ (This aspect of the case will be discussed in section 3 of this chapter.) The district court found that divorcement of production from exhibition was therefore the only effective remedy that would restore competition.¹⁵⁷ The ways and means of implementing this decision were laid down in consent decrees accepted by each of the producers involved.¹⁵⁸

In 1961 Paramount was enjoined from taking over drive-in theaters in two towns and operating them as first-run theaters, because this would have strengthened Paramount's market position in first-run theaters and might have eliminated a potential independent competitor and lessened existing competition. Paramount was permitted to show subsequent runs in these theaters.¹⁵⁹ However, one of the other defendants in the *Paramount* case, Loew's, was permitted to take over a drive-in, because Loew's operated only three of the twenty-three theaters in the relevant market, including the same number of first-run houses as two of its competitors, and this was its first drive-in.¹⁶⁰ And in the same year, Warner Bros. too was permitted to operate a theater again under certain conditions.¹⁶¹

The situation in the *Columbia Steel* case, which the Supreme Court decided shortly afterwards, differed from that in the cases involving the motion-picture industry. In order to satisfy heavy demand for steel during World War II, the government had built a large steel mill at Geneva, Utah, to convert pig iron into semifinished products. This plant was operated on contract by US Steel. After the end of the war, US Steel bought the Geneva plant from the War Assets Administration with the approval of the Department of Justice.

¹⁵² *US v. Crescent Amusement Co.*, 323 US 173 (1944); *US v. Griffith*, *supra* note 150; *Schine Chain Theatres, Inc. v. US*, 334 US 110 (1948).

¹⁵³ *US v. Paramount Pictures, Inc.*, 66 F. Supp. 323, 70 F. Supp. 53 (SD NY 1946).

¹⁵⁴ 334 US 131, 172-74 (1948).

¹⁵⁵ 'If each feature must go to the highest responsible bidder, . . . those with the longest purse - the exhibitor-defendants and the large circuits - would seem to stand in a preferred position. . . . If a premium is placed on purchasing power, the court-created system may be a powerful factor towards increasing the concentration of economic power in the industry rather than cleansing the competitive system of unwholesome practices.' *Id.* at 164.

¹⁵⁶ 85 F. Supp. 881, 894 (SD NY 1949).

¹⁵⁷ *Id.* at 896.

¹⁵⁸ The Paramount decree is in *CCH 1948-1949 Trade Cas.* ¶ 62 377 (SD NY 1949). The other defendants subsequently accepted consent decrees along the same lines.

¹⁵⁹ *CCH 1961 Trade Cas.* ¶ 70 182 (SD NY 1961).

¹⁶⁰ *US v. Loew's, Inc.*, *CCH 1961 Trade Cas.* ¶ 69 932 (SD NY 1961).

¹⁶¹ *US v. Warner Bros. Pictures*, *CCH 1961 Trade Cas.* ¶ 70 067 (SD NY 1961).

This expansion of capacity, which meant a considerable increase in the supply of rolled-steel products on the West Coast, might have made it difficult for US Steel to find a market for the hot-rolled and cold-rolled products coming from the Geneva plant. In order to obviate these difficulties, Columbia Steel Co., the US Steel subsidiary that operated the Geneva plant, acquired Consolidated Steel Corp. Consolidated – at the time the biggest independent fabricator left on the West Coast (though it processed only 3 percent of the rolled steel produced in the area) – had contacted some of the major steel companies with a view to selling its facilities. The government brought suit under the Sherman Act to enjoin this acquisition, arguing that it would eliminate the competition that would otherwise have taken place between US Steel and other steelmakers for Consolidated's business. The government again based its case on the view that vertical integration constituted a *per se* infringement of Sections 1 and 2 of the Sherman Act because an intent to monopolize that part of the market that had belonged to the acquired corporation could be inferred from such integration. In the case in point, therefore, the government did not need to show that the acquisition of Consolidated was actually in restraint of competition.

In its 1948 ruling in this case, the Supreme Court rejected this construction of the government's once and for all.¹⁶² According to the Court, vertical integration might be a manifestation of economically justifiable corporate expansion and could not, therefore, be regarded as a *per se* restraint of trade:

We do not construe our holding in the *Yellow Cab* case to make illegal the acquisition by United States Steel of this outlet for its rolled steel without consideration of its effect on the opportunities of other competitor producers to market their rolled steel.¹⁶³

In a 5–4 decision the Court found that since Consolidated had a share of only 3 percent of the relevant market (for rolled steel products in the eleven western states), and there were sound business reasons for integration, it was hardly possible to object to the merger.¹⁶⁴

The dissenting opinion stressed that this was a further expansion of one of the biggest American corporations and that it should be prohibited for that reason, regardless of good business motives:

Approval of this acquisition . . . makes dim the prospects that the western steel industry will be free from the control of the eastern giants. United States Steel, now that it owns the Geneva plant, has over 51 percent of the rolled steel or ingot capacity of the Pacific Coast area. This acquisition gives it unquestioned domination there and protects it against growth of the independents in that developing region. That alone is sufficient to condemn the purchase.¹⁶⁵

In the absence of monopoly power, then, the government has two options: either it must show that the merger challenged has led to monopoly, or it must adduce business practices to prove specific intent to circumvent competition. The cases against the American Telephone and Telegraph Co., against United Fruit and against International Business Machines are examples of the first possible approach, and those against the Great Atlantic and Pacific Tea Co. and against du Pont in respect of its holdings in General Motors are examples of the second.

The defendant in the *A & P* case, one of the nation's largest food chains, controlling stores and manufacturing and wholesale subsidiaries, was charged in a criminal suit with infringement of Sections 1 and 2 of the Sherman Act. Both before the district court in 1946 and before the court of appeals in 1949, *A & P* lost its case and had to pay a fine.¹⁶⁶ The government later brought a civil suit in order to obtain equity relief, petitioning for the complete vertical and horizontal dissolution of the holding company. In 1954 this action was settled by a consent decree under which the Atlantic Commission Co. (ACCO) – the biggest of its wholesale subsidiaries, which had the dual function of a buying organization for *A & P* and a broker in transactions with the rest of the trade – was to be divorced from the group. A number of trade practices were prohibited too, but these do not concern us here.

In its complaint the government attacked *A & P*'s buying and selling policies and its integrated structure. The Antitrust Division's lawyers asserted that *A & P* sold at lower prices only where it was exposed to competition and that it exploited its buying power in insisting on lower prices than those available to its competitors. The part of the complaint most relevant to this chapter – concerning the integrated structure of the company – alleged a conspiracy to monopolize: the authorities charged that the internal profits made by *A & P*'s factories and ACCO were used to keep down retail prices in *A & P* stores. The company argued, not unjustifiably, that for an integrated concern these 'profits' are simply an accounting check on whether the divisions concerned are operating efficiently. If these divisions become a burden on the company, or if the management thinks it can invest its capital more profitably elsewhere,

¹⁶² *US v. Columbia Steel Co.*, 334 US 495 (1948), affirming 74 F. Supp. 671 (D. Del. 1947).

¹⁶³ 334 US at 521–22.

¹⁶⁴ *Id.* at 527–33.

¹⁶⁵ *Id.* at 540. Justice William O. Douglas, who wrote the dissenting opinion, concluded: 'The least I can say is that a company that has that tremendous leverage on our economy is big enough.' *Ibid.*

¹⁶⁶ *US v. New York Great A & P Tea Co.*, 67 F. Supp. 626 (ED Ill. 1946), *aff'd*, 173 F. 2d 79 (7th Cir. 1949). The Robinson–Patman Act issues in this case will not be discussed here.

it will get rid of them. Moreover, integration into production is of particular importance for a company like A & P. Distribution costs in the food business often make up a disproportionate share of the retail price. This factor enables integrated chains such as A & P to reduce costs extensively, and if competition is effective the savings will be passed on to the consumer. However, on this most relevant aspect the government brief was silent. Consequently, the attitude of the government again amounted to a prohibition of integration.¹⁶⁷

The circuit court's reasoning in its ruling on this case was confused. Hardly any attention was given to determining the real influence of A & P on the food market in the United States; it was simply noted that the company occupied a position of appreciable power. A & P's integration into the wholesale business through ACCO was unacceptable to the circuit court (as it had been to the district court too). It objected to ACCO's adding its wholesaler's margin to its cost price in selling to competing distributors, since this 'increased the price to A & P's competitors, and the brokerage went into A & P's coffers to increase its competitive advantage.'¹⁶⁸ Then the court found particular fault with ACCO's purchasing policy. In the first place, ACCO could always buy where prices were lowest and quality was best, partly because of its excellent sources of information. Secondly, A & P tried to buy at lower prices than its nonintegrated competitors because in its wholesale business it took over a number of functions from its suppliers of fruit and vegetables. For instance, the latter did not need to keep goods in their own cold stores until they had found a customer: ACCO took this job over from them but expected to be paid in the form of brokerage. Although this was prohibited by the Robinson-Patman Act, brokerage was practically always paid.¹⁶⁹ However, this could scarcely be termed price discrimination, which was what the government alleged. Moreover, ACCO's suppliers were not tied: the company's overall share of the market was slight, and nowhere did it have a dominant position. Furthermore, there was no evidence that ACCO had ever abused its alleged power,¹⁷⁰ as the district court had already conceded.¹⁷¹ Thirdly, the court termed A & P's manufacturing units

satellites of the A & P system. Their products were sold only to A & P stores and were invoiced at a markup above the cost of production. These corporations were tools in the hands of A & P, used and useful in maintaining the two-price level to enable it to maintain its position of dominance in the retail food business.¹⁷²

A final instance of A & P's conduct that the circuit court regarded as a use of strategic advantages designed to assist in an attempt to monopolize and in monopolization was the fact that a number of A & P stores were enabled to sell at a loss. In local price wars heavy net losses were tolerated 'for periods

extending over a substantial number of consecutive years.¹⁷³

The rulings in this case diverge sharply from the standpoint adopted by the Supreme Court in previous suits against vertical integration. If a prohibition of trade practices such as those of which A & P was accused is unavoidable under the Robinson-Patman Act, it seems harsh, to say the least, under the Sherman Act. And there was no clear evidence to back up the assertion that A & P tried to obtain a monopoly in the food-distribution business by means of the illegal practices alleged: over the years its share of the market had risen only insignificantly. It was mainly among the chain stores that active competition developed in the food trade in the United States, though in many cases this did provoke the disappearance of small businesses that were unable to compete against the efficient chains. This last development give rise to all kinds of countermeasure in an attempt to convince both state and federal legislatures – under the pretext of securing fair competition – of the need to check competition from these big chains. A typical example of this kind of legislation is the Robinson-Patman Act of 1936, part of which constitutes an amendment to the Clayton Act.

In 1957 the Supreme Court handed down an important ruling in the *du Pont* (General Motors) case.¹⁷⁴ The Antitrust Division had filed suit in 1949, alleging that du Pont's acquisition of General Motors stock forty years before had been intended to provide du Pont with a preferred market for its auto-

¹⁶⁷ M. A. Adelman, 'The Economic Consequences of Some Recent Antitrust Cases – the A & P Case', 39 *Am. Econ. Rev.* 280 (1949, Proceedings), bitterly concludes: 'The only way to be both integrated and legal is to be not only inefficient but completely inefficient.' See also M. A. Adelman, *A & P – A Study in Price-Cost Behavior and Public Policy* 339–40, 346 (Cambridge, Mass.: Harvard UP, 1959); Clair Wilcox, *Public Policies Toward Business* 376–77 (Homewood, Ill.: Irwin, rev. ed. 1960). The government's case is defended by Joel B. Dirlam and Alfred E. Kahn in *Fair Competition* (Ithaca, NY: Cornell UP, 1954) and in a number of articles, including 'Antitrust Law and the Big Buyer: Another Look at the A & P Case', 60 *J. Pol. Econ.* 118 (1952), and 'Integration and Dissolution of the A & P Company', 29 *Ind. LJ* 1 (1953). The standpoint of these two writers, who criticize Adelman's findings, is not discussed here.

¹⁶⁸ 173 F. 2d at 85.

¹⁶⁹ In an earlier case involving A & P the courts had held that 'the ban on brokerage in § 2(c) of the Clayton Act (as amended by the Robinson-Patman Act) applied even where services rendered by a chain reduced a supplier's costs. *Great A & P Tea Co. v. FTC*, 106 F. 2d 667 (3d Cir. 1939), *cert. denied*, 308 US 625 (1940).

¹⁷⁰ See Adelman, *op. cit. supra* note 167, at 322–24; Wilcox, *op. cit. supra* note 167, at 377. But see Dirlam and Kahn, *op. cit. supra* note 167, at 166–69.

¹⁷¹ 67 F. Supp. at 659.

¹⁷² 173 F. 2d at 86.

¹⁷³ *Id.* at 88.

¹⁷⁴ *US v. E. I. du Pont de Nemours & Co.*, 353 US 586 (1957).

motive finishes and fabrics. According to the government, this integration was in conflict with the Sherman Act and with Section 7 of the Clayton Act. In a 4-2 decision the Supreme Court upheld the government, ruling that infringement of the Clayton Act had been shown. Du Pont was required to divest itself of its holdings in GM. We shall come back to this decision in greater detail when we discuss the case law under Section 7 of the Clayton Act in the next chapter.

A number of recent suits brought by the Department of Justice against vertically integrated concerns holding monopolistic positions on their respective markets terminated in consent decrees. One of the first of these was the case against the giant of the American telephone system, the American Telephone and Telegraph Co. In 1949 the government accused AT&T of monopolizing the market for telephone apparatus and equipment through its subsidiary, Western Electric, in violation of Section 2 of the Sherman Act. In its complaint the Antitrust Division asked the district court to divorce Western Electric from AT&T and to split it into three separate firms.¹⁷⁵ It also petitioned that AT&T be compelled to grant licenses to competitors under its patents, at reasonable royalties. Lastly, the price of telephone equipment should be established on the basis of real competition. The consent decree accepted in 1956 fell far short of the government's demands.¹⁷⁶ The parent/subsidiary link with Western Electric was allowed to stand. But the competitors of Western Electric were given access to AT&T patents, and Western Electric was forbidden to compete with them on that part of the market not yet controlled by AT&T. Most of the market, however, was retained by Western, thanks to its relationship with AT&T. The only tangible result, according to Wilcox, was a reduction of the prices that Western Electric charged associated Bell companies.¹⁷⁷

In sharp contrast with this decree stands one of the most far-reaching dissolution orders ever issued in a consent settlement – that in the *United Fruit* case. In 1954 the Department of Justice filed suit under the Wilson Tariff Act and Sections 1 and 2 of the Sherman Act against the United Fruit Co., a fully integrated concern engaged in growing, purchasing, transporting, processing, distributing and selling bananas in Latin America and in the United States. The government held that United had restrained and monopolized various stages of interstate and foreign trade in bananas. The company owed its dominance in the trade to the fact that it owned most of the plantations in Latin America, had a majority interest in International Railways of Central America, operated a fleet of ships, and controlled the entire banana business in the United States. In order to avoid lengthy litigation, which it would probably have lost in any case, United accepted a consent decree in 1958.¹⁷⁸

Its most important provisions can be summarized as follows: first, United had to confine its activities in the United States to importing bananas and had to liquidate its American sales organization; second, United was enjoined from concluding exclusive-dealing agreements with its customers and from compelling banana growers to deliver their entire harvest to United over a period exceeding five years; third, United had to divest itself of all its holdings in International Railways of Central America and was prohibited from acquiring any of its stock in the future. The fourth and most far-reaching requirement was that United should create, out of its own assets, a new and completely independent firm capable of importing into the United States approximately nine million stems of bananas a year. This totals about one third of United's imports in 1958. United's proposed plan for compliance, including the formation of a new company and divestiture of certain assets, received court approval in July 1967. United (now Standard Brands Co.) entered into an agreement with Del Monte for sale of United's specified properties in Guatemala subject to the approval of the court and the Guatemalan Government; and this was approved by the court in November 1972.

The last consent decree we need mention is that negotiated in 1963 in the *International Business Machines Corp.* case. Here, the biggest American manufacturer of electronic data-processing machines, IBM, agreed with the Department of Justice to divest itself of its capacity for the manufacture of tabulating cards in excess of 50 percent of total American capacity. If after 31 December 1967 IBM should again own more than 50 percent of total capacity in the United States, this excess capacity would again have to be split off.¹⁷⁹

4.2.5 Summary of the Law on Monopolies

The Rule of Reason. Nonancillary restraints of trade had already been subject to severe treatment at common law. After the enactment of the Sherman Act, the courts held that *any* agreement between competitors for the purpose

¹⁷⁵ *US v. Western Elec. Co.*, Civil No. 17-49, D. NJ, *Complaint*, 14 Jan. 1949.

¹⁷⁶ According to the Assistant Attorney General, Antitrust Division, in Hearings before Subcommittee No. 5 of the Select House Committee on Small Business, *Distribution Problems*, Pt. 5: 'Antitrust Consent Decrees, A Case Study - The AT&T Consent Decree', 84th Cong., 2d Sess. 6 (1956).

¹⁷⁷ *Op. cit. supra* note 167, at 641.

¹⁷⁸ *US v. United Fruit Co.*, CCH 1958 *Trade Cas.* ¶ 68 941 (ED La. 1958).

¹⁷⁹ *US v. International Business Machs. Corp.*, CCH 1963 *Trade Cas.* ¶ 70 628 (SD NY 1963). In an earlier consent decree IBM had been ordered to train competitors' technicians in the repair and maintenance of IBM machines. CCH 1956 *Trade Cas.* ¶ 68 245 (SD NY 1956).

of regulating or restricting competition should be prohibited *per se* because Section 1 of the Act said as much in so many words. After 1911, with the introduction of the rule of reason into the law, a correct distinction was made between agreements whose main purpose was to restrict competition and agreements in which this was not – or not directly – intended (such as combinations formed by merger). For the latter, the courts have to adopt a case-by-case approach, weighing all the relevant criteria before passing on the reasonableness of any restraint of competition they may cause, but it is not considered necessary to test agreements of the first type by the rule of reason: these are prohibited *per se* as being unreasonable *per se*. Since agreements of this kind are held to conflict with the principle of free competition which is at the root of the law, they are also considered *a priori* to lead to bad performance. Trade associations whose purpose is to provide their members with general information on policy matters have not come under this prohibition, since they are not designed to restrict competition and since any restraint of trade that *is* involved has not been considered unreasonable by the government or the courts.

The Law on Trusts. Combinations formed by merger have been subjected to a case-by-case approach to the reasonableness of the restraint of trade embodied in them, the commonest view of a merger being that since the corporations involved lose their economic independence there must be compelling reasons for them to take such a step other than the restraint of competition alone. That the trusts unreasonably restrained competition was abundantly clear from the evidence, which showed that they had done everything in their power to drive competitors out of their markets (and had succeeded in their attempts).¹⁸⁰ In the course of time, however, the law on combinations formed by merger developed to a point at which mergers that were so all-embracing that only a few independent competitors of the merged corporations remained (i.e. mergers that created a monopoly or near-monopoly situation) were held to be in unreasonable restraint of trade *per se* (and thus in conflict with Section 2 of the Sherman Act) without any showing of abusive practices when the combination was being formed or thereafter. To this extent the disparity between the law on combinations and that on agreements has been reduced.

Where there is still a certain amount of competition left after the merger, it is much more difficult for the government to prove violation of the Sherman Act as the courts have taken considerably greater pains under the rule of reason to analyze the market behavior of the firm involved. Here too, the tests under the rule of reason have become more sophisticated, though they always concentrate on the opportunities left to the remaining competitors.

The Law on Monopolies. The legislative history of the Sherman Act does not help in determining congressional intent in respect of monopolies that were not the product of trusts but had grown through internal expansion and whose conduct was less typically predatory. This should not surprise us, given the state of knowledge at the time about the implications of the phenomenon of market power. The standards of proof in the case law on such monopolies differ from those applied in the law on the trusts. In the first place, more attention has been given to evaluating the firm's position on the market (and therefore also to determining the relevant market). In the second place, the interpretation of intent for a showing of monopolization has evolved too. These developments are related to the fact that the early antitrust cases had been directed chiefly against the predatory tactics of the trusts, in which charges under Section 1 were to the fore, while the Sherman Act suits brought after 1945 were mainly brought under Section 2.

To show that a company has violated Section 2, it must first be proved that the firm has or is trying to establish a monopoly through an exact delimitation of its position on the relevant market. In the actions brought against the early trusts, scarcely any attention was paid to this point. Not only were the activities of the trusts on an industrywide scale, but there was also such clear evidence of predatory practices against their competitors which had resulted in their elimination and had therefore been used *ipso facto* to reinforce or to maintain and exploit the power deriving from the formation of the trusts that this proved both power and intent. Although in later cases, especially those decided since 1945, more consideration has been given to establishing whether a monopoly is in fact present, the evidence put forward by the parties and the courts' findings have often still been only rudimentary from the economic angle. In the *Alcoa* and *Paramount Pictures* rulings, for instance, no account was taken of obvious substitute goods. It was not until the *Times Picayune* decision in 1953 that the Supreme Court considered substitutes that were not physically identical with the product sold by the defendant. In *Cellophane* and *Columbia Steel* the Supreme Court went a step further by defining the relevant market so as to include goods that could be regarded as competitive alternatives for buyers, in terms of their technical characteristics and conditions of sale.¹⁸¹ Since the Supreme Court and lower courts have adopted the same approach again in a number of recent rulings under the Sherman

¹⁸⁰ See George W. Stocking, 'The Rule of Reason, Workable Competition and Monopoly', 64 *Yale LJ* 1107 (1955).

¹⁸¹ See Donald F. Turner, 'Antitrust Policy and the Cellophane Case', 70 *Harv. L. Rev.* 281 (1956); Milton Handler and Stanley D. Robinson, 'A Decade of Administration of the Celler-Kefauver Antimerger Act', 61 *Colum. L. Rev.* 629 (1961).

Act, we may assume that this is now the accepted doctrine. There has also been some development in the way the courts have determined the defendant's position on the relevant market. The rulings in *Alcoa* and certain later Section 2 cases considered market share the only criterion for defining a monopoly position – and hence the only criterion for determining whether a firm has the power to control prices or to exclude competition, which is how the Supreme Court defined monopoly in *American Tobacco* – but more recent decisions have revealed a more sophisticated attitude toward the value of market shares. In *Columbia Steel*, for instance, the Supreme Court observed that 'the relative effect of percentage command of a market varies with the setting in which that factor is placed.'¹⁸² And in cases where the defendant's market share alone was not enough to warrant the conclusion that defendant occupied a monopoly position, other structural indicia were also considered.

The interpretation of the second and most important element in the concept of monopolizing – intent – has also evolved. Before 1945 the courts had to deal almost exclusively with companies' control and liquidation of competitors, the use of predatory and unfair competitive practices. With the decline in importance of the trusts – the main perpetrators of these abuses – the courts were confronted by other forms of market behavior that constituted less obvious proof of intent and were in fact sometimes lawful in themselves. In these cases the courts made the question whether intent had been shown dependent on whether the acquisition, maintenance or use of monopoly power was a result of these practices or of economic circumstances 'thrust upon' the monopolist. To qualify for exemption, a corporation must show that its dominance is a consequence of certain natural or economic laws, the superiority of its products or the efficiency of its production apparatus, or that it is justified for reasons of national defense. However, corporations will not find it easy to convince the courts by this means of the need for monopoly. This can be seen from the courts' refusal to exempt *Alcoa*, a most progressive and essential corporation, and from the warning issued by Judge Wyzanski, in his *Grinnell* ruling, to the effect that monopoly due to these immunizing factors 'is the highly exceptional case, a *rara avis* more often found in academic groves than in the thickets of business . . .'¹⁸³ If the court considers that certain of a monopolist's acts point to an attempt to maintain a monopoly position once gained, closer investigation of the economic background to its position may well become superfluous. A classical example of this was finding intent in *any* action that was not inevitable in the conduct of an efficient business, which was Judge Hand's view of *Alcoa*'s policy of keeping ahead of competition by promoting new applications for aluminum and at the same time keeping enough capacity in reserve to meet the expected increase in demand.

This would have been considered a lawful practice by a firm that did not enjoy a dominant position, but the weight of Alcoa's position made it an act of monopolization. In essence, then, this construction of the Sherman Act comes close to a *per se* condemnation of monopoly.

As far as charges of attempting to monopolize are concerned, the courts have upheld them only where there was a reasonable indication that the attempt might succeed, as is clear from the Supreme Court's definition of this concept:

the employment of . . . practices which would, if successful, accomplish monopolization, and which, though falling short, nevertheless approach so close as to create a dangerous probability of it. . . .¹⁸⁴

However, proof of specific intent is a necessary element in a charge of attempting to monopolize, so the enforcement agencies have frequently brought actions under other sections of the antitrust laws under which it is not so difficult to produce evidence.

Application of the Sherman Act has been along the same lines, as a general rule, in cases of both horizontal and vertical combination. The idea that integration is unreasonable *per se*, on the theory that two plants belonging to the same firm and operating at consecutive stages of the production process monopolize each other's market by ordering exclusively from each other, has been rejected by the courts. The essential question before the courts has been whether integration unreasonably restricts nonintegrated competitors in their freedom of action, i.e. whether smaller businesses are still able to enter the market. This concern for small business is to be found elsewhere in the case law, but it is particularly evident in integration cases. The applicability of the Sherman Act to the impact of integrating firms on competitors is studied chiefly in the light of the degree of integration of the latter and the extent of the dominance enjoyed by the former on the relevant market. In keeping with its attitude to horizontal combinations challenged under the Sherman Act, the Supreme Court has judged integration to be in conflict with the Act whenever the integrating company already had a dominant position at one of the stages of production and integration provided a means whereby the firm concerned could retain or strengthen its position at other stages. Proof of intent to monopolize has generally been presented in the form of evidence

¹⁸² *US v. Columbia Steel Co.*, 334 US 495, 528 (1948).

¹⁸³ *US v. Grinnell Corp.*, CCH 1964 Trade Cas. ¶ 71 298, at 80 246 (D. RI 1964).

¹⁸⁴ *American Tobacco Co. v. US*, 328 US 781, 785 (1946).

that the conduct of the integrated firm has had injurious effects on its competitors – preventing them from obtaining raw materials essential to their production process, for instance, or causing them to lose markets for their products. The same holds good for companies jointly exercising dominance on a market. On the other hand, integration by firms exercising no dominance in their markets – and for which valid reasons of business economics or market strategy could be adduced – have not been regarded as conflicting with the law (as in the *Columbia Steel* ruling, for instance).

Both in cases involving complete or near monopolies and in cases where an attempt to monopolize was charged, market behavior has been judged almost wholly in respect of its impact on existing competitors; a firm's relations with other market participants and aspects of its performance have played little or no part in the courts' considerations. Repeatedly, the courts have refused to regard profit data submitted by either government or defendants as relevant to a charge of monopolization. Though this attitude derives to some extent – at least in the more recent cases – from the absence of sufficient profit information, it is basically due to the courts' general view that the main purpose of the law is to ensure the maintenance of viable competitors. Satisfactory market performance, then, is considered a relevant factor only to the extent to which it is affected by the presence or absence of a suitably competitive environment.

Remedies. The consequence of this basic approach is that American antitrust law is chiefly oriented toward restoring the structural conditions of competition as they had existed prior to the attainment of monopoly. This can be done either directly by eliminating monopolistic market structures or indirectly by prohibiting the exclusionary behavior on which the creation or maintenance of monopoly power is based. Remedies under the Sherman Act do not deal with aspects of performance such as prices or output, even where extensive regulation of such types of business behavior would be feasible and even an appropriate remedy. This stands in sharp contrast to what is normal in competition policies in respect of dominant firms in the European Community, to which we shall return in more detail in Chapter 7.

The dissolution of a firm is without doubt the most sweeping of the remedies that can be applied. Justice Douglas, writing for a unanimous Court in the *Schine* case, stated:

If all that was done was to forbid a repetition of the illegal conduct, those who had unlawfully built their empires could preserve them intact. They could retain the full dividends of their monopolistic practices and profit from the unlawful restraints of trade which they had inflicted on competitors. Such a course

would make enforcement of the Act a futile thing unless perchance the United States moved in at the incipient stages of the unlawful project. For these reasons divestiture or dissolution is an essential feature of these decrees....

Divestiture or dissolution ... serves several functions: (1) It puts an end to the combination or conspiracy when that is itself the violation. (2) It deprives the antitrust defendants of the benefits of their conspiracy. (3) It is designed to break up or render impotent the monopoly power which violates the Act.¹⁸⁵

In a number of cases of infringement of the Act by a dominant firm, where healthy competition could not be restored by any other means, and where this was an economically feasible solution, the courts have decreed dissolution. While several of these cases involved horizontal trusts, most of them concerned vertically integrated firms that had not been constituted for economic motives but were designed solely to extend dominance to other markets. The courts were brought to this view almost automatically where an integrated concern was dominant on one of its markets. But where a dominant firm achieved this position mainly as a result of internal growth, the courts were much less inclined to order dissolution – as can be seen from the *Alcoa* and *United Shoe Machinery* cases. Even though *Alcoa* and *United* were monopolists, the courts ruled out the idea of dissolution. The reasons for this are set out in Judge Wyzanski's *United Shoe Machinery* ruling. Since his view has generally been accepted by the Supreme Court as well in cases under Section 2 of the Sherman Act, we reproduce the following extract from this ruling:

Judges in prescribing remedies have known their own limitations. They do not *ex officio* have economic or political training. Their prophecies as to the economic future are not guided by unusually subtle judgment....

That considerations of this type have always affected antitrust courts is plain from the history of the *Standard Oil*, *American Tobacco* and *Alcoa* cases. To many champions of the antitrust laws these cases indicate judicial timidity, economic innocence, lack of conviction, or paralysis of resolution. Yet there is another way of interpreting this judicial history. In the antitrust field the courts have been accorded, by common consent, an authority they have in no other branch of enacted law. Indeed, the only comparable examples of the power of judges is the economic role they formerly exercised under the Fourteenth Amendment, and the role they now exercise in the area of civil liberties. They would not have been given, or allowed to keep, such authority in the antitrust field, and they would not so freely have altered from time to time the

¹⁸⁵ *Schine Chain Theatres, Inc. v. US*, 334 US 110, 128–29 (1948).

interpretation of its substantive provisions, if courts were in the habit of proceeding with the surgical ruthlessness that might commend itself to those seeking absolute assurance that there will be workable competition, and to those aiming at immediate realization of the social, political, and economic advantages of dispersal of power.¹⁸⁶

Other reasons why dissolution was not ordered in a number of instances were technical and/or economic in nature. These were advanced when it was a case of splitting up an efficient organization without there being any certainty that the smaller units replacing it would do well or when economic policy targets or public policy in general were incompatible with such a remedy. The courts then resorted simply to the prohibition of exclusionary conduct. This is presumably why the government in recent cases against large firms has sought moderate consent settlements instead of pursuing the matter before the courts.

Apart from these proceedings in equity under Section 4 of the Sherman Act, the Attorney General also has power to institute criminal proceedings, which means that any company convicted of violating the statute may be fined and its officers imprisoned. These criminal penalties have been imposed only very rarely in cases of monopoly, but they have often been imposed in cases of restrictive agreements and forms of conspiracy in oligopolies (in the *American Tobacco* ruling of 1946, for instance).

4.2.6 A Critique of the Case Law

If the present state of economic knowledge as to the determination and evaluation of a firm's position on the market is compared with the criteria put forward by the courts under the Sherman Act in judging the products of merger movements in the United States, a number of observations come to mind. These concern the basic approach adopted by the courts toward the concentration phenomenon as such and the evaluation of the situation in particular cases. Our comments on the basic approach all flow from the realization that the link automatically assumed by the courts between the protection of a defendant firm's competitors and market performance does not in fact exist or is very tenuous.¹⁸⁷

One of the main consequences of this assumption has been a stringent *per se* prohibition of agreements between competitors whose sole purpose was to restrict competition, irrespective of whatever positive contribution such agreements might make to economic performance. Thus, such agreements in the form of cooperation between smaller firms, for instance in the field of research and development and marketing, but also where adjustment of capacity in capital-intensive industries during a recession is necessary, have been considered illegal *per se*.

The other main consequence has been that deliberateness in attaining or preserving a monopoly under Section 2 and the unreasonableness of restraints of trade under Section 1 have been shown almost solely by exclusionary practices against competitors or potential competitors, and these elements have played a significant part in showing the existence of monopoly as well. Such an approach can be criticized on a number of different counts, however. First, the approach is beset with difficulties – primarily because it will generally be very hard to prove abusive conduct of this sort under present-day circumstances. For a dominant firm will generally take good care not to attract attention to itself by employing such practices – not only because this would increase its market share and risk bringing it within the courts' definition of 'monopoly' but also because it will have every interest in keeping marginal competitors alive: by so doing, it will be acting in accordance with the protective notions of the social philosophy in which the Sherman Act has its origin.

A second objection is that the protection of a firm's remaining competitors at best prevents the firm from grossly abusing its dominance: it gives us no guarantee that performance will be satisfactory, because competitors will anyhow refrain from cutting prices or marketing new products for fear of reprisals from the monopolist. A typical example of this state of affairs can be seen in the *US Steel* case. The need to show exclusionary tactics in order to obtain conviction under the Sherman Act, however, has also resulted in the notion of exclusion being construed more and more broadly, and the danger there is that types of standard business behavior will become targets of antitrust attack, which has its economic drawbacks. Proceeding in this fashion can only be defended if a *per se* prohibition of dominant market power is what we are aiming at. But if this is not the case – and it is not under American anti-trust law – then the courts' acceptance of the government's charges in most of the Sherman Act cases since 1945 means that they are subscribing to an

¹⁸⁶ *US v. United Shoe Mach. Corp.*, 110 F. Supp. 295, 346–51 (D. Mass. 1953). The opinion expressed by Senator Philip A. Hart in hearings before the Joint Economic Committee on 21 Sept. 1971, to the effect that antitrust enforcement is so difficult and politically sensitive that 'probably no Attorney General will apply them vigorously to established concentration without a new congressional mandate' and that 'the laws provide a leash that we are willing to attach to puppies but are hesitant to apply to mastiffs,' does not take this view sufficiently into account. See also the discussion on this point in Chapter 7 *infra*.

¹⁸⁷ This limitation of the concept of monopolization to the relations between competitors is typically a lawyer's approach to competition. See A. G. Papandreou, 'Market Structure and Monopoly Power', 39 *Am. Econ. Rev.* 883 (1949); Edward S. Mason, *Economic Concentration and the Monopoly Problem* Ch. 15: 'Monopoly in Law and Economics' 332–50 (Cambridge, Mass.: Harvard UP, 1959).

appreciable limitation of the conduct of large firms and in fact ordering them to behave no more dynamically than less efficient competitors. This approach, implicit in *Alcoa* and *A & P*, was adopted explicitly by the Supreme Court a number of years later when it enjoined Swift and other meat packers from carrying through an economically sound vertical expansion. In the *Swift* case in particular, it is difficult to find anything to commend this line of reasoning, because it was used in this important industry to bar firms that were not dominant from cutting down on costs through integration: it was said that less efficient competitors would lose ground.

A third objection to the courts' concentration on exclusionary practices is that this is inadequate: despite vigorous enforcement a number of anti-competitive situations may be allowed to persist. This is particularly evident as regards the showing of intent. By the completely one-sided emphasis they placed on exclusionary behavior, the courts quite overlooked other restraints of competition arising from market power in a number of important cases before 1945. If proof of exclusionary behavior was not forthcoming, no further inquiry was made into any of the other practices by which competition might be affected. This is where the *US Steel*, *International Harvester* and *American Can* rulings fall short from the economic standpoint. In all three cases there was abundant evidence that competition was being impaired as a result of the enormous power of the corporations involved. An economically correct interpretation of the concept of monopolization or of unreasonable restraint of trade will also have to embrace acts other than those which are directly injurious to the interests of competitors and are characteristic of the behavior of a dominant firm – including cases of unsatisfactory market performance.¹⁸⁸

The approach adopted by the courts also resulted in too literal and therefore far too narrow an interpretation being put on the concept of 'monopoly.' The Supreme Court's definition – power to fix prices or to exclude competition – is vague and incomplete. If it is literally construed, it includes all forms of behavior on concentrated markets, even that of a firm whose share of the market depends on its sales of a given brand. For loyal purchasers of its brand, such a firm is in effect the only seller. If the Court's definition is interpreted less stringently, then it provides no standard at all. In fact, both before and after 1945 the courts regarded large market shares or exclusionary tactics (or both) as the only signs of 'monopoly.' According to what we said in Chapter 3, market shares taken alone are utterly inadequate as a means of detecting market power, except in extreme cases.¹⁸⁹ In their approach to the problems created by concentrated market structures, then, the courts have put a construction on the Sherman Act which fails to make the most of the opportunities offered by the statute. It is possible, nonetheless, that the Act has

had some prophylactic effect on concentration, especially through those cases in which far-reaching remedies were applied. Not until we know whether this is in fact so can we judge whether the criticism that has been leveled against the Sherman Act and its interpretation warrants a plea for extension of the concept of monopolization. This is a matter we shall be dealing with in Part 3 of this study.

The content given to the notion of monopoly is not the only weak point in the analysis of competition in the case law. Generally, the determination of the relevant market also has been but marginally considered. Definition of the relevant market – the market on which inquiry into compliance with the law is concentrated and on which the showing of market power hinges¹⁹⁰ – is of major importance in Sherman Act cases, however, because the penalty for infringement may be dissolution. Where the purpose of enforcement is merely to enjoin certain practices of dominant firms rather than to dissolve the firms themselves, a much simpler market analysis may be defended. In such cases what has to be defined is the group of market participants who are affected by the practices in question, not the geographic market on which the dominant firm is normally operating.

In most pre-1945 cases market analysis was not given due prominence. If a firm had abused its power over other firms in respect of a certain product or group of products, this was considered proof of monopoly, and consequently there was no need to be concerned about market delimitation. The result of this *modus operandi* was that in some cases the relevant market turned out too small – in *Alcoa* and *Yellow Cab*, for instance. On the other hand, it must not be overlooked that in the early trust cases the trusts monopolized whole sectors of economic activity, so that there really was no need for extensive market analysis. However, market delimitation was given more attention in suits brought against corporations that had expanded through

¹⁸⁸ The reader is referred to Chapter 3 *supra* for a discussion of the various kinds of unjustifiable market behavior by dominant firms.

¹⁸⁹ Mason, *op. cit. supra* note 187, at 333–46, speaks of an ‘antiquated and inadequate conception of the monopoly problem’. See also Mason, *Preface* to Carl Kaysen and Donald F. Turner, *Antitrust Policy* xiii–xiv (Cambridge, Mass.: Harvard UP, 1959); Adelman, *A & P*, *op. cit. supra* note 167, at 422; Eugene V. Rostow, ‘Monopoly under the Sherman Act – Power or Purpose?’, 43 *Ill. L. Rev.* 745 (1949), and ‘The New Sherman Act, A Positive Instrument of Progress’, 14 *U. Chi. L. Rev.* 567 (1947); William L. McGovern, ‘The Power and the Glory, the du Pont – General Motors Decision’, 46 *Geo. LJ* 655 (1958).

¹⁹⁰ See *Att’y Gen. Nat’l Comm. Antitrust Rep.* 44 (Washington, DC: Government Printing Office, 1955); Note, ‘The Market, A Concept in Antitrust’, 54 *Colum. L. Rev.* 580 (1954); Eberhard Günther, *Relevanter Markt im Recht der Wettbewerbsbeschränkungen* (Karlsruhe: Müller, 1960).

internal growth. The point of departure for the new way of thinking in anti-trust law in this connection is the definition of the market in the *Cellophane* case of 1956. In theory, the reasonable-interchangeability standard adopted by the Supreme Court in this case is in order; in practice, however, the determination of what is a meaningful competitive alternative for a given product presents very great difficulties, for it is not technical substitutability that is the determining factor but substitutability in the eyes of the actual consumer. And in *Cellophane* the Supreme Court did not really go into this matter so deeply, which is why the standard must be applied with caution. In the first place, it takes no account of how production costs compare between the various substitute products. If a manufacturer has a product that costs much less to produce than the figure at which substitute products are sold, he can either charge high prices, making a large profit and contenting himself with a smaller share of the market, or he can increase his share of the market considerably by accepting lower profits. If he takes the second option, his product remains technically interchangeable with more expensive goods, but the difference in price will cause the consumer to reject many of the latter as substitute products. This brings a latent monopoly position into the open.¹⁹¹ In the second place, for market determination in Sherman Act cases it is not enough to establish whether certain purchasers regard two products as interchangeable; the point is whether purchasers of a large enough quantity of each of the two products regard them as substitutable. What the Supreme Court overlooked in the *Cellophane* case was that for a great number of du Pont's customers cellophane was not replaceable and that cellophane hardly compared with competing products in price. In other words, the Supreme Court relied too much on the abstract concept of substitutability and too little on the actual willingness of purchasers to change over, and this is what really matters in determining the relevant market in an antitrust case.

The courts did, however, embark upon satisfactory analysis in order to establish whether a 'monopoly,' once found to exist, could not be exculpated on grounds of economic or other circumstances. In the two *Alcoa* rulings and, even more, the *United Shoe* decision of 1953, the problem whether there were permissible limits to a 'monopoly' position was recognized and approached in an economically acceptable manner, though no detailed consideration was given to the applicability of these criteria to the cases in question.

One of the most difficult problems confronting the courts in antitrust cases is the formulation of appropriate remedies. In a civil suit the choice lies between enjoining specific practices and the much more radical step of partial or complete dissolution. The prohibition of specific business practices whose

sole purpose is to give a company an unwarranted advantage over its competitors (or gradually to starve them out) or to heighten artificially the barrier of entry to certain markets, but which are not essential to the attainment of satisfactory market performance, is an act to be applauded, because competitors and potential competitors are perhaps given a chance thereby. It becomes more difficult to judge when we consider practices that would generally be regarded as normal business conduct but have an exclusionary effect on small competitors when employed by big companies. Whereas the prohibition of United Shoe's practice of obliging customers to lease its machines, which benefited shoe manufacturers but hampered United's competitors in finding outlets, may be considered proper because of the distorting effect of this practice on competition, the prohibition of fair though hard competition (such as A & P's insistence on broker's discounts or Alcoa's construction of enough reserve capacity to meet future increases in demand immediately) is a dubious remedy from the economic viewpoint. Though in these last two cases smaller companies were put at a disadvantage, the behavior condemned demonstrably had a beneficial impact on market performance. It depends on the standpoint of the observer whether he puts advantages for the customer higher than disadvantages for competitors or vice versa. The choice between the two will also depend on whether dominant firms are involved. To this extent, the *Alcoa* and *United Shoe* rulings are more defensible than the *A & P* ruling. For in the first two we can assume that putting a brake on the expansion of a dominant firm may benefit smaller dynamic competitors that had had no chance of expanding because the big companies controlled all outlets. But where a company does not occupy a dominant position – as in the case of A & P – and where there is also keen competition, limiting the expansion of such a firm may involve the danger of reducing efficiency, and the consumer will eventually have to pay for this in higher prices.¹⁹² The fact that protection of weaker competitors impairs the quality of market performance resulting from hard competition has been recognized far too infrequently by the courts.

¹⁹¹ See George W. Stocking and Willard F. Mueller, 'The Cellophane Case and the New Competition', 45 *Am. Econ. Rev.* 29 (1954), and Judge Hand's ruling in *US v. Corn Prods. Ref. Co.*, 234 Fed. 964, 975–77 (SD NY 1916) (case discussed in subsection 2.2 of this chapter). See also Walter Adams, 'The "Rule of Reason": Workable Competition or Workable Monopoly?', 63 *Yale LJ* 348 (1954); *US v. E. I. du Pont de Nemours & Co.*, 351 US 377, 425 (1956).

¹⁹² Adelman, *op. cit. supra* note 167, at 411, remarks: 'Thus the slogans about "power" and "strategic advantage" and "unfair competition" can be again analyzed . . . either as economies of size-plus-integration or as monopoly power. If monopoly power is in fact absent, then the protest is against more economic ways of doing business; and the slogans are merely a way of hiding that fact.'

The dissolution remedy raises quite unique problems. The courts' power to order dissolution constitutes the most spectacular aspect of the American antitrust laws. As we have said, it is striking how hesitant the courts have been to use their power to date. Two factors have been decisive: the substantial economic and political problems involved in splitting up an existing organization, and the courts' lack of expert knowledge. On occasion, this has forced the courts to send a defendant home with a reprimand after issuing a sweeping condemnation.¹⁹³ The courts' assertions that they lack expert knowledge ring true, particularly in those cases where breaking up the units of an enterprise is technically difficult and the government fails to put forward a practicable reorganization plan. Nevertheless, a number of holding companies have in fact been dissolved, though these difficulties weigh less heavily in such cases. The results obtained by these dissolutions will be discussed in detail in Chapter 6, as will the advantages and disadvantages of this remedy.

4.3 THE CASE LAW ON OLIGOPOLIES

With the spread of oligopolistic market structures, the number of antitrust suits filed against alleged oligopolists has increased. However, in comparison with the extent of the oligopoly phenomenon, the number of cases has still not reached a very large total today. The basic reason for this is the absence of specific provisions in the American antitrust laws covering conscious parallelism of action, the characteristic behavioral pattern in oligopolies, though it has to be said that it is no simple matter to find clear evidence of such behavior. The enforcement agencies may attack conscious parallelism under the 'conspiracy in restraint of trade' provision of Section 1 of the Sherman Act. Conspiracy is a criminal-law concept: it is generally taken to mean the joint action of two or more persons aimed deliberately at some unlawful purpose, and it need not be shown that their aims have been accomplished. However, one prerequisite is the showing of 'agreement.' This need not be an overt agreement in the normal sense of the word; on the contrary, evidence of a 'meeting of the minds' is sufficient. Lawsuits against oligopolies in the United States have thus turned upon the law of evidence. The question to be decided is always whether a finding that firms have followed a parallel course of action constitutes sufficient proof of a meeting of the minds or whether further evidence must also be produced. Section 2 of the Sherman Act may also be applied to oligopoly situations: the government must then show conspiracy to monopolize or joint monopolization.

4.3.1 Oligopoly Situations under Section 1 of the Sherman Act

One of the industries in which the antitrust authorities encountered an oligopolistic structure which produced anticompetitive behavioral patterns was the motion-picture industry. The earliest case in which the Supreme Court had to decide whether conspiracy could be inferred from the conduct of the defendants was the *Interstate Circuit* case in 1939. The manager of two big motion-picture theater circuits had sent identical letters to eight film distributors (listing the names of all his addressees) demanding that they should set minimum admission prices for subsequent runs of pictures they had shown on first run. Each of the distributors had agreed to this demand. Although it was proved that the distributors had not consulted each other, the Court found adequate proof of conspiracy in the fact that each distributor knew that his competitors had received the same letter. Such conspiracy among oligopolists violates the Sherman Act if there is proof of intent to put certain groups of market participants in an unfavorable position and the concerted action challenged is the instrument of this purpose:

It was enough that, knowing that concerted action was contemplated and invited, the distributors gave their adherence to the scheme and participated in it. Each distributor was advised that the others were asked to participate; each knew that cooperation was essential to the successful operation of the plan Acceptance by competitors, without previous agreement, of an invitation to participate in a plan, the necessary consequence of which, if carried out, is restraint of interstate commerce, is sufficient to establish an unlawful conspiracy under the Sherman Act.¹⁹⁴

This case does raise the question whether any other course of action was in fact open to the distributors. The two circuits were too important an outlet – not to say the only outlet – for their pictures. And each distributor accepted the circuits' request knowing that the others would follow suit. In a situation such as this, the distributors had to take concerted action without there being any need actually to consult each other. They would only have consulted if they had all decided to refuse the circuits' request. We can only repeat that in the circumstances refusal would have been very difficult. The reason for the lack of competition, then, was to be found in the circuits' monopoly position, not in the concerted action of their suppliers.¹⁹⁵

¹⁹³ Referring to the *Alcoa*, *National Lead*, *Timken* and *Pullman* decisions, Walter Adams was not wholly without justification in entitling an article 'Dissolution, Divorcement, Divestiture: The Pyrrhic Victories of Antitrust', 27 *Ind. LJ* 1 (1951).

¹⁹⁴ *Interstate Circuit, Inc. v. US*, 306 *US* 208, 226–27 (1939).

¹⁹⁵ See Edward H. Levi, 'The Antitrust Laws and Monopoly', 14 *U. Chi. L. Rev.* 153, 177 (1947).

That actual or potential injury to other market participants is crucial for a finding of conspiracy under the Sherman Act was again shown by the Supreme Court's 1954 ruling in the *Theatre Enterprises* case. The owner of a Baltimore movie theater complained that the major companies distributing in Baltimore had refused to give him first-run releases that were given to certain other theaters. He asserted that there was an agreement to this effect between the defendants and that they had therefore acted in violation of the Sherman Act. The Supreme Court, however, stated that while uniform business behavior was relevant evidence,

this Court has never held that proof of parallel business behavior conclusively establishes agreement or, phrased differently, that such behavior itself constitutes a Sherman Act offense. Circumstantial evidence of consciously parallel behavior may have made heavy inroads into the traditional judicial attitude toward conspiracy; but 'conscious parallelism' has not yet read conspiracy out of the Sherman Act entirely.¹⁹⁶

This decision made it clear that the attempt to equate parallel action by oligopolists with conspiracy under the Sherman Act (which would undoubtedly have made it easier for enforcement agencies to bring oligopolistic behavior within the reach of the law) had failed. Decisions since *Theatre Enterprises* have generally followed its conclusions. The courts have tried to find evidence of *consciously* parallel market behavior without indicating in *abstracto* what forms of oligopolistic market behavior are to be regarded as 'conspiracy' within the meaning of Section 1. Conscious parallelism in itself seems insufficient to show a violation of the law, however. This comes out clearly in the following passages from more recent decisions:

We have never recognized conscious parallelism, standing alone, as sufficient to sustain such a finding. . . . If parallel action is compelled by competition in this area, we find it difficult to say that such action warrants a finding of an illicit agreement.¹⁹⁷

The mere fact that two or more of the defendants dealt with plaintiff in a substantially similar manner does not support an inference of conspiracy, even though each knew that the business behavior of another or the others was similar to its own.¹⁹⁸

A business practice found in oligopolistic industries producing homogeneous goods whose price includes a high percentage for transportation costs is the basing-point system. It can hardly be denied that the operation of the system depends on a greater or lesser degree of concerted market behavior, in which,

as in the American cement industry, even the type of transportation used may be prescribed by the manufacturer. In contrast with the situation as regards collusion in the motion-picture industry, there has generally been overwhelming evidence of concerted action to eliminate competition in industries where basing-point systems were in operation. In *Cement Institute* the Supreme Court found the cement industry's basing-point scheme unlawful under the Sherman Act:

It is enough to warrant a finding of a 'combination' within the meaning of the Sherman Act, if there is evidence that persons, with knowledge that concerted action was contemplated and invited, give adherence to and then participate in a scheme.¹⁹⁹

In attacking basing-point systems, the Federal Trade Commission has not only brought conspiracy charges against the firms participating in such schemes: on occasion it has also charged them individually with violating Section 5 of the Federal Trade Commission Act (declaring unfair methods of competition unlawful). The Commission has argued that it makes no difference whether identical prices are achieved through conscious parallel action or through overt collusion. In the *Rigid Steel Conduit* case the Commission's decision was upheld by the circuit court of appeals, which construed Section 5 very widely, allowing charges under the FTC Act to stand even if the conduct at issue might fall short of a Sherman Act violation.²⁰⁰ An equally divided Supreme Court (one member taking no part in the case) affirmed the lower

¹⁹⁶ *Theatre Enterprises, Inc. v. Paramount Film Distrib. Corp.*, 346 US 537, 540-41 (1954).

¹⁹⁷ *Winchester Theatre Co. v. Paramount Film Distrib. Corp.*, 324 F. 2d 652, 653 (1st Cir. 1963).

¹⁹⁸ *Independent Iron Works, Inc. v. US Steel Corp.*, 322 F. 2d 656, 661, 665 (9th Cir. 1963), cert. denied, 375 US 922 (1963). Less typical, in that there was direct proof of agreement, were: *Advertising Specialty Nat'l Ass'n v. FTC*, 238 F. 2d 108 (1st Cir. 1956); *Pittsburgh Plate Glass Co. v. US*, 260 F. 2d 397 (4th Cir. 1958); *Morton Salt Co. v. US*, 235 F. 2d 573 (10th Cir. 1956). In some cases parallel action was found unlawful of itself. *William Goldman Theatres v. Loew's, Inc.*, 150 F. 2d 738 (3d Cir. 1945); *Milgram v. Loew's, Inc.*, 94 F. Supp. 416 (ED Pa. 1950): 'It may be taken as settled that proof of concert of action is of itself sufficient evidence from which an "agreement," as that term is used in the Act, may be found. . . . Present concert of action, further proof of actual agreement among the defendants is unnecessary . . . ' *Id.* at 419. In *Fanchon & Marco, Inc. v. Paramount Pictures, Inc.*, 100 F. Supp. 84 (SD Cal. 1951), *aff'd*, 215 F. 2d 167 (9th Cir. 1954), cert. denied, 348 US 912 (1955), on the other hand, the presumption of agreement was refuted by a showing that uniform action was in fact a sign of competitive market conduct.

¹⁹⁹ *FTC v. Cement Institute*, 333 US 683, 716 n.17 (1948).

²⁰⁰ *Triangle Conduit & Cable Co. v. FTC*, 168 F. 2d 175 (7th Cir. 1948).

court's decision without giving an opinion.²⁰¹ But since there was clear evidence of concerted action, the defendants' pricing system was caught by the Sherman Act in any case.

4.3.2 Oligopoly Situations under Section 2 of the Sherman Act

The enforcement agencies have also brought charges against oligopolistic behavior under Section 2 of the Sherman Act. On this, the Supreme Court has made a number of interesting rulings since 1945. The first, which has gained a certain celebrity in this connection, was the *American Tobacco* ruling of 1946.²⁰² In this criminal suit, a number of leading cigarette manufacturers were accused of conspiring to monopolize, attempting to monopolize and monopolizing the industry. Defendants were the three major cigarette manufacturers in the United States, three buyers of leaf tobacco and the British-American Tobacco Co. These firms, some of them successor companies to the Tobacco Trust (dissolved in 1911), had jointly attempted to gain a monopolistic position on the market by both overt and secret collusion. The successor companies to the old Tobacco Trust were set up in order to bring competition into the industry after 1911. The modern cigarette, produced mainly from domestic tobaccos, made its appearance in 1913 when the R. J. Reynolds Tobacco Co. introduced a new brand, Camel. Camels enjoyed such an overwhelming success that the American Tobacco Co. and Liggett & Myers were soon forced to bring out similar products – Lucky Strikes and Chesterfields. Other manufacturers reacted too late and saw their shares of the market shrink rapidly. The outcome of the developments was a typical oligopoly situation with Reynolds as price leader. This situation in turn was to change in 1931, when the Big Three decided to raise prices since demand was still high in spite of the depression. As a result there was a sharp increase in demand for cheaper brands produced by competitors. The counterattack came in 1933, when the manufacturers of Camels, Lucky Strikes and Chesterfields made two successive cuts in wholesale prices. Their competitors were eventually repulsed by this violent attack, and the Big Three again increased the prices of their most popular brands until in 1940 prices were just lower than they had been after the 1931 increase.²⁰³ The position of the Big Three was virtually impregnable, largely because of the huge sums they spent on advertising.

In its ruling the Supreme Court stated that it had found no evidence of an agreement nor even any sign that would point to the existence of an agreement. There were, however, indications of a 'meeting of the minds':

A friendly relationship within such a long established industry is, in itself, not only natural but commendable and beneficial, as long as it does not breed

illegal activities. Such a community of interest in any industry, however, provides a natural foundation for working policies and understandings favorable to the insiders and unfavorable to outsiders.²⁰⁴

And there was sufficient evidence of such policies and understandings designed to exclude competitors from the market. At tobacco auctions the Big Three had pursued a remarkably concerted policy. Each of them bought only when the other two were present, and before the auctions opened they instructed their buyers to purchase previously agreed quantities at specified prices. During the period when the economy brands were selling well, the Big Three made large purchases of the tobaccos their competitors needed in order to force a price increase on them. Another point against the three leading manufacturers was that their price policies and sales strategies were identical. Finally, the Court regarded their huge expenditures on advertising as proof of the existence of joint power to exclude competition:

Such advertising may benefit indirectly the entire industry, including the competitors of the advertisers. Such tremendous advertising, however, is also a widely published warning that these companies possess and know how to use a powerful offensive and defensive weapon against new competition.²⁰⁵

The Court found that the concerted practices challenged were in conflict with the Sherman Act:

No formal agreement is necessary to constitute an unlawful conspiracy.... Where the conspiracy is proved, as here, from the evidence of the action taken in concert by the parties to it, it is all the more convincing proof of an intent to exercise the power of exclusion acquired through that conspiracy. The essential combination or conspiracy in violation of the Sherman Act may be found in a course of dealing or other circumstances as well as in an exchange of words.²⁰⁶

The policies pursued by defendants were thereupon enjoined. The Court did not pronounce on whether a ban on concerted buying and selling practices

²⁰¹ *Clayton Mark & Co. v. FTC*, 336 US 956 (1949).

²⁰² *American Tobacco Co. v. US*, 328 US 781 (1946).

²⁰³ *Id.* at 804-09. See also William H. Nicholls, *Pricing Policies in the Cigarette Industry* (Nashville, Tenn.: Vanderbilt UP, 1951), and 'The Tobacco Case of 1946', 39 *Am. Econ. Rev.* 284 (1949, Proceedings); Richard B. Tennant, *The American Cigarette Industry* (New Haven, Conn.: Yale UP, 1950).

²⁰⁴ 328 US at 793.

²⁰⁵ *Id.* at 797.

²⁰⁶ *Id.* at 809-10.

between major competitors on an oligopolistic market was an effective decree, and in fact there was no need for it to do so because the government had filed a criminal suit and not civil proceedings.

Subsequent commentators have not found it as easy as the courts to decide whether the Supreme Court's decree meant that parallel action by oligopolists in the domain of market strategy was prohibited under the Sherman Act. A number of writers believed that the *American Tobacco* doctrine could also entail dissolution in oligopoly situations.²⁰⁷ Others held, however, that it was not concerted practice that was prohibited, but only uniform market behavior based on conspiracy.²⁰⁸ More light was shed on the issue in the *Paramount* case, in which the courts considered charges of conspiracy to restrain and monopolize trade in the distribution and exhibition of motion pictures. Speaking for a unanimous Supreme Court, Justice William O. Douglas noted:

It is not necessary to find an express agreement in order to find a conspiracy. It is enough that a concert of action is contemplated and that the defendants conformed to the arrangement.²⁰⁹

But here again it was the fact that the goal of the conspiracy was to monopolize the industry that made it a violation of the Sherman Act. For Justice Douglas added:

It is clear, so far as the five majors are concerned, that the aim of the conspiracy was exclusionary, i.e. it was designed to strengthen their hold on the exhibition field. In other words the conspiracy had monopoly in exhibition for one of its goals . . .²¹⁰

In this case conspiracy was inferred from a system of substantially uniform minimum admission prices that the major distributors imposed upon exhibitors and from a uniform and conventional system for granting runs and clearances. As we pointed out before in discussing the vertical-integration aspects of this case, these practices were designed to exclude nonintegrated exhibitors from the majors' films.

Price leadership has never been the main burden of an antitrust suit, though it did come up in a number of old trust cases under Section 2 – *US Steel* and *International Harvester* in particular. Here the government tried to adduce price leadership as evidence of actual control over prices and therefore of monopoly. But in neither of these cases did the Supreme Court hold that a price leader necessarily had actual power to dictate prices to its competitors and was thus a monopolist. The Court's language in its 1927 *International Harvester* ruling is clear: price leadership 'does not establish any suppression of competition or show any sinister domination.'²¹¹

The case law on oligopolistic behavior under Section 2 of the Sherman Act,

then, is not so unclear as it may seem at first sight. What was condemned in both *American Tobacco* and *Paramount* was not the tacit exclusion of certain forms of competition between oligopolists (conscious parallelism as such) but joint action based thereon with a view to deliberately driving competitors from the market or putting substantial restrictions on their freedom of action – a sort of collective monopolization. We have already met this attitude toward conscious parallelism in the application to oligopolistic market behavior of the ‘conspiracy in restraint of trade’ concept of Section 1 of the Sherman Act. It is in line with the attitude we noted in the interpretation of monopolization in the last section of this chapter. What is relevant to the judgment of uniform market behavior is whether it is based on a meeting of the minds and whether it is liable to harm or has already harmed competitors.

We should finally turn to what may become an important new development in the law on oligopolistic behavior – the application of Section 5 of the FTC Act to charges that have traditionally been brought under Section 2 of the Sherman Act. In its complaint against four manufacturers of breakfast cereals (Kellogg Co., General Mills, Inc., General Foods Corp. and The Quaker Oats Co.) that have a joint market share of 90 percent, the FTC has charged these firms with creating and maintaining a joint monopoly and raising high barriers to entry by unfair methods of competition. In particular, the companies are charged with spending large sums on advertising misleading to consumers, with introducing new but virtually similar brands of breakfast cereals instead of reducing their price and with acquiring small competitors.²¹² The Commission’s proposed relief requires divestiture of assets for the formation of new cereal companies, compulsory licensing of brands and trademarks on a royalty-free basis, prohibition of future acquisitions of competitors and of certain market-strategy techniques. The main advantage of bringing the suit under Section 5 of the FTC Act is that the government does not need to prove intent or the existence of a conspiracy to monopolize. The other most interesting aspect is the relief requested, which goes much further than would

²⁰⁷ See, e.g., Levi, *supra* note 195; Rostow, ‘Monopoly under the Sherman Act – Power or Purpose?’, *supra* note 189; Nicholls, *op. cit. supra* note 203, at 398–99.

²⁰⁸ See, e.g., E. R. Johnston and J. P. Stevens, ‘Monopoly or Monopolization – A Reply to Professor Rostow’, 44 *Ill. L. Rev.* 269 (1949). See also *C-O-Two Fire Equip. Co. v. US*, 197 F. 2d 489 (9th Cir. 1952), *cert. denied*, 344 US 892 (1952).

²⁰⁹ *US v. Paramount Pictures, Inc.*, 334 US 131, 142 (1948).

²¹⁰ *Id.* at 170.

²¹¹ *US v. International Harvester Co.*, 274 US 693, 708 (1927); *accord, US v. US Steel Corp.*, 251 US 417, 447, 449 (1920).

²¹² In the Matter of *Kellogg Co.*, Dkt. 8883, CCH 1972 *Trade Cas.* ¶ 19 898 (FTC complaint 1972).

have been possible with a traditional cease-and-desist order, which would only have tried to correct certain behavioral aspects of the prevailing market situation.

The major drawback of the legal approach adopted by the enforcement agencies in order to bring oligopolistic behavior under the Sherman Act lies in the remedies that can be prescribed in such cases. Unlike the rulings against monopolies considered in the previous section, in which structural remedies were ordered, the rulings in cases against oligopolists confined themselves to prohibiting the concerted market behavior that had led to the exclusion of competitors, and the courts did not inquire into the effectiveness of this remedy. It does not take much imagination to see that proscribing interdependent behavior that is imposed upon a business by the nature of the market situation it is in cannot have much remedial effect. The only chance of an effective remedy being ordered is if a charge of monopolization is brought (and that, of course, raises many legal problems in the great majority of cases) or if the FTC can convince the courts of the applicability of Section 5 of the FCT Act. However, even then, courts may be hesitant to order dissolution. A parallel case, in which the feasibility of structural reorganization in an oligopolistically structured market arose, was in the suit filed against National Lead Co. and du Pont, the two biggest producers of pigments manufactured from titanium oxide.²¹³ According to the government, these two manufacturers, whose joint market share at the time of suit was 90 percent, had conspired to monopolize and together had in fact monopolized this market. The element of conspiracy consisted in the fact that they had concluded licensing agreements with their leading foreign competitors. The government requested not only the cancellation of these agreements but also the divestiture of National Lead and the du Pont subsidiary involved. The district court granted the government's petition that the agreements should be cancelled but did not order divestiture. On appeal, the Supreme Court agreed, ruling that the conditions of competition on the market did not warrant the drastic step of divestiture.

In view of the importance of the Court's views on the use of divestiture as a means of strengthening competition, we conclude by giving part of its findings *in extenso*.

We believe there is neither precedent nor good reason for such a requirement. . . . There is neither allegation in the complaint nor finding of fact by the District Court that the physical properties of either National Lead or du Pont have been acquired or used in a manner violative of the Sherman Act, except as such acquisition or use may have been incidental or related to the agreements above mentioned. . . .

There is no showing that four major competing units would be preferable to two, or . . . that six would be better than four. Likewise, there is no showing of the necessity for this divestiture of plants or of its practicality and fairness. The findings of fact have shown vigorous and effective competition between National Lead and du Pont in this field. . . . It is not for the courts to realign and redirect effective and lawful competition where it already exists and needs only to be released from restraints that violate the antitrust laws. To separate the operating units of going concerns without more supporting evidence than has been presented here to establish either the need for, or the feasibility of, such separation would amount to an abuse of discretion.²¹⁴

4.3.3 A Critique of the Case Law

In oligopoly situations where each of the major firms can exert such influence on the market (through its share of the market) that changes in the prices or other sales conditions imposed by one company have considerable repercussions on the quantities sold by its competitors, these firms are prepared to keep their pricing policies and other sales strategies in line.²¹⁵ Situations of this kind have not – quite rightly – been condemned in the courts. That an oligopolist in determining the price of his products should take account of the reactions of his competitors is not in itself reprehensible market behavior. According to what we said in Chapter 3, this is the case only if there is monopolistic price fixing and other features of unworkable competition – for instance, if not a single firm reduces its prices even when surplus capacity is available as a result of depression, or if the oligopolists refrain from introducing technological innovations even where their smaller competitors have already done so. Where there is strong evidence that a different policy would have been adopted if the behavior and performance of the firms had been dictated by the pressure of competition, we may justly suspect some form or other of agreement.²¹⁶ The more suppliers of a certain product there are, the more surely will the tacit agreement have to give way to other, more organized forms of concerted price fixing. The ‘Gary dinners’ in the steel industry at the beginning of this century were something of a halfway house; much closer cooperation is possible where the basing-point system is adopted. These closer forms of cooperation are found chiefly in unstabilized oligopolies such as the cement industry.

²¹³ *US v. National Lead Co.*, 63 F. Supp. 513 (SD NY 1945), *aff'd*, 332 US 319 (1947).

²¹⁴ 332 US at 351–53.

²¹⁵ Carl Kaysen, ‘Collusion under the Sherman Act’, 65 *QJ Econ.* 263 (1951), speaks of an ‘agreement to agree’.

²¹⁶ See Kaysen, *supra* note 215; Donald F. Turner, ‘The Definition of Agreement under the Sherman Act – Conscious Parallelism and Refusals to Deal’, 75 *Harv. L. Rev.* 655, 658 (1962). For a theoretical discussion of oligopolistic behaviour, the reader is referred to Chapter 3 *supra*.

Certain fundamental obstacles will be encountered where proof of the existence of a tacit agreement has to be produced in order to corroborate evidence of some form or other of collusion to restrain competition, which was the Supreme Court's approach in the cases we have discussed. First, there is the risk that the government will give its attention solely to oligopoly situations where there are clear signs of a collusive agreement. But in the case of oligopolies with only a few very big firms, which is in fact the kind that occurs most frequently, it will be exceptionally difficult to find evidence of a meeting of the minds – witness the painstaking investigations of the Department of Justice in *American Tobacco*, for instance. The second obstacle concerns the measures that should be taken to remedy unsatisfactory market behavior on the part of oligopolists. Government petitions for the prohibition of concerted practices have raised serious doubts in the American business world, especially in connection with the *American Tobacco* ruling. For part of the Supreme Court's decree must be seen as a prohibition of practices that were unavoidable in view of the structure of the cigarette market;²¹⁷ in this respect, the decree has certainly not contributed to healthier competition and thus to improved performance. Some students have formed the opinion that the performance of the cigarette industry was not satisfactory, the dominant manufacturers having avoided price rivalry and, apparently, any technological innovation and for some time any significant major product development.²¹⁸ The high cost of advertising has also come in for general criticism. Yet, quite apart from the legal problems involved, it would have been difficult to formulate a dissolution plan, whether or not this would have been desirable.²¹⁹ For one thing, each of the three firms concentrated on a single brand, which could hardly be divided among them. And then sales promotion had been (and still is) of paramount importance, so that the ratio of selling price to selling costs was much less favorable for a small firm than for a big one. Where it is difficult to restore sound competition in the short run, other means of achieving more acceptable market performance must be found; and it will scarcely be possible to escape some form or other of government influence on the *Alcoa* pattern.

In view of these difficulties, the applicability of the approach under Sections 1 and 2 of the Sherman Act will remain very limited indeed, because firms will avoid all forms of behavior from which a meeting of the minds could be inferred. One other possibility might be for the enforcement agencies to bring parallel actions against oligopolists for certain anticompetitive business practices such as tying devices and exclusive dealing. Discussion of this, however, would take us outside the scope of this book.²²⁰

Yet another possibility is embodied in the recent action of the FTC under

Section 5 of the FTC Act against four breakfast-cereal companies. This case is interesting not only because of the charges brought, which closely resemble monopolization charges under Section 2 of the Sherman Act though they involve a much lighter burden of proof, but particularly because of the structural relief requested. It proves that the antitrust agencies are willing to bypass traditional antitrust approaches and to focus on the real economic causes of unsatisfactory market performance in oligopolistic markets. An endorsement by the Supreme Court of the FTC's suit would mean that the subsidiary goal of the antitrust laws – the protection of consumer interests – would no longer be a mere by-product of the basic purpose of antitrust, which is the protection of competitors, but would begin to be a concurrent antitrust goal, thus bringing modern economic approaches into the courtroom.

²¹⁷ See Nicholls, *op. cit. supra* note 203; Tennant, *op. cit. supra* note 203.

²¹⁸ See A. D. H. Kaplan, *Big Enterprise in a Competitive System* (Washington, DC: Brookings Institution, 1954); Nicholls, *op. cit. supra* note 203.

²¹⁹ Nicholls, *op. cit. supra* note 203, Ch. 28, and *supra* note 203, at 114–16.

²²⁰ This has been tried several times by the American enforcement agencies. Oligopolistic elements came into play and suit was filed under the Sherman Act in the *Automobile finance* cases and the *Motion Picture Advertising* case. In the most important of the *Automobile finance* cases, *US v. General Motors Corp.*, 121 F. 2d 376 (7th Cir. 1941), *cert. denied*, 314 US 618, *rehearing denied*, 314 US 710 (1941), the circuit court affirmed the trial court's finding that tying the business of financing car sales to that of selling cars was illegal under § 1 of the Sherman Act. The government subsequently obtained relief in a civil action against General Motors, and the terms of consent decrees previously negotiated with Ford and Chrysler in respect of the same practices were confirmed. In *FTC v. Motion Picture Advertising Serv. Co.*, 344 US 392 (1953), *reversing* 194 F. 2d 633 (5th Cir. 1952), brought under § 5 of the FTC Act, the Supreme Court held that exclusive contracts providing that theater owners must not show advertising films produced by companies other than the respondent, if taken together with similar types of contract entered into by the three other major advertising-film producers, foreclosed to competitors 75% of the available outlets for the business.

CHAPTER 5

THE LAW ON MERGERS

Mergers fall under the scope of the Sherman Act as well as Section 7 of the Clayton Act of 1914. Unlike the Sherman Act, however, which has only sporadically been applied to mergers, the Clayton Act has been the basis of an ever-increasing flow of lawsuits since it was amended by the Celler-Kefauver Act of 1950. The principal reason for this lies in the object of the law: the Clayton Act is designed to curb concentration in its incipiency, so it applies to mergers that are not yet consummated; the Sherman Act does not apply to proposed mergers, and as a consequence the government has to bear a much heavier burden of proof. In section 1 of this chapter we shall deal briefly with the merger case law under the Sherman Act. The bulk of the chapter is devoted to an analysis and discussion of the implementation of Section 7.

5.1 MERGER CASE LAW UNDER THE SHERMAN ACT

Only rarely in the Sherman Act's history has the statute constituted a real threat to mergers. In a series of early rulings in cases concerning the legality of mergers between competing railroads the Supreme Court held them to be *prima facie* in violation of both Sections 1 and 2 of the Sherman Act. And in cases involving product extension by an already dominant firm, the view of the Court was that extension of the sphere of influence of dominant firms into other, fragmented, markets had undesirable effects on competition in such markets (because such firms might achieve dominance there too) even if the intruding firm could produce at lower cost. For discussion of these cases¹ the reader is referred to Chapter 4. No real merger cases were decided after that until, shortly after the end of World War II, the government filed suit first against the vertical acquisition by a small cab manufacturer of a number of companies operating cabs (the *Yellow Cab* case), and then against an acquisition by Columbia Steel Co., the West Coast subsidiary of US Steel, of a small local competitor, Consolidated Steel Corp., processing only 3 percent of the rolled steel produced in the area. In the *Yellow Cab* case

and on the vertical aspects of the *Columbia Steel* case, the Supreme Court resisted the government's attempts to obtain a *per se* prohibition under the Sherman Act. In cases such as these, the government has to prove that the acquisition adversely affects the opportunities of competitors either to market their products or to obtain supplies.² More important than this for future enforcement activity under the Sherman Act in respect of mergers was the Court's opinion on the horizontal aspects of *Columbia Steel*. In attempting to show that the merger eliminated competition between Consolidated and US Steel in structural steel and pipe, and thus was in unreasonable restraint of trade, the government observed that the merger would bring 24 percent of the orders for structural steel in the western market under US Steel's control. Rejecting market share as the sole criterion for judging horizontal acquisition, the Court instead rehearsed a number of structural and other items which should be taken into account in cases under Section 1:

In determining what constitutes unreasonable restraint, we do not think the dollar volume is in itself of compelling significance; we look rather to the percentage of business controlled, the strength of the remaining competition, whether the action springs from business requirements or purpose to monopolize, the probable development of the industry, consumer demands, and other characteristics of the market. We do not undertake to prescribe any set of percentage figures by which to measure the reasonableness of a corporation's enlargement of its activities by the purchase of the assets of a competitor. The relative effect of percentage command of a market varies with the setting in which that factor is placed.³

This ruling unambiguously applied the rule of reason to merger law under the Sherman Act and made it clear that large market shares alone are not enough to warrant the conclusion that the statute has been infringed; while

¹ *Northern Sec. Co. v. US*, 193 US 197 (1904); *US v. Union Pac. RR*, 226 US 61 (1912); *US v. Southern Pac. Co.*, 259 US 214 (1922). In *Southern Pacific*, quoting *Northern Securities*, the Supreme Court stated: 'Such combinations, not the result of normal and natural growth and development, but springing from the formation of holding companies, or stock purchases, resulting in the unified control of different roads or systems, naturally competitive, constitute "a menace to and a restraint upon that freedom of commerce which Congress intended to recognize and protect and which the public is entitled to have protected."' The product-extension merger cases referred to are *US v. Swift & Co.*, 286 US 106 (1932), and *US v. Griffith*, 334 US 100 (1948).

² *US v. Yellow Cab Co.*, 332 US 218 (1947); *US v. Columbia Steel Co.*, 334 US 495 (1948), affirming 74 F. Supp. 671 (D. Del. 1947). For a full discussion of these cases the reader is referred to Chapter 4 *supra*.

³ 334 US 495, 527-28.

a showing of other factors that *would* warrant such a conclusion is extremely difficult.

In the only other merger case subsequently decided under the Sherman Act, higher market shares were involved. In 1964 the *First National Bank & Trust Co. of Lexington* case was decided by the Supreme Court. This case concerned a merger between the biggest and the fourth biggest commercial banks in Lexington, Kentucky, representing 40 percent and 13 percent respectively of the relevant geographic market. The Court found that the two companies were important competitors and that a merger between them, in view of their large market shares, would lead to the elimination of significant competition, thus constituting an unreasonable restraint of trade in violation of Section 1 of the Sherman Act. The Court did not go into any other factors that might be relevant for judging an acquisition:

Where . . . the merging companies are major competitive factors in a relevant market, the elimination of significant competition between them, by merger or consolidation, itself constitutes a violation of Section 1 of the Sherman Act.⁴

This ruling is strongly reminiscent of the stand taken by the Court in the railroad cases at the beginning of the century, and these cases are indeed cited in the majority opinion.⁵ Though the majority said it had considered all the factors cited by the Court in its 1948 *Columbia Steel* decision, there is not much evidence that it did. The dissenting opinion pointed out – and at least one writer has agreed – that neither postacquisition evidence nor the probable development of the industry was taken into consideration.⁶ In view of the already concentrated structure of the relevant market before the merger, it is doubtful, however, if consideration of these factors would have exonerated the merger before the law.

The possibility of judging mergers between major competitors in the same way as contracts in restraint of trade considerably eases the burden of proof resting on the antitrust agencies. Nevertheless, this road has never since been tried on its own, and attention has been centered on Section 7. The dissenting justices in *Lexington* commented that the Department of Justice had based its case on the Sherman Act because it was not certain whether Section 7 of the Clayton Act applied to banking. As the ruling in *Philadelphia Bank*, discussed later in this chapter, established that it did, there was no longer any need to attack mergers under the provisions of Section 1 of the Sherman Act only.

5.2 THE CONTENT OF SECTION 7 OF THE CLAYTON ACT

The substantial changes made in Section 7 by the 1950 amendment were necessitated by the unsatisfactory drafting of the 1914 Act, the interpretation of which by the courts had opened up a number of loopholes, with the result that this section of the Act played only a small part in antitrust cases between 1914 and 1950. Before examining its interpretation after 1950, let us consider the reasons for the failure of the statute in its original form.

5.2.1 The Clayton Act of 1914

The passing of the Clayton Act, like that of the Sherman Act, was a matter of national concern. During the presidential campaign of 1912 antitrust problems were again a major issue for all the political parties. There were three main reasons for this renewal of interest in antitrust policy since the Sherman Act had been enacted. First, the Congress considered it a short-coming of the Sherman Act that it could not be invoked against corporations *until they had obtained* a dominant position on the market, whereas a merger might well have harmful effects on competition if market dominance were *liable* to result from it. A statute was therefore needed that would curb monopoly in its incipency, that would allow the government to take action before complete dominance was attained.⁷ A second reason was the dissatisfaction felt in many quarters after the Supreme Court's ruling in the *Standard Oil* case in 1911, which established a distinction between 'reasonable' and 'unreasonable' restraints of trade in judging mergers;⁸ this, it was feared, might give rise to considerable uncertainty as to whether combinations were or were not in conflict with the Sherman Act. Lastly, it was felt that there should be an independent agency endowed with more far-reaching powers than those enjoyed by the Bureau of Corporations for checking undesirable economic concentration. The Bureau of Corporations had been set up in 1903 as part of the Department of Commerce and Labor, mainly to

⁴ *US v. First Nat'l Bank & Trust Co. of Lexington*, 376 US 665, 671-72 (1964). The four biggest competitors of the merging banks had market shares of 17, 13, 9 and 8% respectively. The Supreme Court reversed the ruling of the lower court, which had dismissed the government's complaint after taking the reasons for the merger into consideration.

⁵ The cases cited include *Northern Sec. Co. v. US*, *supra* note 1; *US v. Union Pac. RR*, *supra* note 1; *US v. Reading Co.*, 253 US 26 (1920); *US v. Southern Pac. Co.*, *supra* note 1.

⁶ See Benjamin J. Klebaner, 'The Lexington Merger Decision and Its Significance for Commercial Banking', 11 *Antitrust Bull.* 897 (1966).

⁷ See, e.g., S. Rep. 698, 63d Cong., 2d Sess. 1 (1913).

⁸ *Standard Oil Co. of NJ v. US*, 221 US 1 (1911).

carry out investigations into the structure of markets. The government's purpose had been to gather material for future action against dominant firms, and it also hoped to rouse public opinion against unlawful trade practices by regularly publishing information about the major corporations in the land.

The text of Section 7 of the Clayton Act as finally passed by House and Senate was a compromise between a number of often conflicting opinions, and it was anything but clear:

That no corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital of another corporation engaged also in commerce, where the effect of such acquisition may be to substantially lessen competition between the corporation whose stock is so acquired and the corporation making the acquisition, or to restrain such commerce in any section or community, or tend to create a monopoly of any line of commerce.⁹

This was hardly a suitable basis for an effective merger policy. In the first place, the Act refers to a corporation's acquisition of the stock of another, but not to the acquisition of assets, though this form of combination was already widespread before 1914.¹⁰ The reason for the omission of this point must be that Congress regarded the creation of holding companies as the only hindrance to the ideal of free competition. Secondly, the Act refers to competition *between* the acquiring and the acquired corporation, which on a literal interpretation could make any acquisition of a competitor illegal. Thirdly, the terms of the Act lack precision: its loose wording is somewhat reminiscent of the style of the Sherman Act.

Section 7 lays down three statutory tests on which the establishment of a holding company or any other form of stock acquisition may be prohibited: where its effect 'may be to substantially lessen competition between the corporation whose stock is so acquired and the corporation making the acquisition,' where the consequence 'may be . . . to restrain . . . commerce in any section or community,' and where the effect of such action 'may be to . . . tend to create a monopoly of any line of commerce.' Congress failed to lay down exact criteria on the basis of which the courts could enforce the law. There was no agreement on the circumstances in which the forms of combination coming under the Act should be condemned. The only thing that seems to have been certain was that Congress did not intend an outright prohibition of the acquisition of shares. The courts could not even turn for guidance to the economic or legal literature of the day, since the terminology of the Act did not correspond to the terms used by economic and legal writers.¹¹ Once again, therefore, the judge had the last word – and immediately after

the enactment of the statute there was already a general demand for more explicit and comprehensive legislation.

5.2.2 An Analysis of the Cases between 1914 and 1950

The Clayton Act gives power to proceed against alleged violations of the law to a number of agencies, including the two antitrust agencies proper – the Antitrust Division of the Department of Justice and the Federal Trade Commission. Section 15 empowers the Department of Justice to institute proceedings;¹² Section 11 originally vested authority to enforce compliance in the Interstate Commerce Commission and the Federal Reserve Board (the Federal Communications Commission and the Civil Aeronautics Board were added later) as well as the Federal Trade Commission. Private persons (both individuals and corporations) are also entitled to sue for damages sustained by violation of Sections 2, 3, 7 and 8.¹³ The law deriving from suits brought by most of these agencies or persons is of little importance to this study. We shall concentrate exclusively on the activities of the Department of Justice and the Federal Trade Commission, the latter being the more active of the two before the Act was amended.

⁹ 38 Stat. 731 (1914), 15 USC 18.

¹⁰ See Henry R. Seager and Charles A. Gulick, *Trust and Corporation Problems* 65 (New York: Harper, 1929); Arthur S. Dewing, *Corporate Promotions and Reorganizations* (Cambridge, Mass.: Harvard UP, 1914); David Dale Martin, *Mergers and the Clayton Act* 234–40 (Berkeley and Los Angeles: University of California Press, 1959). In commenting on the 1950 amendment, however, some writers have contested this point. See A. D. H. Kaplan, *Big Enterprise in a Competitive System* Ch. 1 (Washington, DC: Brookings Institution, 1954); Comment, 'Section 7 of the Clayton Act: A Legislative History', 52 *Colum. L. Rev.* 766, 768–69 (1952); Notes, 68 *Yale LJ* 1629 (1959).

¹¹ For an extensive historical survey of the origins of the 1914 Act, see Allyn A. Young, 'The Sherman Act and the New Antitrust Legislation, Part II', 23 *J. Pol. Econ.* 305 (1915); Martin, *op. cit. supra* note 10.

¹² Section 15, in relevant part, reads: 'That the several district courts of the United States are hereby invested with jurisdiction to prevent and restrain violations of this Act, and it shall be the duty of the several district attorneys of the United States, in their respective districts, under the direction of the Attorney General, to institute proceedings in equity to prevent and restrain such violations. . . .' 38 Stat. 737 (1914), 15 USC 25.

¹³ Section 4 states: 'That any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefore in any district court of the United States . . . without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee.' 38 Stat. 731 (1914), 15 USC 15. Section 16 entitles 'any person, firm, corporation, or association . . . to sue for and have injunctive relief, in any court of the United States having jurisdiction over the parties, against threatened loss or damage by a violation of the antitrust laws, including sections two, three, seven, and eight of this Act' 38 Stat. 737 (1914), 15 USC 26.

5.2.2.1 *The Substantiality Test of Section 7*

As was observed above, a literal interpretation of the Act would render impossible any merger in which a corporation acquired a controlling interest in a competitor. Moreover, the words 'may be' in Section 7 implied that the firms concerned need not be actually competing with one another at the time of the stock transaction: potential competition was enough, so that even acquisitions for diversification purposes might fall within the scope of the Act.¹⁴ This construction of Section 7 was upheld by the courts in a single ruling only,¹⁵ and the enforcement agencies made no attempt to rely upon it thereafter. They took the view that a merger had caused a substantial lessening of competition within the meaning of Section 7 if premerger competition between the acquiring and the acquired corporations could be shown to have been substantial.

Instances of this latter interpretation can be found in actions against three meat packers (Western Meat Co., Swift & Co and Armour & Co.) and a bottle manufacturer (Thatcher Manufacturing Co.). In 1922 and 1923 the Federal Trade Commission had issued cease and desist orders in respect of a number of mergers effected by these companies. These orders reached the circuit courts of appeals in 1924 and 1925; the order against Western Meat was overruled, those against Swift and Thatcher sustained, while judgment on Armour was reserved until the Supreme Court had ruled on the others.¹⁶ In the *Western Meat* case the Commission had considered it sufficient proof of substantiality to show that before the merger Western Meat and the packer whose stock it had purchased had been competing with each other in respect of a number of products in certain states, without making it clear what precise test would show whether this competition was or was not 'substantial.' The same situation arose in the *Swift* case, where the court of appeals, without elaborating on the substantiality test, upheld the Commission's contention that Section 7 had been violated because Swift, another meat packer and two companies taken over by Swift had been competing with each other in part of the United States before the merger in selling a number of products to certain customers. Nor did the Commission give any further consideration to the relevant market. In the *Thatcher* case, on the other hand, the Commission interpreted the test 'to substantially lessen competition' as relating to the change in the share of the acquiring corporation in the total production of the industry concerned – in this case, output of milk bottles. Since the series of mergers in which it was engaged had put Thatcher's share up to 70 percent, the Commission considered that Section 7 had in fact been violated.¹⁷ The circuit court agreed with this line of reasoning and ruled in favor of the Commission, except in the case of the merger between Thatcher

and one small firm whose main line of manufacture was in different kinds of bottle than those produced by Thatcher. As this firm's share of the total annual output of milk bottles in the United States was so small (0.8 percent), the court found that this merger did not substantially lessen competition.¹⁸

This unsatisfactory 'direct competitors' approach, without reference to the competitive environment in which the merger took place, did nothing to remedy the vagueness and ambiguity of Section 7. It was not until 1930, in the *International Shoe* case, that the Supreme Court ruled on the substantiality test.¹⁹ This ruling is of interest both for its treatment of the test of Section 7 and for its discussion of the applicability of the antimerger statute when a firm in failing financial circumstances is involved in the merger. We shall confine ourselves here to discussing the substantiality test, reverting to the doctrine of the failing corporation in subsection 4.4 of this chapter. The issue in this case was the legality of a merger between two shoe manufacturers, International Shoe Co. and W. H. McElwain Co., against which the Commission had issued a cease and desist order in 1925, rejecting McElwain's defense that it was in serious financial difficulties at the time of the merger.²⁰ The Commission's order was sustained when International Shoe appealed to the circuit court, whereupon the company took its case to the Supreme Court.²¹ Unlike the Commission and the circuit court, the Supreme Court was at great pains to establish whether the two companies were direct competitors. The patent-leather shoes manufactured by McElwain were of a different shape from those of International and different materials were incorporated in them. McElwain sold mostly to wholesalers and large stores, while International's chief customers were small-town stores. The Court therefore held that the two corporations' markets were different enough both geographically and in view of the nature of the product. Only about 5 percent of the production of the two companies was sold in the same areas to the same shoe stores and wholesalers.²² This, according to the Court, was insufficient evidence on which to assume substantial competition between the two before the merger:

¹⁴ If such acquisition of stock is for investment purposes, however, it is not reached by Section 7.

¹⁵ The decision related to a merger between Alcoa and Cleveland Products Co. — *Aluminum Co. of America v. FTC*, 284 Fed. 401 (3d Cir. 1922), *cert. denied*, 261 US 616 (1923).

¹⁶ *Western Meat Co. v. FTC*, 1 F.2d 95 (9th Cir. 1924), 4 F.2d 223 (9th Cir. 1925); *Swift & Co. v. FTC*, 8 F.2d 595 (7th Cir. 1925); *FTC v. Thatcher Mfg. Co.*, 5 F.2d 615 (3d Cir. 1925).

¹⁷ In the Matter of *Thatcher Mfg. Co.*, Dkt. 738 (1923).

¹⁸ 5 F.2d 615.

¹⁹ *International Shoe Co. v. FTC*, 280 US 291 (1930).

²⁰ In the Matter of *International Shoe Co.*, Dkt. 1023 (1925).

²¹ *International Shoe Co. v. FTC*, 29 F.2d 518 (1st Cir. 1928), *rev'd*, 280 US 291 (1930).

²² 280 US at 301-02.

Mere acquisition by one corporation of the stock of a competitor, even though it results in some lessening of competition, is not forbidden; the Act deals only with such acquisitions as probably will result in lessening competition to a substantial degree . . . that is to say, to such a degree as will injuriously affect the public.²³

The remarkable thing about this ruling is not that both conditions had to be fulfilled (while the statute, on a literal interpretation, is satisfied with the first), but the construction given to the second condition. For the Court here seems to introduce the rule-of-reason interpretation of the Sherman Act with its much heavier burden of proof for the enforcement agencies. So instead of applying Section 7 to mergers in the manner intended by the lawmakers, i.e. to apply less rigorous standards than those appropriate under the Sherman Act, the Court robbed the statute of its original purpose. For as easily as leaning toward a Sherman Act interpretation, the Court could well have read into the original wording of Section 7 the interpretation applied after the 1950 amendment. There are unfortunately no Supreme Court rulings on merger cases under unamended Section 7 thereafter.²⁴

5.2.2.2 *The Remedies under Section 7*

Another problem of particular interest in the merger cases before 1950 was how far divestiture of both the assets *and* the stock of an unlawfully acquired company could be ordered. As we have already pointed out, the intent of Congress was not to apply the Clayton Act to merger by acquisition of assets but to limit its application to the formation of holding companies. However, the courts did not simply conclude from this that remedy should be limited to divestiture of stock. The circuit court that decided *Western Meat* found that the Commission had no power to do more than order the sale of stock. The courts that ruled on *Swift* and *Thatcher*, on the other hand, held that the FTC did have the right to order complete dissolution. The Supreme Court, simultaneously hearing appeals on all three cases, made a distinction between a situation in which the assets of the acquired corporation had been taken over by the acquiring corporation *before* the Commission's order, and a situation in which the assets had not been acquired until *after* the FTC had instituted proceedings against the two corporations. In the first, the Court held that the Commission was not empowered to demand redistribution of assets. But in the second, the Commission could prevent a subsequent acquisition of assets through its condemnation of the purchase of stock.²⁵

Ruling in the *Arrow-Hart & Hegeman* case in 1934, however, the Supreme Court made it abundantly clear that the FTC had no power itself to order divestiture of assets in this second instance. The Commission had complained

against the formation of a holding company by two competing electrical-appliance manufacturers. Shortly after the FTC's action, the two companies had merged their assets as well. The court of appeals subsequently upheld the cease and desist order issued by the Commission demanding the complete dissolution of Arrow-Hart & Hegeman Electric Co. into its two original components.²⁶ On appeal, however, the Supreme Court reversed the lower court's finding:

The Commission is an administrative body possessing only such powers as are granted by statute. It may make only such orders as the Act authorizes; may order a practice to be discontinued and shares held in violation of the Act to be disposed of; but, that accomplished, has not the additional powers of a court of equity to grant other and further relief by ordering property of a different sort to be conveyed or distributed, on the theory that this is necessary to render effective the prescribed statutory remedy.²⁷

This ruling definitively denied the FTC power to obtain proper relief under Section 7. The Commission made no attempt to obtain a reversal of this decision in similar cases later on.

5.2.2.3 *The Applicability of Section 5 of the FTC Act*

An early attempt by the FTC to condemn a merger as an unfair competitive practice is worth mentioning. The Commission based its case against Eastman Kodak in 1925 on Section 5 of the Federal Trade Commission Act of 1914, which specifies that 'unfair methods of competition in commerce are . . . unlawful.' The Commission had ordered Eastman Kodak to dispose of its controlling interest in three corporations manufacturing film material. The circuit court of appeals overruled the Commission's order on the grounds that the Commission could not prohibit acquisition of assets under Section 5, and the Supreme Court upheld this view.²⁸ The Commission has not since attempted to obtain a reversal of this ruling.

²³ *Id.* at 297-99.

²⁴ Though a number of lower courts issued decisions reflecting the Supreme Court's ruling in *International Shoe*. See, e.g., *V. Vivaudou, Inc. v. FTC*, 54 F.2d 273 (2d Cir. 1931); *US v. Republic Steel Corp.*, 11 F. Supp. 117 (ND Ohio 1935). In the latter case the court applied the Sherman Act test explicitly (at 121).

²⁵ *FTC v. Western Meat Co., Thatcher Mfg. Co. v. FTC, Swift & Co. v. FTC*, 272 US 554, 561 (1926).

²⁶ *Arrow-Hart & Hegeman Electric Co. v. FTC*, 65 F.2d 336 (2d Cir. 1932).

²⁷ 291 US 587, 598-99 (1934).

²⁸ *Eastman Kodak Co. v. FTC*, 7 F.2d 994 (2d Cir. 1925), *aff'd*, 274 US 619 (1927).

5.2.3 The 1950 Amendment (The Celler-Kefauver Act)

5.2.3.1 *Origins*

Between 1921 and 1949 some twenty different proposals to amend Section 7 of the Clayton Act were submitted to Congress.²⁹ The last six of these years, from 1943 to 1949, saw the greatest activity, chiefly as a result of the recommendations of the Temporary National Economic Committee (TNEC).³⁰ Three different kinds of bill were introduced: there were bills on the basis of TNEC recommendations that would require prior approval of mergers exceeding a specified size; there were bills that advocated prohibition of acquisition of assets too under an otherwise unchanged Section 7; and there were bills that also incorporated a change in the substantiality test. A proposal of this last kind was eventually accepted by Congress in 1950.

The FTC was the driving force behind nearly all the bills to amend the Clayton Act. This was due to the Commission's belief that a more intensive approach to the merger question was necessary because the high rate of mergers, especially since the TNEC had issued its final report, had brought the concentration of economic power to a critical point and would probably push it even further unless preventive measures were taken promptly.³¹ Both the Commission and congressional supporters of an amendment to the Clayton Act believed that this increase in concentration was having a bad effect on competition and constituted a menace to free enterprise. During hearings on a bill submitted by him, Congressman Estes Kefauver stated:

We must decide very quickly what sort of country we want to live in. This nation was founded and built by men who believed in individualism. It has grown under a system carried on largely by individual capital. The increased concentration of economic power is harming free enterprise. The present trend of great corporations to increase their economic power is the antithesis of meritorious competitive development.³²

The basic approach of the advocates of more effective legislation was to try to close the asset loophole in Section 7, that is to induce Congress to declare that Section 7 applied also to the acquisition of assets.³³ Up to 1940 there were even bills laid before Congress aimed at prohibiting all mergers between companies whose joint share of the market totalled more than 10 percent.³⁴

After 1940 attention was also turned to the possibility of introducing compulsory registration of mergers and to the amendment of the substantiality test. The proposal for compulsory registration of mergers exceeding a specified capital or share of the market was one of the TNEC recommendations, but this never got as far as the statute book. The bills brought forward after 1945

to amend the test of Section 7 of the Clayton Act were intended not only to widen the scope of the Act to embrace acquisition of assets but also to modify its wording in order to eliminate the reference to a substantial lessening of competition *between* two merging corporations. For the Supreme Court's interpretation of Section 7 in *International Shoe* circumvented the difficulties inherent in defining substantiality only by substituting a Sherman Act test for the Clayton Act test. Subsequent application of the Sherman Act to merger cases made it clear that this statute provided no adequate basis for an effective antitrust policy on mergers and thus constituted another reason for pressing for amendment of the test of Section 7. More particularly, the Supreme Court's 1948 ruling under the first two sections of the Sherman Act on the acquisition of Consolidated Steel Corp. by Columbia Steel, a subsidiary of US Steel, strengthened this opinion. As to whether the case involved unreasonable restraint, the Court remarked:

[W]e do not think the dollar volume is in itself of compelling significance; we look rather to the percentage of business controlled, the strength of the remaining competition, whether the action springs from business requirements or purpose to monopolize, the probable development of the industry, consumer demands, and other characteristics of the market.³⁵

The Court's view, then, was that under the Sherman Act the relevant points were the purpose of the merging corporations and the reasonableness of the consequences of the merger as regards competition on the market. Section 7,

²⁹ See Comment, *supra* note 10, and Martin, *op. cit. supra* note 10.

³⁰ TNEC, *Final Report and Recommendations*, S. Doc. 35, 77th Cong., 1st Sess. 38-40 (1941).

³¹ See FTC, *The Present Trend of Corporate Mergers and Acquisitions* (Washington, DC: Government Printing Office, 1947), in *Hearings on HR 515 before Subcommittee No. 2 of the House Committee on the Judiciary*, 80th Cong., 1st Sess. (1947). The FTC based its findings on the number of mergers, without inquiring into the importance of the mergers; it believed that the increase in concentration was a result of the increase in mergers. For a critical appraisal of this view see our discussions of the merger movement in American industry in Chapter 2 *supra* and Chapter 6 *infra*.

³² *Hearings on HR 515, supra* note 31, at 7.

³³ See *Hearings on HR 2734 before a Subcommittee of the House Committee on the Judiciary*, 81st Cong., 1st Sess. 23 (1949); *Hearings on HR 2357 before Subcommittee No. 3 of the House Committee on the Judiciary*, 79th Cong., 1st Sess. 66-86 (1945); FTC, *The Merger Movement, A Summary Report* (Washington, DC: Government Printing Office, 1948), and subsequent annual reports. See also Martin, *op. cit. supra* note 10.

³⁴ This is extensively dealt with in Milton Handler and Stanley D. Robinson, 'A Decade of Administration of the Celler-Kefauver Antimerger Act', 61 *Colum. L. Rev.* 629 (1961).

³⁵ *US v. Columbia Steel Co.*, 334 US 495, 527 (1948). For full treatment of this ruling, see Chapter 4 *supra*.

however, had originally been drafted precisely in order to obviate such an investigation into intent and an economic assessment of the consequences of a merger, preferring a rapid decision and swift action where necessary.

Finally, in 1950 an amendment introduced by Senator Emanuel Celler and Congressman Estes Kefauver to change the wording of Section 7 was enacted by the Congress. As amended, the first paragraph of Section 7 now reads as follows:

That 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.³⁶

5.2.3.2 *An Analysis of the Text*

The intent of Congress is clear if we reread the reports published by the House and Senate Judiciary Committees during the preparations for the bill.³⁷ In 1949 the Judiciary Committee of the House of Representatives stated:

Acquisitions of stock or assets have cumulative effect, and control of the market sufficient to constitute a violation of the Sherman Act may be achieved not in a single acquisition but as the result of a series of acquisitions. The bill is intended to permit intervention in such a cumulative process when the effect of an acquisition may be a significant reduction in the vigor of competition, even though this effect may not be so far-reaching as to amount to a combination in restraint of trade, create a monopoly, or constitute an attempt to monopolize. . . .³⁸ [I]t would be unnecessary for the government to speculate as to what is in the 'back of the minds' of those who promote a merger; or to prove that the acquiring firm had engaged in actions which are considered to be unethical or predatory; or to show that as a result of a merger the acquiring firm had already obtained such a degree of control that it possessed the power to destroy or exclude competitors or fix prices.³⁹

The Senate Judiciary Committee found a similar purpose in the bill:

The Committee wishes to make it clear that the bill is not intended to revert to the Sherman Act test. The intent here, as in other parts of the Clayton Act, is to cope with monopolistic tendencies in their incipency and well before they have attained such effects as would justify a Sherman Act proceeding.⁴⁰

The legislative history and the text of the statute show, then, that Congress did not wish to prohibit all mergers *per se* nor on the other hand to enjoin

them only when they were accomplished facts and had created dominant positions. Congress wished to steer a middle course between these two possible approaches by writing into the Act the test of the probability of substantial lessening of competition or a tendency to create a monopoly.

Amended Section 7 includes three tests which call for clarification:

- (1) the test 'in any line of commerce in any section of the country' – requiring determination of the relevant product market and the relevant geographic market;
- (2) the test 'may be';
- (3) the test 'substantially to lessen competition, or to tend to create a monopoly.'

On the test of the relevant market in Section 7, the House Judiciary Committee report notes:

The test of substantial lessening of competition or tending to create a monopoly is not intended to be applicable only where the specified effect may appear on a nationwide or industrywide scale. The purpose of the bill is to protect competition in each line of commerce in each section of the country.⁴¹

As for the words 'any line of commerce,' the Senate Judiciary Committee adds:

It is intended that acquisitions which substantially lessen competition, as well as those which tend to create a monopoly, will be unlawful if they have the specified effect in any line of commerce, whether or not that line of commerce

³⁶ 64 Stat. 1125 (1950), 15 USC 18. The second paragraph of Section 7, originally designed to bring acquisitions by purely holding companies within the reach of the Act, was also amended. Under the 1914 text, two or more corporations had to be acquired, because Congress considered there could be no lessening of competition between firms where one of the two was not engaged in commerce. In 1950 the relevant passage was amended to read 'one or more,' so that the two paragraphs now amount to the same thing.

³⁷ HR Rep. 1191, 81st Cong., 1st Sess. (1949); S. Rep. 1775, 81st Cong., 2d Sess. (1950).

³⁸ HR Rep. 1191, *supra* note 37, at 8. The report goes on to name some of the ways in which this effect may be brought about: '... elimination in whole or in material part of the competitive activity of an enterprise which has been a substantial factor in competition, increase in the relative size of the enterprise making the acquisition to such a point that its advantage over its competitors threatens to be decisive, undue reduction in the number of competing enterprises, or establishment of relationships between buyers and sellers which deprive their rivals of a fair opportunity to compete.' *Ibid.*

³⁹ *Ibid.*

⁴⁰ S. Rep. 1775, *supra* note 37, at 4.

⁴¹ HR Rep. 1191, at 8.

is a large part of the business of any of the corporations involved in the acquisition.⁴²

The Senate Committee goes into more detail on the phrase 'in any section of the country.' It advocates a case-by-case approach,⁴³ using the Supreme Court's formula in the *Standard Oil of California* case of 1949 (attacking exclusive dealerships under Section 3 of the Clayton Act) to give a more precise definition of the geographic market:

As the Supreme Court stated in *Standard Oil Co. v. US* (337 US 293), 'Since it is the preservation of competition which is at stake, the significant proportion of coverage is that within the area of effective competition.'

In determining the area of effective competition for a given product, it will be necessary to decide what comprises a significant segment of the market. An appreciable segment of the market may not only be a segment which covers an appreciable segment of the trade, but it may also be a segment which is largely segregated from, independent of, or not affected by the trade in that product in other parts of the country.

It should be noted that although the section of the country in which there may be a lessening of competition will normally be one in which the acquired company or the acquiring company may do business, the bill is broad enough to cope with a substantial lessening of competition in any other section of the country as well.⁴⁴

We may deduce from these reports that the test 'in any line of commerce in any section of the country' is satisfied where a merger may substantially lessen competition in *any* group of products in *any* geographic area. Given the drafting of the statute, then, the courts and enforcement agencies are left with a wide degree of latitude in defining the market so as to facilitate the finding of a violation. This is an interpretation we come across in studying cases brought under Section 2 of the Sherman Act as well. As it is hardly possible in Section 2 cases to separate the delimitation of the relevant market from the analysis of the firm's conduct toward other transactors and, as we saw in Chapter 4, market definition in a number of cases is even dictated by the findings on abusive conduct, the linking of market definition and the finding of a violation can often defended – even from the economic standpoint. This is not so, however, in the case of mergers if they are to be judged in accordance with the purpose of Section 7 – either before they are consummated, or after they are consummated where there is no showing of abusive conduct. In such cases, unlike Sherman Act cases, we must confine ourselves in the main to assessing changes in market structure, and this brings

determination of the relevant market into its own. In the course of this chapter we shall be dealing at length with the importance of market definition in Section 7 cases.⁴⁵

On the meaning to be attached to the words 'may be,' the Senate Judiciary Committee remarks that the test is not possibility but a reasonable degree of probability, which in fact is how these words were interpreted before the amendment:

The words 'may be' have been in Section 7 of the Clayton Act since 1914. The concept of reasonable probability conveyed by these words is a necessary element in any statute which seeks to arrest restraints of trade in their incipency and before they develop into full-fledged restraints violative of the Sherman Act. A requirement of certainty and actuality of injury to competition is incompatible with any effort to supplement the Sherman Act by reaching incipient restraints.⁴⁶

The explanation of the test 'substantially to lessen competition, or to tend to create a monopoly' in the Judiciary Committees' reports is vague and sometimes even ambiguous. Although the House Committee report refers to the Supreme Court's opinion on the purpose of the Clayton Act as expressed in its *International Shoe* ruling, which, as we have seen, introduced certain features of the Sherman Act test into a Clayton Act proceeding, it shortly thereafter adds:

Under HR 2734 a merger or acquisition will be unlawful if it may have the effect of either (a) substantially lessening competition or (b) tending to create

⁴² S. Rep. 1775, at 5.

⁴³ 'What constitutes a section will vary with the nature of the product. Owing to the differences in the size and character of markets, it would be meaningless, from an economic point of view, to attempt to apply for all products a uniform definition of section, whether such a definition were based upon miles, population, income, or any other unit of measurement. A section which would be economically significant for a heavy, durable product, such as large machine tools, might well be meaningless for a light product, such as milk.' *Id.* at 5-6.

⁴⁴ *Id.* at 6.

⁴⁵ There is no general consensus among writers on the role of the determination of the relevant market in Sherman and Clayton Act cases. See, e.g., Irston R. Barnes, 'Legal Issues and Economic Evidence in Cartel Law', in *International Conference on Restraints of Competition* (Frankfurt on Main, June 1960), *Cartel and Monopoly in Modern Law* 805-88 (Karlsruhe: Müller, 1961), and 'Competitive Mores and Legal Tests in Merger Cases: the du Pont - General Motors Decision', 46 *Geo. LJ* 564, 602 (1958); Joel B. Dirlam and Irwin M. Stelzer, 'The du Pont - General Motors Decision: In the Antitrust Grain', 58 *Colum. L. Rev.* 24, 40 (1958); Donald F. Turner, 'Antitrust Policy and the Cellophane Case', 70 *Harv. L. Rev.* 281, 315 n.80 (1956).

⁴⁶ S. Rep. 1775, at 6.

a monopoly. These two tests of illegality are intended to be similar to those which the courts have applied in interpreting the same language as used in other sections of the Clayton Act.⁴⁷

This last passage has given rise to a great deal of discussion, because two months before the House report was published the Supreme Court had handed down a decision in a suit brought against Standard Oil of California (the *Standard Stations* case)⁴⁸ under Section 3 of the Clayton Act, the test of which is almost identical with the test of amended Section 7.⁴⁹ The point at issue in *Standard Stations* was the legality of exclusive supply contracts entered into between Standard Oil of California, the biggest company in the western United States (and one of the companies that had been formed after the dissolution of the original Standard Oil trust in 1911), accounting for 23 percent of the market, and the operators of some 6 000 independent service stations. These stations bought \$58 million worth of gasoline a year (6.7 percent of total sales of all companies in the relevant market) and \$8 million worth of other products from Standard. According the Court, there were two possible interpretations of the statutory test embodied in Section 3:

whether the requirement of showing that the effect of the agreements 'may be to substantially lessen competition' may be met simply by proof that a substantial portion of commerce is affected or whether it must also be demonstrated that competitive activity has actually diminished or probably will diminish.⁵⁰

The majority of the Court held that the wording of the law did not necessitate an investigation into the actual effects of the agreements on competition and favored the first interpretation, whereas a minority of justices found the standard applied by the majority an insufficient basis on which to evaluate the situation.⁵¹

This is not the place to consider whether a distinction should be made between judging exclusive agreements and judging mergers. However, some comment needs to be made on a number of questions that have arisen in connection with the assertion that the House Judiciary Committee had this ruling in mind in the passage cited above. Handler notes that the opinion of the Court in the *Standard Stations* case is not mentioned anywhere in the report of the House Judiciary Committee. The Senate Committee report, which was published a year after the ruling, is also quite silent on this point, except where it quotes the ruling in connection with the definition of the relevant geographic market. Consequently, it cannot be argued that Congress intended to give a *Standard Stations* interpretation to the 'substantial

lessening of competition' test.⁵² However, the Senate report's reference to *Standard Stations* can be held with equal justification to support the contention that Congress did have the ruling in mind and that this is why it refrained from being more explicit.⁵³ For if Section 7 as amended contains the same formulation of the statutory test as was already to be found in other clauses of the Clayton Act, the Supreme Court's interpretation of the test in those other clauses before Section 7 was amended must naturally apply for the time being to amended Section 7 also.

5.2.3.3 *The Scope of Section 7*

Section 7 reaches all forms of merger — integration and diversification as well as horizontal mergers — that lead to a substantial lessening of competition on the market.

One of the main reasons for the enactment of more effective merger legislation was to combat a steadily increasing tendency toward concentration; and, in turn, one of the reasons for this was the importance that was attached to the existence of small business concerns.⁵⁴ While the bill was being discussed no mention was made of mergers between small firms, but the text of the statute shows clearly that such mergers are not caught by Section 7. This, however, does not apply to mergers between a big corporation and a smaller competitor — the type of combination that had been the main target for FTC criticism. The test of a tendency to create a monopoly can bring the acquisition of a small firm by a big one into conflict with the Act if the acquisition is one of a series of similar mergers, though each merger individually need not be in direct conflict with Section 7.

⁴⁷ HR Rep. 1191, at 7–8. For the *International Shoe* ruling see subsection 2.2.1 *supra*.

⁴⁸ *Standard Oil Co. of Cal. v. US*, 337 US 293 (1949).

⁴⁹ Although Section 3 does not contain the words 'in any section of the country,' they can well be supplied. As the Supreme Court stated: 'It is clear, of course, that the "line of commerce" affected need not be nationwide, at least where the purchasers cannot, as a practical matter, turn to suppliers outside their own area.' *Id.* at 299 n.5.

⁵⁰ *Id.* at 299.

⁵¹ '[T]o demand that bare inference be supported by evidence as to what would have happened but for the adoption of the practice that was in fact adopted or to require firm prediction of an increase of competition as a probable result of ordering the abandonment of the practice, would be a standard of proof, if not virtually impossible to meet, at least most ill-suited for ascertainment by courts.' *Id.* at 309–10.

⁵² See Milton Handler, *Antitrust in Perspective* 64 (New York: Columbia UP, 1957); Handler and Robinson, *supra* note 34.

⁵³ See, e.g., Interim Report of the Antitrust Subcommittee of the House Committee on the Judiciary, 84th Cong., 1st Sess., *Corporate and Bank Mergers* 19–20 (1955).

⁵⁴ This is also evidenced by the special statutes enacted to protect and promote smaller firms in the United States, such as the Small Business Act of 1958 (72 Stat. 384, 15 USC 631).

In certain circumstances the acquisition of one corporation by another may not constitute an infringement of Section 7 – for instance, if the acquired corporation is in such financial difficulties that there is some risk of its going bankrupt. On this point the Senate Judiciary Committee had this to say:

According to decisions of the Supreme Court, the Clayton Act does not apply in bankruptcy or receivership cases. Moreover, the Court has held, with respect to this specific section, that a company does not have to be actually in a state of bankruptcy to be exempt from its provisions; it is sufficient that it is heading in that direction with the probability that bankruptcy will ensue.⁵⁵

A violation of the Act would be conceivable if several corporations, both big and small, should show interest in such an acquisition, with the more powerful ones making the more tempting offers. In that event the Senate Committee noted that ‘any firm in such a condition [bankruptcy] should be free to dispose of its stock or assets.’⁵⁶ In such a situation, then, the interests of the failing corporation should prevail over what might be the best choice from the competition standpoint.

Finally, some comment should be made on acquisitions to which Section 7 does not apply. These are: (1) acquisitions involving unincorporated businesses; (2) transactions carried out under the authority of regulatory agencies; (3) acquisition of stock solely for investment, provided the stock is not used in a manner conflicting with Section 7; (4) the formation of subsidiaries to carry on the business of the parent company.

Clearly, these exemptions can be interpreted loosely or strictly. For instance, the Department of Justice can still file a suit against companies that have obtained authorization for a given merger from a regulatory agency if it believes that the agency concerned did not give enough consideration to the interests of workable competition. The Bank Merger Act of 1966 is the only statute that refers explicitly to this point. It stipulates that a merger cannot be consummated within thirty days of approval by the banking agencies. If the Department of Justice does not file suit within this period, the merger is thereafter immune from antitrust attack except under Section 2 of the Sherman Act.

In the case of the fourth exemption, the question arises whether the formation of joint ventures does or does not fall under the Act. We shall revert to these problems in the course of this chapter.

5.2.3.4 *Enforcement Agencies. Remedies*

Section 11 of the Clayton Act, as amended in 1950, vests authority to enforce compliance with Section 7 in the Federal Trade Commission, except in re-

spect of fields coming under the jurisdiction of the Interstate Commerce Commission, the Federal Communications Commission, the Civil Aeronautics Board and the Federal Reserve Board. Power to institute proceedings is also vested in the Attorney General under Section 15 of the Act. The division of labor between the Antitrust Division and the FTC observed in Chapter 4 applies to the enforcement of Section 7 as well. Since 1950, the FTC has concentrated primarily on its 'traditional' industries – cement, dairy produce and baking. Both the FTC and the Department of Justice have taken action in the paper industry and in retail department and retail grocery stores. In other industries the Antitrust Division has been the sole agency to institute proceedings. Lastly, any person, firm, corporation or association is entitled under Section 16 to sue for relief against threatened loss or damage by a violation of the antitrust laws. Any injured party can claim threefold recovery of damages. This last form of enforcement has been of little or no significance for Section 7, however.

The findings of the enforcement agencies do not in themselves constitute proof of infringement of the Act; this can only be established by the courts. But many companies do not let matters get as far as the courts: they accept consent settlements. Where action is initiated by the Department of Justice, consent decrees are issued by the district courts. Where the FTC intends to issue a formal complaint, it serves notice to the party concerned, together with a proposed form of consent order. If the party named in the proposed complaint does not reply within ten days, or replies that he is not interested in having the proceeding disposed of by consent order, the complaint is issued and served forthwith. About half the merger cases brought under the amended Act have ended in consent settlements.⁵⁷

Before a corporation takes action that might be in conflict with the antitrust laws, it is at liberty to seek the advice of one or other of the antitrust agencies. They may then issue a statement of intention not to start proceedings; or they may say that they will take action if the merger is consummated; or they may simply decline to state their views. Only a few companies have so far made use of the opportunity of seeking clearance in this way, for the enforcement agencies reserve the right to bring civil suits against the corporations concerned if subsequent developments warrant such action (advisory opinions given by the FTC may even be reconsidered and revoked

⁵⁵ S. Rep. 1775, at 7. *International Shoe* is a case in point.

⁵⁶ *Ibid.*

⁵⁷ For a detailed review of economic patterns in consent orders, see Betty Bock, *Mergers and Markets* (New York: National Industrial Conference Board, 3d-7th eds. 1964-69).

at any time), the parties concerned have to give the government information which might later be used against them, this may constitute an early warning for the enforcement agencies and, finally, a long time span elapses before a decision is obtained.

The right of the courts and the FTC to order appropriate relief, and the limits within which they may do so, are not set out clearly in the statute. Section 15 of the Clayton Act, which gives the district courts jurisdiction to hear cases concerning Section 7, is similar in content to Section 4 of the Sherman Act. A number of rulings by the Supreme Court in cases brought under Section 7 show that it sees no restriction on the jurisdiction of the district courts to take remedial action. In the second *du Pont* (General Motors) case, the Supreme Court noted that 'Congress would not be deemed to have restricted the broad remedial powers of courts of equity without explicit language doing so in terms, or some other strong indication of intent.'⁵⁸ No such ruling has been made with reference to the powers of the FTC; here, the only enlightenment we can get is from the text of the Act. The FTC derives its authority to enforce compliance from Section 11 of the Clayton Act, which prescribes that if the Commission finds an infringement of the Act it must issue an order requiring the party concerned 'to cease and desist from such violations, and divest itself of the stock, or other share capital, or assets, held . . . in the manner and within the time fixed by said order.'⁵⁹

As will be seen below, divestiture has been the most frequent relief, but other remedies have been asked as well. Then there is the possibility for the government to apply for a preliminary injunction. Section 15 of the Clayton Act permits the courts to grant such preliminary relief 'as shall be deemed just in the premises.' The courts have interpreted this as requiring the government to show a reasonable probability that it will finally win its case and that an immediate threat to competition exists so that effective permanent relief will not be possible if the merger, once carried through, has to be broken up after court proceedings.⁶⁰ The FTC has no authority to issue a preliminary injunction in Section 7 cases, but in *FTC v. Dean Foods Co.* the Supreme Court held that the Commission has the standing to seek temporary injunctive relief from a court of appeals 'upon a showing that an effective remedial order, once the merger was implemented, would otherwise be virtually impossible, thus rendering the enforcement of any final decree of divestiture futile.'⁶¹

5.3 INTERPRETATION OF THE CLAYTON ACT (1): THE RELEVANT MARKET

5.3.1 Introduction

Since 29 December 1950, the date on which the Celler–Kefauver Act passed into law, enforcement of the merger provisions has gradually come to constitute a major part of the activities of the two antitrust agencies. The two agencies usually learn of combinations to be investigated through the financial press or from complaints by third parties. While there is little consultation between the FTC and the Department of Justice for purposes of deciding which agency should deal with any given case, the Antitrust Division has clearly taken over the lead in the enforcement of Section 7 in all but those sectors mentioned above as falling chiefly within the FTC's jurisdiction. There have been a number of private injunctive suits for violation of Section 7, most of them brought by the management or stockholders of the acquired corporations.

A general look at the case law under amended Section 7 – to which we will confine ourselves in this study – shows that the enforcement agencies have instituted proceedings against mergers most often where the acquiring firm was among the nation's two hundred largest companies or was one of the major organizations in its field. And government complaints have often emphasized the fact that the acquired unit occupied a prominent place in its industry or that the acquisition was one of a series in an industry in which there was already a strong tendency toward concentration. On the other hand, mergers between firms with assets or sales of less than \$50 million have not normally been attacked if their market share was small, the industry concerned was otherwise only moderately concentrated and the enforcement agencies did not consider that the merger was one of a series whose cumulative effect would be incompatible with Section 7. As regards type of acquisition, most of the proceedings instituted to date have concerned mergers between competitors. In recent years, however, the number of conglomerate mergers that have been attacked has been rising steadily. This reflects the rapidly growing importance of this type of external expansion in the United States, the reasons

⁵⁸ *US v. E.I. du Pont de Nemours & Co.*, 366 US 316, 328 n.9 (1961).

⁵⁹ 38 Stat. 734 (1914), as amended by Celler–Kefauver Act (29 Dec. 1950), 64 Stat. 1126, 15 USC 21.

⁶⁰ For a full development of this and the following arguments, see Grant S. Lewis, 'Preliminary Injunctions in Government Section 7 Litigation', 17 *Antitrust Bull.* 1 (1972).

⁶¹ 384 US 597, 605 (1966).

for which were explained in Chapter 2. The Antitrust Division also instituted proceedings against a joint venture for the first time in January 1961, and further complaints have followed.

It was quite some time before final decisions were handed down in actions brought by the enforcement agencies against mergers under the 'new' Section 7. The first ruling of the Supreme Court dates from 1957 in a suit initially brought under the 'old' Section 7 in 1949 – *du Pont* (General Motors). The FTC had instituted a number of proceedings before 1957, but the Commission did not render its decisions until much later. There were no important rulings by the lower courts before 1957. Recent years have seen a change in this situation. There are now a considerable number of rulings by the Supreme Court under this section of the Act, and there have also been a number of guiding decisions by lower courts and the FTC. This body of case law, together with the merger guidelines issued by the Department of Justice in 1968, does offer enlightenment to firms wishing to merge. This is particularly important in view of the fact that the United States has no statutory machinery for premerger notification and clearance.

In discussing the case law, we shall give separate attention to the courts' interpretation of the relevant market and of the substantiality test. This treatment is justified in the light of what we have said about the role of market determination in merger cases. The law does not require a finding that the merging firms were competitors in most of the products that they manufactured: the merger may be violative of Section 7 if there was premerger competition somewhere for a single product only. Consequently, antitrust suits have featured a search for competing products on the same geographic markets. Given the broad criterion for market determination that has been developed in merger suits filed under Section 7, it has been possible to bring within the reach of the law all those cases in which there was reason to investigate whether the merger was liable to have the effects described in the law, i.e. mergers involving at least one leading firm. Only pure conglomerate mergers (in which the companies involved manufactured completely different products before merging) or mergers between firms operating in completely different parts of the country or even in different countries can be regarded as falling outside the scope of the Act.

Whether legally relevant markets *can* be found will depend – especially as regards determination of the product market – on the construction that is put upon the concept of substitutability. If the bounds of substitutability are narrowly drawn, it will often be difficult to find joint products. But once joint products *are* found, there is a better chance of showing that the effects of the merger on competition in these products is substantial, because certain products are not

considered part of the joint market and the share of the merging partners in the market thus defined is consequently larger. With broadly defined product markets, the companies' share may dwindle and so may the possibility of showing that the merger substantially lessens competition. It is clear, then, that there may be a serious conflict between the economist's idea of what should be regarded as the relevant market in merger cases and that of a lawyer who is trying to bring as many mergers as possible under the law – much more conflict, indeed, than arises in monopolization cases under Section 2 of the Sherman Act. The following analysis of the case law on mergers will make this clear.

5.3.2 Determination of the Product Market

The du Pont (General Motors) Case. In 1957 the Supreme Court handed down its opinion in *du Pont (General Motors)*, much of which was taken up by the determination of the relevant product market. This action was brought against General Motors, US Rubber, two holding companies in which members of the du Pont family had controlling interests, and du Pont itself. In a landmark suit filed in 1949 du Pont was accused of having obtained a preferential position in selling its automotive finishes and fabrics to General Motors through its acquisition of a 23-percent interest in General Motors between 1917 and 1920,⁶² thus violating Sections 1 and 2 of the Sherman Act and unamended Section 7 of the Clayton Act (though the essence of the complaint was the infringement of the Sherman Act). US Rubber was accused of enjoying a similar position as regards sales of its tires. In addition, each of the corporations involved had agreed to turn over to the others any discoveries it might make in their fields. The Department of Justice demanded that du Pont be made to sell its holdings of General Motors stock.⁶³

In 1954 the district court held for the defendants on all counts, concluding that the original stock acquisition had been an investment and that in its purchasing policy General Motors had always been concerned to find the best products at the lowest price, irrespective of its connection with du Pont. Even before the transaction du Pont had been the biggest supplier of General Motors; so du Pont had obtained its dominant position on its own merits.⁶⁴ The government appealed, and in a 4–2 decision the Supreme Court found

⁶² At the time of the Supreme Court's decision, du Pont held some 63 million shares of GM stock with a market value of \$2 400 million. This gave du Pont control of the boards of directors of GM and US Rubber.

⁶³ *US v. E.I. du Pont de Nemours & Co.*, Civil 49-C-1071 (ND Ill. 1949).

⁶⁴ 126 F. Supp. 235, 297 (ND Ill. 1954).

against du Pont, arguing chiefly from Section 7 of the Clayton Act, unlike the Antitrust Division in its complaint, and still basing itself on the unamended statute. The Court's opinion was important for three main reasons. First, it applied Section 7 to vertical integration, although in 1955 the FTC had declared that vertical mergers were not reached by it.⁶⁵ Second, the Court stated that the authorities might at *any* time institute proceedings against stock acquisition under Section 7 if a reasonable probability of a substantial lessening of competition on the relevant market could be shown:

Section 7 is designed to arrest in its incipency not only the substantial lessening of competition from the acquisition by one corporation of the whole or any part of the stock of a competing corporation, but also to arrest in their incipency restraints or monopolies in a relevant market which, as a reasonable probability, *appear at the time of suit* likely to result from the acquisition by one corporation of all or any part of the stock of any other corporation.⁶⁶ [Emphasis supplied.]

So an acquisition need not have violated Section 7 at the time of the actual transaction: it is sufficient that at the time of suit the merger has had the anticompetitive effect described in the law. Third, the Court defined a much smaller relevant product market than it had in another case against du Pont, handed down a year before under Section 2 of the Sherman Act. It rejected the view that the product market consisted of all fabrics and finishes as such but differentiated by the uses to which they were put, reasoning as follows:

The record shows that automotive finishes and fabrics have sufficient peculiar characteristics and uses to constitute them products sufficiently distinct from all other finishes and fabrics to make them a 'line of commerce' within the meaning of the Clayton Act. . . . Thus, the bounds of the relevant market for the purposes of this case are not coextensive with the total market for finishes and fabrics, but are coextensive with the automobile industry, the relevant market for automotive finishes and fabrics.

This conception of the relevant market also meets the requirement of substantiality since, in the language of the Court, 'the substantiality of a relevant market comprising the automobile industry is undisputed.'⁶⁷

The Court decided on this market definition partly on the basis of du Pont's defense that it had become the biggest supplier of General Motors because of the quality and individuality of its products and not because of its holdings in the company. The majority view was that the peculiar use of a product by certain customers (the automotive industry) who were clearly distinguished from others (such as the furniture trade) constituted a market within the

meaning of the Act. The dissenting justices held that there was not a sufficient showing to justify determination of a separate submarket because paints and fabrics used for automobiles were also used extensively outside the industry (for coating refrigerators and other appliances or in the manufacture of furniture and railroad upholstery, for instance). However, the dissenting opinion made no comment on the general principles that should underlie market definition under Section 7.

Why did the Court favor a narrow market definition in *General Motors*, after defining the market so broadly in *Cellophane*?⁶⁸ It has been remarked that the selfsame justices who wrote the majority opinion in *General Motors* were the minority in the *Cellophane* decision,⁶⁹ but this is not a relevant point since the basic principles of market definition applied in the two opinions were the same. It is more reasonable to assume that the broader interpretation of these principles enunciated in the *Cellophane* case was now restricted to Section 2 of the Sherman Act. The FTC and the Antitrust Division have been inclined to refer to the intention of Congress that Section 7 should have a preventive effect, so that the relevant market should be given appreciably narrower bounds under this section. However, it seems likely that the narrow definition of the market was also occasioned by the Court's impression of the size of the two corporations and the typical market situation in the automobile industry. Ford and Chrysler manufacture their own finishes and General Motors is practically a monopsonist for automotive finishes and the like, with another giant concern supplying its needs almost single-handed.⁷⁰

Lower Court and FTC Decisions after du Pont (General Motors). Lower-court decisions handed down since *du Pont (General Motors)* show that in

⁶⁵ FTC, *Report on Corporate Mergers and Acquisitions* 148 (Washington, DC: Government Printing Office, 1955).

⁶⁶ 353 US 586, 589 (1957).

⁶⁷ *Id.* at 587.

⁶⁸ See Guy B. Maseritz, 'The Relevant Market - A Case Study of the du Pont - General Motors Decision', 6 *Antitrust Bull.* 487 (1961).

⁶⁹ Mark S. Massel, *Competition and Monopoly* 272 (Washington, DC: Brookings Institution, 1962).

⁷⁰ Dirlam and Stelzer have expressed much the same view: 'We cannot agree with the contention that the decision would have been the same had du Pont and GM been one tenth their absolute size but still of the same relative importance in their respective markets' (*supra* note 45, at 41). This, then, is a good example of a pragmatic decision. For a criticism of the general line of reasoning followed by the Court, see Handler, *op. cit. supra* note 52, at 61; Carl Kaysen and Donald F. Turner, *Antitrust Policy* 134 (Cambridge, Mass.: Harvard UP, 1959); Jesse W. Markham, 'The du Pont - General Motors Decision', 43 *Va. L. Rev.* 881 (1957).

considering the substitutability of physically different goods the courts wished to follow a middle course between the opinions expressed in the two *du Pont* cases. By regarding as irrelevant the possible substitutability of heterogeneous products, but as relevant an actual high degree of substitutability between slightly different product lines, the courts have rejected the broad *Cellophane* interpretation under Section 2 of the Sherman Act for the determination of the relevant market under Section 7 of the Clayton Act.

The tenor of the *Cellophane* ruling was one of the factors that played a part in the definition of the market by the district and circuit courts in the *American Crystal Sugar* case in 1957 and 1958.⁷¹ The American Crystal Sugar Co., a major manufacturer of beet sugar, tried to resist the acquisition of a large proportion of its stock by the Cuban-American Sugar Co., a competitor, by alleging violation of Section 7. Cuban-American based its defense on the grounds that it manufactured cane sugar and that there were traditional differences in the markets for the two types of sugar: cane sugar was sold under brand names to the consumer, while beet sugar was sold in bulk. The trial court, upheld by the appellate court, rejected this reasoning. It was only in certain cases that cane sugar had a higher degree of consumer acceptance, and this had disappeared once a determined effort had been made to market beet sugar. A second proof of this was the technical interchangeability of cane and beet sugar for most uses.⁷²

Closer to the *du Pont* (General Motors) ruling was a district-court decision of 1958 in the suit filed by the Antitrust Division against a planned merger between Bethlehem Steel Corp. and Youngstown Sheet & Tube Co. – the second and sixth largest steel producers in the United States. Both parties adopted a twofold approach to the market. In the first place, there was the question whether the steel industry could be regarded as one single big market. The answer to this depended on whether iron and steel had sufficient peculiar characteristics and uses to make it impossible for them to be replaced by other metals. The court considered that they had: not only had iron and steel considerably more uses than copper or aluminum, but for a great number of purposes they were irreplaceable. Finally, the iron and steel industry was ‘commonly recognized by its members as well as the community at large as a separate industry. It has its own trade association, treating the industry as separate and distinct.’⁷³

A second problem that had to be solved concerned the treatment of the various steel products as separate product markets within the industry. The two steel producers held the view that ingot should be regarded as constituting a relevant market of its own because the steel mills generally had a greater capacity for producing finished products than for producing ingot,

and ingot could therefore be allocated to those finished products for which there was greatest demand. Bethlehem and Youngstown also argued for relevant submarkets each consisting of various groups of end products which, although they differed from each other in the use to which they were put, could be manufactured on the same product line or with only relatively minor alterations⁷⁴ – presumably as a means of reducing their market shares in the larger markets so defined. The two companies backed up this ‘production-flexibility theory’ (also known as the ‘mill-product-line theory’) by referring to the Supreme Court’s 1948 ruling in the *Columbia Steel* case – an action brought against another merger in the steel industry.⁷⁵ The district court, however, rejected this line of argument as a basis for market delineation. Quite apart from the fact that the case at bar was principally one of horizontal merger under Section 7 and not, like *Columbia Steel*, a case of integration under the Sherman Act, production flexibility was utilized solely in the interests of the producers. The steel producers’ faculty of shifting from one product to another in response to changes in demand might be detrimental to consumers, who could not simply change over to buying other products: ‘The only flexibility the buyer has is in the choice of the company from which he buys the product he needs. It is just such freedom of choice that § 7 is designed to protect and for that reason line of commerce must take into account buyers and uses.’⁷⁶ A third reason why the court could not accept this theory was that it was theoretical in character: it had never been satisfactorily tested in practice. The district court did not reject the idea that

⁷¹ *American Crystal Sugar Co. v. Cuban-American Sugar Co.*, 152 F. Supp. 387, 399 (SD NY 1957), *aff’d*, 259 F.2d 524 (2d Cir. 1958).

⁷² The circuit court stated: ‘Although there was some evidence that soft drink manufacturers are reluctant to use beet sugar, almost all the testimony supported the trial court’s finding of substantially complete functional interchangeability, under the tests laid down in the *du Pont* case [Cellophane], as the defendant conceded. We conclude that in so far as there is in the market existence of separate “buyer demands” for cane and beet sugar, it betokens not an absence of competition between cane and beet but only that for the time being as to certain customers one or the other form of the product for one reason or another has forged ahead in the competitive race.’ 259 F.2d at 530. *Accord*, *Hamilton Watch Co. v. Benrus Watch Co.*, 114 F. Supp. 307, 311 (D. Conn. 1953), *aff’d*, 206 F.2d 738 (2d Cir. 1953). In this case the trial court discussed two lines of commerce: jeweled watches generally and nationally advertised branded jeweled watches. A more precise market definition – based on number of jewels and price, for instance – was not attempted by either trial or appellate court.

⁷³ *US v. Bethlehem Steel Corp.*, 168 F. Supp. 576, 593 (SD NY 1958).

⁷⁴ *Id.* at 590–91.

⁷⁵ *US v. Columbia Steel Co.*, 334 US 495, 510–11 (1948). See Chapter 4 *supra*.

⁷⁶ 168 F. Supp. at 592 n.34.

there might, within a group of products of the same kind, usually combined in a single industry such as the steel industry, be submarkets of products answering a single purpose. However, unlike the defendants, it regarded the price and peculiar uses of the product as the main criteria on which the definition of relevant product submarkets should be based, reasoning that the broad interpretation of the relevant market in cases under Section 2 of the Sherman Act should not simply be applied to cases under Section 7 of the Clayton Act. In the words of the court:

It should be noted that the basic issue in the *Cellophane* case was that of monopoly power . . . Obviously, when the question is power over price, substitute products may be relevant because they can limit that power. The issue under § 7 of the Clayton Act is not whether a merger may result in a company having power over price or the power to exclude competition. The issue under § 7 is whether there is a reasonable probability of substantial lessening of competition. There can be a substantial lessening of competition with respect to a product whether or not there are reasonably interchangeable substitutes. The merger of two producers of a product may substantially lessen competition or tend to create a monopoly in the market for that product even though it does not substantially lessen competition or tend to create a monopoly in the broader market embracing all the products which are reasonably interchangeable with that product . . . This does not, however, mean that interchangeability can be ignored - a high degree of interchangeability may under certain circumstances make it more or less the same product. [*American Crystal Sugar.*]⁷⁷

Rather than the submarkets consisting of various groups of end products which the defendants would have preferred, the court accordingly held a number of narrowly defined product lines (such as hot-rolled sheet, cold-rolled sheet, butt-weld pipe) to be relevant submarkets within the steel industry.

The FTC also adopted the relevant-market test laid down in *du Pont* (General Motors) in its rulings.⁷⁸ In the case of a merger between two paper companies, the Crown Zellerbach Corp. (one of the biggest firms in the industry) and a smaller competitor, the St. Helens Pulp & Paper Co., the FTC and subsequently the court of appeals rejected the contention that the relevant market should include all kinds of paper manufactured by St. Helens because there were not enough joint characteristics to justify it. Instead, the Commission urged that the only items that should be considered in determining the relevant market were certain well-known packaging materials that constituted subgroups for census purposes. Like the Commission, the court rejected as unrealistic the production-flexibility argument of Crown Zellerbach that in determining the relevant market account should be taken of all kinds of paper that could be manufactured on its machines, including types that were not yet in production.⁷⁹

The fact that an economically meaningful product market may be divided into several narrowly defined submarkets that can each be distinguished as a line of commerce within the meaning of Section 7 on the basis of differences in price and quality comes out clearly in two decisions handed down by the FTC in 1960 and 1961. In the first case, against *A. G. Spalding & Bros., Inc.*, a manufacturer of athletic goods that had taken over a smaller competitor, the athletic-goods industry was regarded as a separate industry within which no less than nineteen submarkets for equipment for all kinds of sport could be distinguished. Each of these submarkets was again subdivided into higher and lower price categories (based on the classification used in its statistics by the Athletic Goods Manufacturers Association), the higher-priced goods being designed for competitions and good amateur games and the cheaper lines for children's play.⁸⁰ This definition of the market brought both companies into the same line of commerce. A clear departure from the applicability of *Cellophane* principles to Section 7 cases can also be found in *Union Carbide*, in which the FTC challenged the acquisition by Carbide, the largest producer of polyethylene resin, of Visking, the biggest manufacturer of polyethylene film. In its defense of the acquisition, Union Carbide, relying on *Cellophane*, maintained that the relevant market consisted of all flexible packaging materials. The Commission, however, did not agree. It found that while polyethylene and other packaging materials might be interchangeable for some customers, there would always be a certain number who would remain loyal to polyethylene. So it was the effect of the merger on this market that had to be examined. The Commission supported its view by pointing out the difference in price between polyethylene and cellophane.⁸¹ However, it is interesting to note that advertised brands of comparable goods have not in them-

⁷⁷ *Id.* at 593 n.36.

⁷⁸ In the Matter of *Crown Zellerbach Corp.*, Dkt. 6180 (FTC opinion and order 1957), *Crown Zellerbach Corp. v. FTC*, CCH 1961 Trade Cas. ¶ 70 038 (9th Cir. 1961), cert. denied (US Sup. Ct. 1962); In the Matter of *A. G. Spalding & Bros.*, Dkt. 6478 (FTC opinion and order 1960), *A. G. Spalding & Bros. v. FTC*, CCH 1962 Trade Cas. ¶ 70 266 (3d Cir. 1962); In the Matter of *Erie Sand & Gravel Co.*, Dkt. 6670 (FTC opinion and order 1959), *Erie Sand & Gravel Co. v. FTC*, CCH 1961 Trade Cas. ¶ 70 028 (3d Cir. 1961); In the Matter of *Union Carbide Corp.*, Dkt. 6826 (FTC opinion and order 1961), CCH 1961 Trade Cas. ¶ 15 503.

⁷⁹ CCH 1961 Trade Cas. ¶ 70 038, at 78 151.

⁸⁰ CCH 1962 Trade Cas. ¶ 70 266, at 76 036, 76 042.

⁸¹ CCH 1961 Trade Cas. ¶ 15 503. In *Erie Sand & Gravel* the FTC ordered the respondent to divest itself of the acquired company, holding that there were separate markets for lake sand and other types of sand.

selves been held to constitute distinct relevant markets, the only exception being made for cosmetics.⁸²

Unlike the decisions of the FTC, which bear a strong relationship to the *du Pont* (General Motors) ruling, later decisions of lower courts in suits brought by the Antitrust Division give a broader definition of the market.⁸³ In the *Columbia Pictures* case, in 1960, a subsidiary of Columbia had obtained from Universal Pictures exclusive television rights to Universal feature films made before 1948. The Antitrust Division considered that the exhibition of these films was likely to fall into the hands of a single company. The district court, however, held that these films had to compete not only with pre-1948 films but also with all other kinds of comparable program material. Consequently, it found that there was no contradiction in this respect between the rulings of the Supreme Court in *du Pont* (Cellophane) and *du Pont* (General Motors):

The tests enunciated by the authorities are consistent. Effectively, the test 'reasonable interchangeability for the purposes for which [the products] are produced – price, use and qualities considered,' and the test 'sufficient peculiar characteristics and uses to constitute them products sufficiently distinct . . . to make them a "line of commerce" within the meaning of the Clayton Act' are but different verbalizations of the same criterion.⁸⁴

The Brown Shoe Case. The Supreme Court's ruling in *Brown Shoe* is famous for its definitive elucidation of the meaning of the *du Pont* (Cellophane) and the *du Pont* (General Motors) decisions in respect of the relevant product market for purposes of Section 7, thus clearing up the ambiguity previously surrounding this concept.⁸⁵

The Court adopted a pragmatic approach, distinguishing between the outer boundaries of a relevant market and the submarkets of this broader market, the consequences of the merger on which should also be investigated. In defining the outer boundaries, the Court took the broad view, using both the test from its *Cellophane* ruling – 'the reasonable interchangeability of use or the cross elasticity of demand between the product itself and substitutes for it' – and the test from its *Columbia Steel* ruling – 'cross elasticity of production facilities.'⁸⁶ But the Court held that determination of the outer boundaries of the relevant market was not sufficient for the application of Section 7, thus denying the applicability of the criteria used to define the relevant market in cases under Section 2 of the Sherman Act to market definition in Section 7 cases:

[W]ithin this broad market, well-defined submarkets may exist, which, in themselves, constitute product markets for antitrust purposes. . . . The boundaries

of such a submarket may be determined by examining such practical indicia as 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. Because Section 7 of the Clayton Act prohibits any merger which may substantially lessen competition 'in any line of commerce' (emphasis supplied), it is necessary to examine the effects of a merger in each such economically significant submarket to determine if there is a reasonable probability that the merger will substantially lessen competition.⁸⁷

If, then, there is a demonstrable danger that a merger will lessen competition on a *submarket* – and not necessarily on the broader market – the merger may be condemned. And although the Supreme Court states that the indicia must be applied in such a way that the submarket determined thereby is economically significant, they really come down to a choice based on very narrow technical criteria which leave the authorities and the courts a great deal of latitude in bringing mergers under the law: any group of customers or competitors on whom the authorities wish to show that a merger might have injurious effects could now be termed a line of commerce within the meaning of Section 7, provided the group can somehow be differentiated from other groups.

In its ruling in the *Brown Shoe* case, in which the Department of Justice challenged a merger between two shoe manufacturers, each with its own chain of retailers, the Brown Shoe Co. and the G. R. Kinney Co., the Supreme Court distinguished between three product submarkets – those for men's, women's and children's shoes. Although it would not involve a firm in too much difficulty to convert from manufacturing men's shoes to women's or children's shoes and vice versa, the Supreme Court found that an actual subdivision of the market into these types was justified because they were manufactured in separate plants and because they were not interchangeable for the consumer. Another of the indicia suggested by the Court – distinct prices –

⁸² See, e.g., *Packard Motor Car Co. v. Webster Motor Car Co.*, 243 F.2d 418 (D. DC 1957), cert. denied, 355 US 822 (1957); *US v. Guerlain, Inc.*, 155 F. Supp. 77 (SD NY 1957), 358 US 915 (1958). These were not merger cases, however.

⁸³ *US v. Columbia Pictures Corp.*, CCH 1960 Trade Cas. ¶ 69 766 (SD NY 1960); *US v. Ling-Temco Electronics, Inc.*, CCH 1961 Trade Cas. ¶ 70 160 (ND Tex. 1961).

⁸⁴ CCH 1960 Trade Cas. ¶ 69 766, at 77 007–08. In *Ling-Temco* the district court refused to divide the aerospace field into separate product markets because the fluid state of the industry made definition impracticable.

⁸⁵ *Brown Shoe Co. v. US*, 370 US 294 (1962), affirming 179 F. Supp. 721 (ED Mo. 1959).

⁸⁶ 370 US at 325 n.42 (citing *US v. Columbia Steel Co.*, 334 US 495, 510–11).

⁸⁷ 370 US at 325.

which Brown Shoe had advanced in support of a further subdivision into cheap and expensive shoes (Brown mainly sold more expensive shoes than Kinney) was ruled irrelevant, however, because the Court felt that shoes in the various price classes did in fact compete with each other.

Supreme Court Decisions after Brown Shoe. Several actions brought by the Justice Department since the *Brown Shoe* ruling have come before the Supreme Court, and in all of them definition of the relevant product market played a decisive role. In decisions on horizontal bank mergers, starting with *Philadelphia National Bank* in 1963, the Supreme Court firmly stated that the cluster of commercial bank products and services had to be considered the relevant line of commerce, thus keeping commercial banking distinct from other financial service.⁸⁸ While the Court took up an economically acceptable standpoint on this matter, it made considerable use of its discretion in respect of market definition to find a clear violation of the Act in two rulings in 1964 in suits challenging product-extension mergers by Alcoa and Continental Can.

The first of these actions was brought to decide whether Alcoa's acquisition in 1959 of a small firm, the Rome Cable Corp., which chiefly manufactured copper conductor wire and cable, was in conflict with Section 7. Rome Cable manufactured only very little aluminum conductor wire and cable, unlike Alcoa – which had pioneered the product and maintained a very strong position ever since. A central issue in the case was whether aluminum and copper conductor wire and cable were competing products and whether a distinction should be made between the insulated and the bare varieties. The district court, relying on *Brown Shoe*, had ruled after an extensive analysis of the facts that conductor wire and cable manufactured from aluminum and copper constituted a single market and concluded that the combined share of the merged companies on the relevant market was too small to warrant a finding against the merger. The same was true in the case of bare aluminum cable, which was considered a distinct line of commerce within the larger market.⁸⁹ The Supreme Court thought differently. A 6–3 majority held that though there was some competition between copper and aluminum used in insulated cable, aluminum had displaced copper in bare conductor cable because it was cheaper. The Court noted the insensitivity of the demand for both products to price changes. It then added insulated aluminum wire and cable to the market for the bare product, without clearly justifying the nonincorporation of insulated copper wire and cable. However, the line of commerce thus defined was the only one of a number of product combinations that gave relative importance to the market shares of both companies, Alcoa coming out as the biggest

producer with 27.8 percent and Rome Cable ranking ninth with 1.3 percent. It was this, no doubt, that enabled the Court to regard as violative of Section 7 the disappearance of Rome Cable as an independent competitor in this oligopolistic market. Although the merger had taken place a number of years previously, the Court did not consider postmerger evidence in support of its view.⁹⁰

The arguments put forward by the majority of the Court drew sharp criticism from the three dissenting justices. In their opinion the determination of the market was contrary to the facts, and the majority had ignored them. In the first place, there was complete manufacturing interchangeability between copper and aluminum if manufacturers converted from one metal to the other when demand fluctuated. Secondly, the extensive inquiry by the court below had shown clearly that customers' choice of aluminum or copper wire did not depend only on existing price differences but also on a number of other factors, including costs of installation and the like, which were often higher for aluminum than for copper. Thirdly, all electrical conductors could be said to be for conducting electrical current, so that the majority's reasoning should be applied to copper as well as to aluminum cable and wire.

The Supreme Court's market definition appears to reflect its willingness to find against mergers which may have anticompetitive effects somewhere. We are left with the same impression on reading the *Continental Can* ruling. In this case the Antitrust Division was attempting to undo a merger between the second largest producer of metal containers in the United States (Continental Can Co.) and the nation's third largest producer of glass containers (Hazel-Atlas Glass Co.). The government had argued that the relevant market included plastic, glass and metal containers and a half dozen specific lines of container products, and that both metal and glass containers were used interchangeably. The district court, rejecting this argument, had relied on the purely technical standpoint that since containers of metal, glass or plastic were manufactured on different machines in different plants, these packaging materials constituted separate markets, so that the merger did not substantially reduce competition.⁹¹ The Supreme Court reversed this ruling. Certain products, such as beer, soft drinks and baby food, were packed either in metal or in glass containers, and the two companies had therefore been competitors

⁸⁸ *US v. Philadelphia Nat'l Bank*, 374 US 321 (1963); *US v. Phillipsburg Nat'l Bank & Trust Co.*, 399 US 350 (1970).

⁸⁹ *US v. Aluminum Co. of America*, 214 F. Supp. 501 (ND NY 1963).

⁹⁰ 377 US 271 (1964).

⁹¹ *US v. Continental Can Co.*, 217 F. Supp. 761 (SD NY 1963).

before the merger in this part of the packaging industry: hence, the merger would put an end to this competition. In answer to Continental's defense that for most of the food market metal and glass were not substitutes, the Court held that 'complete interindustry competitive overlap need not be shown':

That there are price differentials between the two products or that the demand for one is not particularly or immediately responsive to changes in the price of the other are relevant matters but not determinative of the product market issue....

Where the area of effective competition cuts across industry lines, so must the relevant line of commerce⁹²

The reasoning used in *Alcoa* (Rome) to include in the same line of commerce the product of merging firms that could be considered directly competitive in only a minority of cases was thus overturned by the same Supreme Court only three weeks later. The obvious conclusion to be drawn is that it was the Court's intention to bring the merger between Continental and Hazel-Atlas within the reach of Section 7: this is in fact the only point on which there is legal consistency between the two decisions. Justice John M. Harlan brought this out clearly in his dissenting opinion, stating that the Court 'chooses ... to invent a line of commerce the existence of which no one, not even the government, has imagined; for which businessmen and economists will look in vain; a line of commerce which sprang into existence only when the merger took place and will cease to exist when the merger is undone.'⁹³

Finally, mention should be made of the judgment in *Greater Buffalo Press*⁹⁴ – a case of a merger between the largest daily newspaper in California and a local newspaper. The Supreme Court affirmed the ruling of the district court, which had not been willing to regard the two papers as complementary, since it did not consider that price differences in the case of low-priced products such as newspapers were enough to support a conclusion that they were not competitors, other indicators pointing in the opposite direction.

Lower Court and FTC Decisions after Brown Shoe. On the whole, the lower courts and the FTC have defined 'line of commerce' in a way that accords more with economic realities than the Supreme Court's definition. This can be seen not only in the cases reversed by the Supreme Court but also in a number of decisions against which no appeal was lodged. In a suit against Lever Bros., which had acquired from Monsanto Chemical exclusive manufacturing and sales rights to a low-sudsing detergent for use in washing machines, the district court found that this detergent could not be replaced at all, or only with great difficulty, by other detergents not designed for automatic washing

machines and thus constituted a 'line of commerce' on its own.⁹⁵ In an FTC complaint against an aluminum-foil manufacturer, the Reynolds Metals Co., which had taken over a small producer of florist foil, the finding of the FTC that florist foil was distinguished sufficiently from other, though technically comparable, products such as aluminum foil for decorative purposes and aluminum foil in general was upheld on appeal, though the circuit court found against the FTC on the substantiality test.⁹⁶ The Commission had noted that decorative-foil convertors did not supply the florist industry and that the florist industry purchased only from firms manufacturing packaging material exclusively for it. Lastly, users of decorative foil remained loyal to this product although florist foil was considerably cheaper. And in *Brillo*, where the largest American manufacturer of steel wool had acquired another company manufacturing the same product, the Commission divided the market for steel wool into a household and an industrial submarket on the grounds that there were important differences in the manufacturing processes of the two types of steel wool, that widely different prices prevailed, and that the industry as a whole distinguished the two types of wool from each other.⁹⁷

5.3.3 Determination of the Geographic Market

The Supreme Court's ruling in *Brown Shoe* also had an appreciable influence on the development of case law relating to the test 'any section of the country' in Section 7 – the geographic dimensions of the relevant market. In the decisions of lower courts and the Federal Trade Commission prior to *Brown Shoe*, we find the elements which were eventually formulated by the Supreme Court. In *American Crystal Sugar* it was decided that the relevant geographic market was the area in which the two companies involved concentrated their principal sales efforts and in relation to which their plants were most favorably situated. This second point is of importance for sugar refineries in par-

⁹² 378 US 441, 455, 457 (1964).

⁹³ *Id.* at 476–77.

⁹⁴ *US v. Greater Buffalo Press, Inc.*, 402 US 549 (1971).

⁹⁵ *US v. Lever Bros. Co.*, CCH 1963 Trade Cas. ¶ 70 770 (SD NY 1963). See also *US v. Bliss & Laughlin, Inc.*, CCH 1962 Trade Cas. ¶ 70 292 (SD Cal. 1962), *id.* ¶ 70 538 (US Sup. Ct. 1962), remanded for consideration in the light of *Brown Shoe*, CCH 1963 Trade Cas. ¶ 70 734 (SD Cal. 1963).

⁹⁶ *Reynolds Metals Co. v. FTC*, 309 F.2d 223 (DC Cir. 1962).

⁹⁷ In the Matter of *Brillo Mfg. Co.*, Dkt. 6557, CCH 1963 Trade Cas. ¶ 16 543 (FTC opinion and order 1963). See also In the Matter of *Luria Bros. & Co.*, Dkt. 6156, CCH 1962 Trade Cas. ¶ 16 183 (FTC opinion and order 1962).

ticular, because of the high cost of transporting sugar to the market. The circuit court gave no consideration to the possibility of dumping on the relevant market by companies established outside this area.⁹⁸ In the *Bethlehem Steel* case Bethlehem and Youngstown had insisted that in view of high freight costs and the homogeneous nature of the product a company could only compete successfully within a certain area around its mills. Since in this case the mills of the two corporations were situated in different parts of the United States, the defendants claimed that there were three different markets: Bethlehem sold chiefly in the eastern and western United States, while Youngstown was primarily active in the midcontinent area. With this market delimitation, the two steel companies would sell only about 10 percent of their combined output in overlapping territories. The district court disagreed, finding that steel transportation costs were sufficiently small in relation to production costs to make competition on a nationwide scale possible, which was demonstrated by the fact that price alignment was a normal means of competition and that in times of shortage buyers absorbed higher freight costs for suppliers from a distance. Moreover, the iron and steel industry recognized no separate geographic markets within the United States. Finally, Bethlehem often shipped steel products into what it claimed to be Youngstown's territory. On all these grounds, the court held that the relevant geographic market for iron and steel products was the national market.⁹⁹ The court also designated as relevant submarkets a few geographic areas that were important markets for both producers.¹⁰⁰

In the *Crown Zellerbach* case, however, the court of appeals found that the territory of the United States was not the relevant market, though Crown did have customers throughout the country. The court held that there were certain areas where the sales of both Crown and St. Helens were heavily concentrated and these were also the areas in which the merger would have most impact.¹⁰¹ We find a similar line of argument in the *Spalding, Columbia Pictures* and *Erie Sand & Gravel* rulings.¹⁰² The FTC took analogous considerations into account in determining the relevant geographic market. In its celebrated *Pillsbury Mills* decision of 1960, in which the merger between Pillsbury, a major miller, and a smaller competitor in the southeastern United States was enjoined, the FTC limited the relevant market to the southeastern states. In support of its position, the Commission noted that the acquired company was one of the few local suppliers in that part of the country that had always met competition from large, nationwide millers such as Pillsbury.¹⁰³

In defining the relevant geographic market in *Brown Shoe*, the Supreme Court was guided by essentially similar principles to those it had used to define the relevant product market:

The geographic market selected must, therefore, both 'correspond to the commercial realities' of the industry and be economically significant. Thus, although the geographic market in some instances may encompass the entire Nation, under other circumstances it may be as small as a single metropolitan area. . . . The fact that two merging firms have competed directly on the horizontal level in but a fraction of the geographic markets in which either has operated, does not, in itself, place their merger outside the scope of Section 7.¹⁰⁴

Without entering into a detailed analysis of buying patterns in individual cities, the Supreme Court supported the lower court's conclusion that at the manufacturing level the market was national, while at the retail level every city with a population exceeding 10 000 and its immediately contiguous territory should be considered a relevant market, thus recognizing that the shopping centers on the outskirts were in direct competition with the specialized stores in central downtown districts. This criterion was adopted for cities where both Brown and Kinney had stores before the merger and for cities where only Kinney had been in business and Brown acquired a market through the merger (the vertical aspect of the case).¹⁰⁵

About one year later, the Supreme Court enjoined a proposed merger between two big commercial banks in Philadelphia, the Philadelphia National Bank and the Girard Trust Corn Exchange Bank. The government argued that commercial banking is basically a local industry controlled largely by state branching laws and that the four-county Philadelphia metropolitan area was the relevant geographic market. The defendant banks, on the other hand, suggested different market areas for different banking services, all of which were larger than the government's market. In particular, the banks claimed that the much larger market for big loans was a relevant market because one of their reasons for merging was that it would enable them to advance big loans to large potential customers outside Philadelphia, heretofore the privilege of New York banks.

⁹⁸ *American Crystal Sugar Co. v. Cuban-American Sugar Co.*, 259 F.2d 524, 528-29 (2d Cir. 1958).

⁹⁹ *US v. Bethlehem Steel Corp.*, 168 F. Supp. 576, 599 (SD NY 1958).

¹⁰⁰ *Id.* at 601-03.

¹⁰¹ Case cited note 78 *supra*.

¹⁰² Cases cited notes 78 and 83 *supra*.

¹⁰³ In the Matter of *Pillsbury Mills, Inc.*, Dkt. 6000, CCH 1960 Trade Cas. ¶ 29 277 (FTC opinion and order 1960).

¹⁰⁴ *Brown Shoe Co. v. US*, 370 US 294, 336-37 (1962), citing *American Crystal Sugar Co. v. Cuban-American Sugar Co.*, 152 F. Supp. 387, 398 (SD NY 1957).

¹⁰⁵ 370 US at 338.

The Court first dealt with the general lines on which the determination of the relevant geographic market should be based:

The proper question to be asked in this case is not where the parties to the merger do business or even where they compete, but where, within the area of competitive overlap, the effect of the merger on competition will be direct and immediate. . . . This depends upon 'the geographic structure of supplier-customer relations.'¹⁰⁶

The Court considered that if this rule were to be applied to the market in bank services, it should be remembered that the customer preferred to have his bank close at hand and that therefore the lion's share of the customers of a bank would not live far away from the bank's premises. This argument led the Court to agree that the four-county metropolitan area was the relevant market. It conceded that its market definition did not completely cover the factual situation because large customers had to go to New York and for very small depositors the market was perhaps too extensive. But in cases like this a 'workable compromise' had to be found in order to apply Section 7 –

some fair intermediate delineation which avoids the indefensible extremes of drawing the market either so expansively as to make the effect of the merger upon competition seem insignificant, because only the very largest bank customers are taken into account in defining the market, or so narrowly as to place appellees in different markets, because only the smallest customers are considered.¹⁰⁷

We find the Supreme Court adopting a comparable approach in its *Phillipsburg* decision. Here, the community involved was much smaller than the one in *Philadelphia National Bank*, and so were the banks. The Court, observing that 'geographic convenience can be a more powerful influence than the availability of a higher rate of interest at a more distant, though still nearby, bank,' especially where small customers are involved, held that Phillipsburg was the relevant area, since it was there that the direct and immediate effects of the proposed merger would be felt.¹⁰⁸ The Court rejected the defendant banks' contention that the area thus defined could not be considered an 'economically significant section of the country' because the town's population was under 90 000, referring to its decision in *Brown Shoe*, where it had held that cities 'with a population exceeding 10 000 and their environs' were relevant geographic markets.

In its other decisions the Supreme Court, evidently pursuing the same objective as in its delimitation of the product market, has succeeded admirably in

tailoring its definition of the relevant geographic market to the finding of a violation of Section 7. In considering a proposed merger between two breweries selling on a nationwide scale, the Supreme Court was candid enough to state that the test 'any section of the country' was fulfilled if the antitrust agencies could prove that the merger had given rise to restraint of competition in *any* market, irrespective of its relevance in economic terms, thus disregarding its own language in *Brown Shoe*:

the District Court thought that in order to show a violation of Section 7 it was essential for the Government to show a 'relevant geographic market' ... [but the] ... language of this section requires merely that the Government prove the merger has a substantial anticompetitive effect somewhere in the United States.... This phrase does not call for the delineation of a 'section of the country' by metes and bounds as a surveyor would lay off a plot of ground.¹⁰⁹

Among the three market definitions considered (the United States as a whole, the three-state area of Wisconsin, Illinois and Michigan, and the state of Wisconsin alone), the Court endorsed the government's approach, concentrating on the impact of the merger on beer sales in Wisconsin only, where a combined market share of 24 percent resulted. The main points that led to this particular market being singled out were that Wisconsin had the highest per-capita beer consumption of the United States, that most of the beer consumed came from breweries within the state, that beer prices varied from state to state and that the market shares of the leading brewers were stable. The fact that Wisconsin residents only consumed a small part of the beer produced in their state, most of which went to other states since the beer market was in fact national, was disregarded. We shall come back to the economics underlying the determination of the relevant market in Section 7 proceedings in our discussion of the case law later in this chapter.

5.3.4 Summary of the Case Law on Determination of the Relevant Market

In amending the Clayton Act in 1950, the Congress gave no guide to the interpretation of the two tests 'any line of commerce' and 'any section of the country' in Section 7. Subsequent rulings by the courts show that the criteria

¹⁰⁶ *US v. Philadelphia Nat'l Bank*, 374 US 321, 358 (1963). The Court cites Betty Bock, *Mergers and Markets* 42 (New York: National Industrial Conference Board, 1st ed. 1960), and Kaysen and Turner, *op. cit. supra* note 70, at 102.

¹⁰⁷ 374 US at 361.

¹⁰⁸ *US v. Phillipsburg Nat'l Bank & Trust Co.*, 399 US 350, 363-64 (1970).

¹⁰⁹ *US v. Pabst Brewing Co.*, 384 US 546, 548 (1966).

of market definition then employed in applying Section 2 of the Sherman Act to dominant firms could not be taken over as an aid to construing Section 7. Specific statements as to the nonapplicability of Sherman Act tests are hard to find. Only in *Bethlehem Steel* did a lower court explicitly reject the criteria from *du Pont* (Cellophane) as irrelevant for a product market definition under Section 7. Whereas most lower courts did in fact fall back on the broader Sherman Act criteria, the Supreme Court took an independent stance which it elaborated at some length in its *Brown Shoe* opinion. There it made a distinction between a broad product market, roughly corresponding to the *Cellophane* guidelines, and segments of this market. It denied the relevance of the larger market for Section 7 purposes and concentrated instead on the smaller submarkets, for which it laid down rather flexible criteria, thus falling in entirely with the views of the enforcement agencies.¹¹⁰ Because this is the only instance in which the Court was at pains to give a general survey of these criteria, it is worth while to repeat them here. According to the Supreme Court, then, a product, or a group of products, or a certain geographic area may constitute a relevant submarket within the meaning of Section 7 if the following tests are satisfied. First, there must be public or industry recognition of the submarket as a separate economic entity. Second, the products concerned must be distinguished from others by peculiar characteristics and uses. Third, production facilities must be used exclusively or principally for manufacturing certain products, while a different process is used for others. Fourth, the products in question must be sold to distinct customers. Fifth, a given product or group of products must be distinct in price from others which may be of the same kind. Sixth, there must be specialized vendors. The seventh and last of the indicia suggested by the Court is a kind of cross-elasticity factor which it termed 'sensitivity to price changes.' With particular reference to the determination of the geographic market, the Court added that account should also be taken of the customs of the industry concerned, and that the market should be of some economic significance.

Most of these tests can be found in decisions before *Brown Shoe*, but the Court has not entirely lived up to them since: it has given emphasis sometimes to one or other, sometimes to a combination of tests, but it has never given full weight to all the relevant tests.

In the Merger Guidelines released on 30 May 1968, the Department of Justice defines the market as 'any grouping of sales... in which each of the firms whose sales are included enjoys some advantage in competing with those firms whose sales are not included,' and the definitions of the relevant product and geographic market are completely in line with the latest law. For instance, the market definition of *Alcoa* is implicitly approved in the statement:

The sales of any product or service which is distinguishable as a matter of commercial practice from other products or services will ordinarily constitute a relevant product market, even though, from the standpoint of most purchasers, other products may be reasonably, but not perfectly, interchangeable with it in terms of price, quality and use.

The Supreme Court's ruling in *Continental Can* is reflected in the second instance of a 'line of commerce' recognized by the Merger Guidelines:

the sales of two distinct products to a particular group of purchasers . . . where the two products are reasonably interchangeable . . . in terms of price, quality and use. In this latter case, however, it may be necessary also to include in that market the sales of one or more other products which are equally interchangeable with the two products

'Section of the country' in Section 7 is defined by the Department as

the total sales of a product or service in any commercially significant section of the country (even as small as a single community), or aggregate of such sections, . . . if firms engaged in selling the product make significant sales of the product to purchasers in the section or sections.¹¹¹

These definitions make it possible, in the case of horizontal, semihorizontal (market- and product-extension) or vertical mergers, for relevant markets to be found that will provide maximum likelihood of the market shares of the firms involved being considerable – one of the decisive criteria on which the courts have found infringements of Section 7, as will be seen in the following section of this chapter.

5.4 INTERPRETATION OF THE CLAYTON ACT (2):

THE SUBSTANTIALITY TEST

As we pointed out in our analysis of the text of amended Section 7 earlier in this chapter, there is only contradictory evidence on what the Congress had in

¹¹⁰ Reflected in the following remark made by Victor R. Hansen, Assistant Attorney General, Antitrust Division, 1956–59, in a speech ('The Current Federal Policy on Antitrust Matters') before the Metropolitan Economic Association: 'I should like to make clear that in our opinion the line of commerce test of Section 7 is a far less rigid test than the one required by Section 2 of the Sherman Act under the doctrine of the Cellophane case.'

¹¹¹ US Department of Justice, 'Merger Guidelines' para. 3, 1 CCH *Trade Reg. Rep.* ¶ 4430 (3 June 1968) [hereinafter cited as *Guidelines*].

mind as regards the substantiality test. During debates on the bill in the Judiciary Committees there was no clear indication whether the substantiality test might be satisfied solely on the basis of the expected effect on competition of the immediate change in the structure of the market to which the merger gave rise or whether, if available, postacquisition evidence such as the merger's influence on market performance should also be taken into account. The enforcement agencies and the courts were thus left every possible scope for filling out the law in their consideration of specific cases. And it was not until 1962, in its landmark ruling in *Brown Shoe*,¹¹² that the Supreme Court gave an extensive interpretation.

Another point of uncertainty concerned the scope of the law. The government's first actions were directed against horizontal and vertical acquisitions only. In *Brown Shoe*, however, the Supreme Court remarked that the Congress certainly intended Section 7 to apply to conglomerate mergers also, and the enforcement agencies have since begun to take action in what is currently the most important form of combination in American industry. And, more recently still, action has been taken against joint ventures as well. These suits will be dealt with separately. Because of the intermingling of horizontal and vertical aspects in most merger cases tried before the FTC and the courts, the case law on both types of merger will be discussed jointly.

5.4.1 Horizontal and Vertical Mergers

5.4.1.1 *The du Pont (General Motors) Decision*

In *du Pont (General Motors)* the Supreme Court laid down a quantitative test by which to judge the effects of the acquisition of stock involved in this case on competition in the relevant market: 'in order to establish a violation of Section 7 the government must prove a likelihood that competition may be "foreclosed in a substantial share of [that market]."' ¹¹³ Here the Court was citing an earlier ruling in a case concerning exclusive-dealing agreements,¹¹⁴ with the apparent intention of judging vertical mergers by the same criteria as such agreements. In the view of the Court, the holdings of *du Pont* in *General Motors* were in conflict with Section 7 on the basis of this criterion – and for two reasons. First, *General Motors* in 1947 accounted for 38.5 percent of the total national sales of the automobile industry in the United States. Since *du Pont* provided 68 percent of the automotive finishes used by *General Motors* and 38.5 percent of the automotive fabrics (before 1946 the figures had been 67 percent and 52.3 percent), *du Pont* supplied a considerable proportion of the requirements of the automobile industry.¹¹⁵ To prove a violation of the law there was no need for the government to show that *du Pont* was the only

supplier of General Motors or that as a result of the stock transaction between du Pont and General Motors all competitors of du Pont must have been excluded from the market. It was sufficient that du Pont's preferential position had made it more difficult for its small competitors to deliver to General Motors. Second, du Pont had not become the main supplier of General Motors until it had acquired a large number of shares in the automobile company: 'du Pont purposely employed its stock to pry open the General Motors market to entrench itself as the primary supplier of General Motors' requirements for automotive finishes and fabrics.'¹¹² As evidence on this point the Court relied on correspondence dating from 1917 which showed that the appointment of a senior du Pont executive as vice-president of General Motors had been intended to make du Pont a permanent supplier of General Motors. The divestiture by du Pont of its holdings in General Motors that the Court ordered as a remedy created major problems, not only in view of the magnitude of the transactions required but also because the stock had been acquired thirty-two years before the suit was initiated. Because of the major tax problems involved in this transaction, Congress went so far as to pass a special law in 1962 that allowed du Pont stockholders to pay only capital-gains-tax rates on the General Motors shares distributed to them instead of the higher income-tax rates which normally would have applied.

It is a moot point whether the Court would have applied the purely quantitative *Standard Stations* test if the connection between du Pont and General Motors had been horizontal. The Court speaks repeatedly of 'foreclosure' – the act of making it impossible for other competitors to break through a commercial link between buyer and seller. But this does not apply to a horizontal merger, which does not cut off any competitors of the merged corporations from their market nor any customers from their suppliers, at least not directly. A vertical merger does have a direct quantitative effect in this respect: for

¹¹² Case cited note 104 *supra*.

¹¹³ *US v. E.I. du Pont de Nemours & Co.*, 353 US 586, 595 (1957). Strictly speaking, this was not a horizontal acquisition but a diversification, so discussion at this point is inappropriate. However, the significance of the case, and the fact that it was the first to be decided under § 7 after the 1950 amendment, both justify inclusion in this section. Though suit had been brought under old § 7, the Court's views are generally considered pertinent to interpretation of the tests in the law as amended.

¹¹⁴ *Standard Oil Co. of Cal. v. US*, 337 US 293, 314 (1949), commonly referred to as the *Standard Stations* case.

¹¹⁵ 353 US at 596. Du Pont accounted for 24% of total sales of automotive finishes in 1946 and for 26% in 1947; the equivalent figures for fabrics were 19% and 15%.

¹¹⁶ *Id.* at 606.

nonintegrated buyers the sources of supply are reduced, and for nonintegrated sellers the number of outlets is reduced.¹¹⁷

In their dissenting opinion, two of the Supreme Court justices observed that there was no evidence to support the majority's conviction that General Motors felt obliged because of the du Pont stockholdings to buy du Pont finishes and fabrics. But even if this had been so, it was still not proved that the exclusive supplying of General Motors by du Pont related to a substantial portion of the relevant market. Rejecting a quantitative definition of the substantiality test, the minority noted that there would only be substantial lessening of competition if 'such foreclosure . . . significantly limits the competitive opportunities of others trading in that market.'¹¹⁸ Proof of actual lessening of competition is thus required. This, however, is a Sherman Act test, and as such the minority's construction is contrary to the intent of Congress. It has not found favor in subsequent cases.

5.4.1.2 Lower Court and FTC Decisions before *Brown Shoe*

The purely quantitative approach to the substantiality test of Section 7 did not turn out to be the only factor considered by the lower courts and the FTC in decisions rendered after *du Pont* (General Motors), though it was the major criterion in most. While putting most emphasis on market shares, the courts and the FTC also took account of the reasons for the merger, its expected effects on the efficiency of the corporations involved and other nonstructural qualitative criteria.¹¹⁹ The same approach was adopted by the courts in their rulings in private injunctive suits.¹²⁰

Important lower-court rulings prior to the Supreme Court's key decision in *Brown Shoe* include *American Crystal Sugar*, *Bethlehem Steel*, *Maryland & Virginia Milk Producers* and *Columbia Pictures*. In the *American Crystal Sugar* case, the merger of two sugar manufacturers would have given them a joint market share of almost 14 percent, which would have made the new combination the second biggest company on the relevant market.¹²¹ The district court, upheld by the circuit court of appeals, found this quantitative factor inadequate if taken alone as grounds for finding against the merger under Section 7. The additional factors that both courts considered germane were: (1) the extremely rigid market structure – resulting from the restrictive allocation of production quotas under the National Sugar Act, which gave scant opportunity for the expansion of existing competitors or the establishment of new ones (so that merger had become the obvious way for a company to increase its share of the market); (2) the active role both corporations played in the sugar industry, which contrasted sharply with the lack of competition between the three biggest sugar producers;¹²² (3) the expected increase in efficiency resulting from the

merger.¹²³ The fact that the merger would eliminate active competition between the firms involved and doubts about the argument that the merging corporations would be able to compete more effectively against the Big Three of the sugar industry led both courts to condemn the merger: 'A union of two units of economic significance fails to give rise to a presumption that competition is thereby promoted; in the abstract such a union is inimical to independent pricing policies, price flexibility, and the dispersion of market power.'¹²⁴

Another scheme for an important merger, this time between two major steel companies, was declared violative of Section 7 by a district court in 1958 as regards both its horizontal and its vertical aspects. The Antitrust Division had contested the lawfulness under Section 7 of a merger between the second biggest steelmaker in the United States, the Bethlehem Steel Corp., accounting

¹¹⁷ This aspect of the case is discussed further in Kaysen and Turner, *op. cit. supra* note 70, at 130; Notes, 68 *Yale LJ* 1636 (1959); Edward H. Levi, 'The du Pont Case and Section 7 of the Clayton Act', 3 *Antitrust Bull.* 3, 7 (1958).

¹¹⁸ 353 US at 627.

¹¹⁹ The only exceptions are in fact the rulings by district court and court of appeals in *Hamilton Watch Co. v. Benrus Watch Co.*, 114 F. Supp. 307, 315 (D. Conn 1953), *aff'd*, 206 F.2d 738, 743 (2d Cir. 1953). The fact that in the relevant market Hamilton ranked fourth with an 11% market share, Benrus following close behind in fifth place with 9½%, was sufficient proof for the courts to hold the acquisition violative of the statute. The quantitative criterion had also been rejected in a lower-court ruling prior to *du Pont* (General Motors). In *Transamerica Corp. v. Board of Governors of Fed. Reserve System*, 206 F.2d 163 (3d Cir. 1953), the Board held that in judging the merger between Transamerica and a number of other banks the court should construe Section 7 along the same lines as those followed by the Supreme Court in *Standard Stations* (under Section 3 of the Act). The court, however, found that it was not sufficient in a case brought under Section 7 to show that the merger concerned corporations with a substantial share of the relevant market. Exclusive dealing was a *per se* restraint of trade, so that under Section 3 it was only necessary to show that the restraint affected a substantial part of the relevant market. A merger, on the other hand, was not a *per se* restraint of competition, so that a substantial lessening of competition resulting from a merger could not be shown from a quantitative analysis alone. *Id.* at 170. For the position of the Board, see *In the Matter of Transamerica Corp.*, 38 *Fed. Reserve Bull.* 368 (1952).

¹²⁰ See, e.g., *General Outdoor Advertising Co. v. Gamble*, CCH 1961 *Trade Cas.* ¶ 70 137 (D. Minn. 1961); *Vanadium Corp. of America v. Susquehanna Corp.*, 203 F. Supp. 686 (D. Del. 1962); *Maryland Cas. Co. v. American Gen. Ins. Co.*, 232 F. Supp. 620 (D. DC 1964); *American Crystal Sugar Co. v. Cuban-American Sugar Co.*, *supra* note 71; *Crane Co. v. Briggs Mfg. Co.*, 280 F.2d 747 (6th Cir. 1960); *Hamilton Watch Co. v. Benrus Watch Co.*, *supra* note 119; *E. L. Bruce Co. v. Empire Millwork Corp.*, 164 F. Supp. 446 (SD NY 1958).

¹²¹ *American Crystal Sugar Co. v. Cuban-American Sugar Co.*, 152 F. Supp. 387, 390-91 (SD NY 1957), *aff'd*, 259 F.2d 524 (2d Cir. 1958).

¹²² 152 F. Supp. at 395-99.

¹²³ 259 F.2d at 531.

¹²⁴ 152 F. Supp. at 399-400.

for more than 16 percent of total US ingot capacity, and a competitor that stood sixth in order of size, the Youngstown Sheet & Tube Co., with 4.5 percent of ingot capacity. Ruling on this case, District Judge Edward Weinfeld stressed a quantitative rather than a qualitative interpretation.¹²⁵ He began by noting that there was a substantial lessening of competition within the meaning of Section 7 if a merger 'substantially increases concentration' or if it 'eliminates a substantial factor in competition.' In view of the integration aspects of the case, the judge added 'eliminates a substantial source of supply' and 'results in the establishment of relationships between buyers and sellers which deprive their rivals of a fair opportunity to compete.'¹²⁶

The ruling deals mostly with the concentration aspects of the case. In Judge Weinfeld's view, the Bethlehem/Youngstown merger, involving the absorption by 'the No. 2 colossus of the steel industry... of No. 6 - another giant' was 'clearly the kind of further concentration in an oligopoly framework that Congress was concerned with. "Tend to create a monopoly" clearly includes aggravation of an existing oligopoly situation.'¹²⁷ The court cited a number of areas where the merger would have the effect of lessening competition within the meaning of Section 7. As for its horizontal implications, the difference in size between the Big Two of the industry and their competitors would increase as a result of the merger, bringing the combined market share of US Steel and Bethlehem to about 50 percent of the nation's steel output. Further, the oligopolistic structure of the industry was basically the result of a series of mergers and the growth of Bethlehem was itself a typical example of a trend toward concentration which it was the purpose of the Act to prevent. Finally, the prospect that a new competitor might take the place of Youngstown had to be considered 'practically nihil.' Since 1935 only two small corporations had finally succeeded with a great deal of government assistance in gaining a 1.6-percent share of the total market. If the industry were to be concentrated still further, it would be even more difficult than before for the small steelmakers to compete with the majors.

The court considered that the vertical implications of the proposed merger would have an anticompetitive impact as well. It rejected the defense of the two steelmakers that their principal customers, the automobile companies, had many alternative sources of supply, so that there was no question of supplies drying up: '[T]he Congress ... did not ... intend to give free play to the balancing power of gigantic enterprises and leave the less powerful purchaser helpless.' And the court saw major difficulties for small, nonintegrated steel companies should the merger be realized, because Youngstown, unlike Bethlehem, did not produce the whole range of fabricated steel products but supplied certain semifinished products to small firms for further processing. One of

these items was wire rope, which the court considered in some detail, meticulously examining the situation of the independent wire-rope fabricators, for 'one of the factors which led to the passage of amended Section 7 was the threat to small business by the merger movement.'¹²⁸

Judge Weinfeld also gave considerable attention to the advantages that the merger might have for Bethlehem and Youngstown. The defense had laid particular stress on the fact that the merger would make it possible to expand the production capacity of Youngstown, which was said to be necessary in order to absorb excess demand in the Chicago area, and that the combined corporations would be better able to compete with US Steel – an argument similar to that put forward by Cuban-American in the *American Crystal Sugar* case. Elaborating on the first of these assertions, Bethlehem said that a considerable saving would be obtained if the existing plant of Youngstown could be expanded instead of Bethlehem's needing to construct new plant. Furthermore, Youngstown was not in a position to carry out such an expansion itself, because it lacked the know-how, experts and the necessary capital.¹²⁹ Judge Weinfeld did not consider these defenses directly (because they 'involve matters of business judgment and, in a sense, matters of preference'), but he did note that the arguments put forward by the defendants 'are not persuasive in the light of their prior activities and history, their financial resources, their growth and demonstrated capacity through the years to meet the challenge of a constantly growing economy.'¹³⁰ Both Bethlehem and Youngstown had a period of vigorous growth behind them. Moreover, 'for a number of years the return on its [Youngstown's] invested capital was greater than that earned by either United States Steel or Bethlehem.' And other steel companies had already begun independently to expand their production capacity in the Chicago area. So Judge Weinfeld found that the 'counterbalancing benefits' alleged by the

¹²⁸ Judge Weinfeld observed that the contentions of the two schools – 'quantitative substantiality' and 'qualitative substantiality' – had become 'more a battle of words than a search for the correct interpretation of Section 7.' *US v. Bethlehem Steel Corp.*, 168 F. Supp. 576, 603 n.51 (SD NY 1958).

¹²⁹ *Id.* at 603.

¹²⁷ *Id.* at 604–07.

¹²⁸ *Id.* at 617–18.

¹²⁹ 'Bethlehem, acknowledging it has the know-how and the experience in that field, contends that the construction of an entirely new fully integrated plant in the Chicago area of 2 500 000 tons of ingot capacity is not economically feasible. It estimates that such a new plant would cost \$750 000 000 (or \$300 per ton of ingot capacity) as compared to \$358 000 000 (or \$135 per ton of ingot capacity) for expansion of Youngstown's existing plants under the plan outlined above. Bethlehem also rules out as uneconomical the construction of a new plant in the Chicago area limited to structural shape and plate mills.' *Id.* at 615.

¹³⁰ *Id.* at 616.

two corporations were not very convincing and certainly did not offset the harmful effects on competition of bringing a capacity of 24 million tons of steel into the hands of a single corporation. As regards the second assertion, the judge feared that if he approved a merger between Bethlehem and Youngstown on the grounds that this would make it easier for them to compete with US Steel, a chain reaction of mergers would follow in the industry, and there would be a danger that eventually only three steel companies would survive.¹³¹ It is difficult to tell what attitude the court would have taken had it been offered a more convincing efficiency defense. However, there is not much point in conjecture since the court made it clear that 'good motives afford no defense' and that '[Congress] made no distinction between good mergers and bad mergers.'¹³²

In the *Maryland & Virginia Milk Producers Association* case, the Antitrust Division succeeded in convincing the district court of the unlawfulness of the merger between Maryland & Virginia, the biggest milk cooperative in Washington, DC, and a smaller competitor, Embassy Dairy;¹³³ on appeal, the Supreme Court upheld the government's contention that the Association's purpose in merging was to eliminate its most dangerous competitor.¹³⁴ The Association had such a dominant position (86 percent of all sales of fluid milk in the Washington metropolitan area) that the danger of increasing this weighed heavily in the Court's deliberations. Another important factor was that Embassy had been the biggest customer of dairy farmers outside the cooperative, so that there was a danger of their coming to depend on Maryland & Virginia. The merger might also have harmful effects on consumers (in the form of price increases), because Embassy's prices were extremely competitive.

Mergers between smaller corporations in industries in which entry barriers are not high and which new companies have in fact entered have generally not been held violative of Section 7 by the courts. This was the situation in *Columbia Pictures* and a number of other cases. In the rulings of district courts in these cases, moreover, we often find remarks to the effect that nothing can be gathered about the effects of a merger on competition in the relevant market from a study of market shares alone: nonquantitative criteria should also be taken into account.¹³⁵

An interpretation of the substantiality test comparable to that of the courts is also to be found in the earlier rulings of the FTC under Section 7.

The first case to come before the FTC after the amendment of Section 7 (*Pillsbury Mills*) is a good example of the Commission's approach. The FTC examiner, in 1953, acknowledged that the statute demanded a case-by-case interpretation, though this did not imply a Sherman Act approach, for that would need to be more penetrating. The examiner's decision was concerned with structural factors, such as the tendency toward concentration in the flour

industry, the lack of opportunity for entry of new companies and the dominance of Pillsbury.¹³⁶ In its final decision, which was only rendered in 1960, the Commission referred back to these criteria. It found that Pillsbury had become the first-ranking company in the relevant market through the merger, and the two biggest millers now had a combined market share of 20 percent; that the number of milling establishments had declined sharply in recent years without any newcomers entering the industry; and, finally, that the company acquired by Pillsbury had been an important and effective competitor. On these grounds, the FTC declared the merger inadmissible.¹³⁷

The FTC's interpretation in its 1957 *Crown Zellerbach* opinion followed the same lines, making it clear that the Commission had no intention of going to unnecessary lengths in the examination of other than structural data when the merger was of some quantitative importance. The fear of an 'economic extravaganza' expressed in congressional circles after the first *Pillsbury* opinion thus proved to be unjustified.¹³⁸ In *Crown Zellerbach*, the Commission again based its opinion on structural considerations only. It opposed the merger chiefly because the competition provided by St. Helens as a fully integrated and powerful company (market share 11 percent) would disappear if it merged with Crown, at the same time appreciably increasing Crown's already sizable share (51.5 percent) of the relevant market – the market in 'census' coarse paper.

¹³¹ *Id.* at 618. An interesting view of the contentions of the two sides in this case is expressed by Charles Lithermann, 'Bethlehem-Youngstown, Controversial Engagement', *Fortune*, June 1957, p. 145. Lithermann points out that Bethlehem (notwithstanding explicit statements during the trial) always intended to construct a plant in the Chicago area irrespective of the merger with Youngstown. He also notes that Youngstown 'with \$620 000 000 of assets . . . has substantially the same access to the capital market as Bethlehem' and that much smaller steel companies 'have financed expansion proportionately much larger.' *Id.* at 188.

¹³² 168 F. Supp. at 612–13.

¹³³ *US v. Maryland & Virginia Milk Producers Ass'n*, 167 F. Supp. 799 (D. DC 1958).

¹³⁴ 362 US 458 (1960).

¹³⁵ *US v. Columbia Pictures Corp.*, CCH 1960 Trade Cas. ¶ 69 766 (SD NY 1960); *US v. Jerrold Electronics Corp.*, CCH 1960 Trade Cas. ¶ 69 784 (ED Pa. 1960); *US v. Bliss & Laughlin, Inc.*, *supra* note 95; In the Matter of *Kaiser Indus. Corp.*, Dkt. 8341, CCH 1963 Trade Cas. ¶ 16 529 (FTC order dismissing complaint 1963); *US v. Ling-Temco Electronics, Inc.*, CCH 1961 Trade Cas. ¶ 70 160 (ND Tex. 1961); *Briggs Mfg. Co. v. Crane Co.*, 185 F. Supp. 177 (ED Mich. 1960), *aff'd per curiam*, 280 F.2d 747 (6th Cir. 1960).

¹³⁶ In the Matter of *Pillsbury Mills, Inc.*, Dkt. 6000, Opinion of the Commission (21 December 1953).

¹³⁷ *Id.*, Opinion of the Commission (16 December 1960), p. 15.

¹³⁸ See, e.g., Interim Report of the Antitrust Subcommittee of the House Committee on the Judiciary, 84th Cong., 1st Sess., *Corporate and Bank Mergers* 23 (1955) and the Statement of Representative Wright Patman in the same subcommittee's Hearings on *Current Antitrust Problems* 84 (1955).

The Commission laid particular emphasis on the fact that elimination of St. Helens as the only other producer supplying a large selection of papers at all times would drive the jobbers into the arms of Crown, which, through its Zellerbach Paper division, was simultaneously competing with them. For producers outside the relevant market could not provide a reasonable substitute at times of shortage, and the chance that new manufacturers producing a sufficiently wide variety of papers for the jobbers might be able to enter the market had to be regarded as extremely slim. The same danger of concentration of supply in the hands of one firm also threatened the nonintegrated processors in the paper industry.¹³⁹ On appeal, the circuit court sustained most of these arguments, concentrating on the fact that even before the merger Crown was decisively dominant and that the merger made it even more so.¹⁴⁰

The Commission was confronted with a comparable market situation in the *Union Carbide* case, this time involving a vertical merger. In 1956, when Union Carbide had merged with Visking, Union Carbide was the biggest American manufacturer of polyethylene resin, with a market share of 48 percent, and accounted for 59 percent of domestic shipments to polyethylene-film extruders. Visking, the acquired company, was the major manufacturer of film and thus bought most of Carbide's production. The other competitors of Carbide were all much smaller. Further, the initial cost of manufacturing polyethylene resin was rather high, so that new competitors would encounter serious difficulties in entering the market. Although there had been no evidence of abuse of power since the merger had taken place – in fact Union Carbide's share of the market had fallen – the Commission declined to take these factors into account in reaching its judgment. Union Carbide still had a preponderant share of the market, and the merger gave it the power, the FTC believed, to lower the price of polyethylene film below the breakeven point of Visking's small nonintegrated competitors and thus drive them out of the market. This made the merger violative of Section 7.¹⁴¹

The FTC's decision in the *Spalding* case, which was upheld by the circuit court of appeals, was based on an extensive analysis of competitive relationships in the relevant market.¹⁴² In determining the influence of the merger on the market in athletic goods for professionals and amateurs, the Commission and the court considered the following facts relevant. First, measured by sales Spalding was the second-ranking firm in this industry, while Rawlings, the acquired company, came fourth. The merger brought Spalding into first place. Second, the market was found to be highly concentrated, the three major manufacturers of sports equipment having had a joint market share of 50 percent some years before the merger. Admittedly, this percentage had declined slightly in the meantime, but it was still very considerable. Third,

Rawlings had been an active competitor before the merger and had also been growing rapidly. Fourth, the competitors remaining in the market after the merger were all appreciably smaller than the large producers and – more important – they all concentrated on a single line while the Big Three provided a general range of goods. Fifth, the position of the major manufacturers was reinforced further by endorsement contracts with star athletes, their ability to advertise on a nationwide scale, considerable facilities for research, and so on. Finally, the Commission found that the opportunity for new firms to enter the industry was very slight, and the mortality rate among the smaller companies was particularly high. On appeal, the court held that, to the extent that the merging companies were complementary, they would probably no longer buy from other manufacturers as well. Furthermore, Spalding and Rawlings had also sold articles to small competitors in the past, and although there was no evidence that they had in fact withheld supplies, the court found it an important point that once merged they would have the power to do so. A final point to which the Commission had objected and that was accepted by the court was the reinforcement of Spalding's price leadership by the merger. Given the typically oligopolistic structure of the industry, it could hardly be expected that this would be terminated in the future.

5.4.1.3 *The Brown Shoe Decision*

The cases discussed above were virtually all concerned with mergers that enhanced the power of already leading firms. Consequently, for judging the admissibility of horizontal mergers under Section 7, criteria other than those directly related to the structure of the markets were not of immediate relevance, and the general neglect of available postmerger market information, for instance, by the courts and the FTC cannot in most instances be regarded as evidence of an inadequate approach to the merger problem. It is a completely different matter, of course, when cases have to be decided involving horizontal and vertical mergers between firms that are far from dominant on their markets – a category that has predominated among the more recent actions brought by the antitrust agencies. The first case of this kind to come to the Supreme Court

¹³⁹ In the Matter of *Crown Zellerbach Corp.*, Dkt. 6180, Opinion of the Commission (26 December 1957).

¹⁴⁰ *Crown Zellerbach Corp. v. FTC*, CCH 1961 Trade Cas. ¶ 70 038 (9th Cir. 1961), *cert. denied* (US Sup. Ct. 1962).

¹⁴¹ In the Matter of *Union Carbide Corp.*, Dkt. 6826, Opinion of the Commission (25 September 1961), CCH 1961 Trade Cas. ¶ 15 503, at 20 373.

¹⁴² In the Matter of *A. G. Spalding & Bros.*, Dkt. 6478 (FTC opinion and order 1960), *A. G. Spalding & Bros. v. FTC*, CCH 1962 Trade Cas. ¶ 70 266 (3d Cir. 1962).

(it was at the same time the Court's first case under new Section 7) involved the acquisition by Brown Shoe Co. of G. R. Kinney Co. The Court's decision is important in that it laid down ground rules for the interpretation of the merger statute.¹⁴³

Both Brown Shoe and Kinney operated their own shoe-store chains at the time of the trial. There was some degree of specialization between the two in that Brown manufactured and sold shoes in the medium price range while Kinney concentrated on low-priced shoes. Both markets were unconcentrated, Brown being one of the few sizable firms. In 1955 it was the fourth largest shoe manufacturer, accounting for some 4 percent of national output; Kinney was the twelfth largest with 0.5 percent. At the retail level, Brown owned 2.1 percent of all the nation's specialized retail shoe outlets and Kinney 1.6 percent. The firm created by the merger had become the third largest shoe producer and the second largest shoe retailer in the United States. However, as we noted in section 3 of this chapter, the courts defined the relevant geographic market much more narrowly in respect of shoe retailing, i.e. individual cities with a population exceeding 10 000 and their immediate surrounding area. By this measure, the combined market share of the two companies would be more than 20 percent in 32 geographic submarkets for women's shoes and in 31 submarkets for children's shoes.

The government had based its complaint solely on a quantitative interpretation of the statutory test. Vertical integration was held by the Antitrust Division to conflict with Section 7 if there was 'foreclosure of a substantial share of a substantial market,' while in the case of a horizontal merger the 'elimination in whole or in material part of the competitive activity of an enterprise which had been a substantial factor in competition . . . was to be deemed to reflect a likelihood of a substantial lessening of competition or of a tendency to monopoly.'¹⁴⁴ The district court was unwilling to rely on this purely quantitative approach. It noted that an interpretation of Section 7 emphasizing market shares would discourage only mergers with a large share of the market, while competition could also be lessened by a series of mergers involving smaller corporations. The court therefore advocated a more extensive study of the impact of a merger on the structure of the market.¹⁴⁵

This idea was further developed by the Supreme Court: while holding that Section 7 did not demand as thoroughgoing an analysis as was customary under the Sherman Act, it insisted that the merger must 'be functionally viewed, in the context of its particular industry.' By this, the Court meant that a merger should be judged in the light of its impact on the most relevant aspects of market structure:

whether the consolidation was to take place in an industry that was fragmented rather than concentrated, that had seen a recent trend toward domination by a few leaders or had remained fairly consistent in its distribution of market shares among the participating companies, that had experienced easy access to markets by suppliers and easy access to suppliers by buyers or had witnessed foreclosure of business, that had witnessed the ready entry of new competition or the erection of barriers to prospective entrants¹⁴⁶

Although, as regards the horizontal aspects of the case, Brown's market share in shoe retailing alone constituted strong grounds for the Court's finding that the merger was in violation of Section 7, other factors supported this conclusion. One of the most important considerations was the tendency toward increasing concentration in shoe retailing, of which the merger at issue was symptomatic:

If a merger achieving 5 percent control were now approved, we might be required to approve future merger efforts by Brown's competitors seeking similar market shares. The oligopoly Congress sought to avoid would then be furthered and it would be difficult to dissolve the combinations previously approved.¹⁴⁷

We cannot avoid the mandate of Congress that tendencies toward concentration in industry are to be curbed in their incipiency, particularly when those tendencies are being accelerated through giant steps striding across a hundred cities at a time. In the light of the trends in this industry we agree with the government and the court below that this is an appropriate place at which to call a halt.¹⁴⁸

Lastly, the Court felt that in the fragmented shoe retailing industry a major retail chain could exercise a far-reaching influence on shoe fashions to the detriment of smaller competitors unable to maintain competitive inventories. Indulging in a very broad interpretation of congressional intent, the Court remarked:

[E]xpansion [of integrated chains] is not rendered unlawful by the mere fact that small independent stores may be adversely affected. It is competition, not competitors, which the Act protects. But we cannot fail to recognize Congress's

¹⁴³ *Brown Shoe Co. v. US*, 370 US 294 (1962).

¹⁴⁴ Brief for the US, p. 131, citing *US v. Bethlehem Steel Corp.*, 168 F. Supp. 576, 590 (SD NY 1958).

¹⁴⁵ *US v. Brown Shoe Co.*, 179 F. Supp. 721 (ED Mo. 1959).

¹⁴⁶ 370 US at 321-22.

¹⁴⁷ *Id.* at 343.

¹⁴⁸ *Id.* at 346.

desire to promote competition through the protection of viable, small, locally owned businesses. Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets. It resolved these competing considerations in favor of decentralization. We must give effect to that decision.¹⁴⁹

The Supreme Court's ruling on these various factors signifies that only in very few instances do horizontal mergers fail to conflict with Section 7. Mergers falling within these rigid structural limits may only escape condemnation if it can be shown that there are

mitigating factors, such as the business failure or the inadequate resources of one of the parties that may have prevented it from maintaining its competitive position [or a] demonstrated need for a combination to enable small companies to enter into a more meaningful competition with those dominating the relevant markets.¹⁵⁰

The same type of reasoning led the Supreme Court to a finding that the vertical aspects of the merger were violative of Section 7 as well. The Court reiterated its view that 'diminution of the vigor of competition which may stem from a vertical arrangement results primarily from a foreclosure of a share of the market otherwise open to competitors,'¹⁵¹ thus equating the judgment of vertical mergers with that of vertical agreements. In *Brown Shoe*, however, the Court held that the market shares of the two corporations were insufficient in themselves as grounds for a finding of substantial foreclosure, and 'the very nature and purpose of the arrangement' and 'the trend toward concentration in the industry' had therefore to be taken into account in judging the merger under Section 7. Brown's intent in seeking vertical integration was to find new markets for its products ('Brown's avowed policy of forcing its own shoes upon its retail subsidiaries'). And the steadily increasing trend toward integration by the principal shoe manufacturers made it ever more difficult for the small manufacturers to find outlets. Finally, the Court failed to discover 'any countervailing competitive, economic or social advantages' in favor of the merger.¹⁵²

5.4.1.4 *Supreme Court Decisions after Brown Shoe*

When mergers occurred in an already concentrated industry, the Supreme Court scrupulously focused its attention on the market shares of the merging corporations in its rulings after *Brown Shoe*, thus according with the view it took in that case.

Bank Merger Rulings. The suits filed by the Antitrust Division against a number of bank mergers constituted a relatively novel phenomenon. The only case of interest before 1963 had been *Transamerica*, in which the Board of

Governors of the Federal Reserve System had taken issue against mergers carried out by the biggest American bank.¹⁵³ Despite the very large number of mergers between commercial banks, a result of the fact that American law forbids banks in the major cities to increase the number of branches they operate, there were until recently no big antimerger cases in the banking business, because of the widespread belief that bank mergers were not reached by Section 7. No doubt for this reason the Department of Justice in 1961 based its complaint against Philadelphia National Bank mainly on an alleged violation of Section 1 of the Sherman Act and only secondarily on violation of Section 7 of the Clayton Act, whereas it was an infringement of Sections 1 and 2 of the Sherman Act exclusively that was alleged against the First National Bank & Trust Co. of Lexington in the same year. However, in its decision in *Philadelphia National Bank* the Supreme Court, judging the merger under Section 7 alone, found that this regulated industry was not immune.¹⁵⁴

At issue in the *Philadelphia National Bank* case was a proposed merger between the second and third largest of the forty-two commercial banks with head offices in the Philadelphia metropolitan area. If consummated, the merger would make the resulting bank the biggest in the area, with 36 percent of total assets. It and the second largest bank would then have 59 percent of total assets between them, and the four largest together would have 78 percent. The Supreme Court laid great emphasis on these market shares and on the steady increase of concentration in banking, pointing out that in a strongly concentrated industry it is important to hinder any, even slight, increase in concentration. This last comment has had particular influence on rulings on diversification, as we shall see below. Referring to the dominant theme of Congress's consideration of the amendments to Section 7 in 1950, the Court averred:

This intense congressional concern with the trend toward concentration warrants dispensing, in certain cases, with elaborate proof of market structure,

¹⁴⁹ *Id.* at 344.

¹⁵⁰ *Id.* at 346.

¹⁵¹ *Id.* at 328.

¹⁵² *Id.* at 328-34. At 344, the Court also mentions the possibility that such vertical mergers might cut out wholesalers; this could cause many independent stores to go out of business, which might reinforce the trend toward oligopoly.

¹⁵³ *Transamerica Corp. v. Board of Governors of Fed. Reserve System*, 206 F.2d 163 (3d Cir. 1953).

¹⁵⁴ 'The fact that the banking agencies maintain a close surveillance of the industry with a view toward preventing unsound practices that might impair liquidity or lead to insolvency does not make federal banking regulation all-pervasive . . . ' *US v. Philadelphia Nat'l Bank*, 374 US 321, 352 (1963). The ruling in *US v. First Nat'l Bank & Trust Co. of Lexington*, 376 US 665 (1964), is discussed in section 1 of this chapter.

market behavior, or probable anticompetitive effects. Specifically, we think that 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.¹⁵⁵

In their defense the appellees had concentrated on showing that their merger was prompted by considerations of efficiency. They submitted that the merger would enable them to compete with New York banks for large-scale loans to Philadelphia borrowers and that a large bank was needed to bring business to the area and stimulate its economic development. The merger would also provide a welcome opportunity for extending the city's network of branch banks. The Court considered these arguments irrelevant under Section 7. Its answer to the first defense was that the efforts of the corporations to become as big as a specific competitor by means of merger might finally lead to a series of mergers and thus to complete monopolization of banking in Philadelphia in the end. The intention of Congress, however, had been to prevent any such outcome. As to the banks' second efficiency defense, the Court clearly stated that it was not appropriate either because it necessitated detailed economic analysis of the potential consequences of a merger on the relevant market:

[A] merger the effect of which 'may be substantially to lessen competition' is not saved because, on some ultimate reckoning of social or economic debits and credits, it may be deemed beneficial. A value choice of such magnitude is beyond the ordinary limits of judicial competence, and in any event has been made for us already, by Congress when it enacted the amended Section 7. Congress determined to preserve our traditionally competitive economy. It therefore proscribed anticompetitive mergers, the benign and the malignant alike, fully aware, we must assume, that some price might have to be paid.¹⁵⁶

The Court's attitude in *Philadelphia National Bank* shows clearly that, at least in a merger between important competitors involving a considerable increase in concentration, the effects on competition are to be determined solely by market shares and concentration patterns, and the competition philosophy displayed by the Court elsewhere in its ruling strongly resembles conditions of pure competition, so often referred to in Sherman Act cases. In such a structuralist approach, business reasons supporting the need for merger do not constitute a defense under the merger statute since the Court is unwilling to engage in any tradeoff reasoning.

In this case, as in *Lexington* (discussed in section 1 of this chapter), the problem of banking as a regulated industry having a preferred status under the

antitrust laws was not the major point at issue. However, two recent decisions of the Supreme Court on procedural issues in the *First City National Bank of Houston* and *Provident National Bank* cases¹⁵⁷ throw some light on this problem. One of the questions that arose here was whether, once the government has shown that a merger substantially lessens competition, it is up to the defendants or to the government to show whether the merger's anticompetitive effects are outweighed by its contribution to 'the convenience and needs of the community,' a defense specifically mentioned in the Bank Merger Act.¹⁵⁸ In these decisions the Court made it clear that the defendants and not the government bore the burden of proof. Moreover, *Houston* seems to state that the courts must try *de novo* the issues presented and may not limit themselves to a review of the decision of the relevant federal banking agency on the basis of the substantiality or weight-of-the-evidence rule.

In *Nashville* the Court elaborated somewhat on the issue of the defense open to the banks by stating that 'before a merger injurious to the public interest is approved, a showing [must] be made that the gain expected from the merger cannot reasonably be expected through other means.'¹⁵⁹

In *Phillipsburg National Bank* the Supreme Court followed the rule already applied in *Philadelphia National Bank* and enjoined a merger between two banks that were very small in absolute terms. As was observed in section 3 of this chapter, the relevant geographic market was defined as a town with 90 000 inhabitants, 90 percent of each bank's depositors living in that town. In this market, the two prospective merger partners ranked third and fifth in terms of assets in 1967 – with \$23.9 million and \$17.3 million respectively. The merger would have produced a bank with a 19.3-percent market share behind the largest bank in the area, which had 35.5 percent of the market. The Supreme Court made it clear, however, that it is not absolute magnitude but competitive effect that is relevant in a judgment under Section 7:

Mergers of directly competing small commercial banks in small communities, no less than those of large banks in large communities, are subject to scrutiny under these standards. Indeed, competitive commercial banks, with their cluster of products and services, play a particularly significant role in a small community unable to support a large variety of alternative financial institutions.¹⁶⁰

¹⁵⁵ 374 US at 363.

¹⁵⁶ *Id.* at 371.

¹⁵⁷ *US v. First City Nat'l Bank of Houston, US v. Provident Nat'l Bank*, 386 US 361 (1967).

¹⁵⁸ 74 Stat. 129 (1960), 12 USC 1828(c).

¹⁵⁹ *US v. Third Nat'l Bank in Nashville*, 390 US 171, 190 (1968).

¹⁶⁰ *US v. Phillipsburg Nat'l Bank & Trust Co.*, 399 US 350, 354 (1970).

The majority of the Court, relying on the principles elaborated in its *Philadelphia National Bank* decision,¹⁶¹ found that the market shares involved and the level of concentration attained as a result of the merger warranted the conclusion that the merger would substantially lessen competition. Although it had been expected since *Houston* that the Supreme Court would give a ruling on whether the convenience and needs of the community clearly outweighed the anticompetitive effects which had been found to result from the merger, the Court again referred the matter back to the district court, which was required to 'reliably establish the unavailability of alternative solutions to the woes' afflicting the banks.¹⁶² This obviously indicates that the Supreme Court was unwilling to lay down more specific guidelines for this particular defense.

Other Rulings. The Supreme Court's conviction that horizontal mergers should generally be forbidden is also apparent in a number of decisions concerning mergers between industrial firms. In 1964 the Court handed down two important rulings in what from an economic standpoint could have been considered product-extension mergers. The first case dealt with the government's complaint against the acquisition by Alcoa – a major producer of aluminum conductor wire and cable – of a small firm, the Rome Cable Corp., which chiefly manufactured copper conductor wire and cable. The second – a complaint against Continental Can Co. – concerned the lawfulness of a merger between the second biggest manufacturer of metal cans and the second largest manufacturer of glass bottles in the United States. As will be recalled from our discussion earlier in this chapter, the market definition employed by the Court in both cases had been limited to the areas to which the expansion of corporate activities had been directed, disregarding obvious substitutes in the one and taking into account products which were not immediately competitive in the other.

In both cases the Supreme Court overruled the reasoning of the courts below (which had stressed the economic reasons behind the merger and concluded that no harm to competition would be done),¹⁶³ relying on an interpretation of Section 7 that had already been applied in some previous cases. The Court found that the corporations involved had already occupied an important place on a market before merger, so that a further increase of their market share was *per se* in conflict with Section 7 because concentration would thereby be increased to an unacceptable extent. In the *Alcoa* case, Alcoa's acquisition of Rome had added 1.3 percent to its market share of 27.8 percent for the products defined as relevant by the Supreme Court. In *Continental Can*, the six biggest corporations in the market for metal and glass containers had a combined share of 70.1 percent – Continental in second place with 21.9 percent, and the glass

manufacturer it had acquired in sixth place with 3.1 percent. Alcoa's and Continental's share of the market after the merger thus came to an order of magnitude that had been severely criticized in *Philadelphia National Bank*.

Over and above these two factors applying to both cases – the market shares involved and the trend toward increased concentration by merger – in *Alcoa* the Court also stressed the point that it was important to maintain the independence of small firms such as Rome:

The record shows indeed that Rome was an aggressive competitor. It was a pioneer in aluminum insulation and developed one of the most widely used insulated conductors. . . . Preservation of Rome, rather than its absorption by one of the giants, will keep it 'as an important competitive factor,' to use the words of S. Rep. No. 1775, p. 3. Rome seems to us the prototype of the small independent that Congress aimed to preserve by Section 7.¹⁶⁴

This was reason enough for the Court not to enter into an elaborate examination of market structure, market behavior and probable anticompetitive effect, disregarding the fact that entry of new competitors into the market was relatively easy, for instance.

The Supreme Court has taken the same hard line in its decisions on horizontal mergers in food distribution and breweries. In the relevant market defined by the Court in *Von's Grocery*, the merger of Von's Grocery Co. with Shopping Bag Food Stores had produced the second largest retail grocery chain in the Los Angeles area, accounting for 7.5 percent of all grocery sales. More than these market shares, the Court, in finding a violation of Section 7, laid heavy stress on the past history of acquisition in a market where the total number of competitors was rapidly declining. The majority view was that the words 'tend to create a monopoly' in Section 7 were designed to forestall just such a trend.¹⁶⁵ The Court was apparently impressed by the fact that between 1950 and 1961 the number of independent single-unit grocery stores in the area had declined from 5 363 to 3 818, whereas the market share of the top twenty chains had risen from 44 percent in 1948 to 57 percent in 1958. In their dissenting opinion, two justices stressed the 'transcending social and technological changes' that were at the basis of this movement, considering the ease of entry to the market

¹⁶¹ 374 US at 363.

¹⁶² 399 US at 372.

¹⁶³ *US v. Aluminum Co. of America*, 377 US 271 (1964); *US v. Continental Can Co.*, 378 US 441 (1964).

¹⁶⁴ 377 US at 281.

¹⁶⁵ *US v. Von's Grocery Co.*, 384 US 270, 278 (1966).

a successful competitive stimulus.¹⁶⁶ Further, they rightly observed that the majority appeared to consider that the intensity of competition was directly proportional to the number of competitors – which amounted to a *per se* prohibition of mergers. But a decline in the number of competitors was by no means the same thing as a trend toward monopoly.

We find the same majority view repeated in the *Pabst* ruling.¹⁶⁷ Although the market situation was clearer in this case than in *Von* (a joint market share rising to 24.4 percent after the merger in the smallest relevant market), it was not so much this specific percentage but rather the general trend of concentration in the industry that was the Court's reason for finding against the appellants.

In a recent decision, the Supreme Court sustained the government and the district court before it in considering the acquisition in 1961 by the Ford Motor Co. of a supplier of spark plugs, Electric Autolite Co., as a violation of Section 7. At the time of acquisition, Autolite controlled 15 percent of the market, with Ford constituting an outlet for approximately 10 percent of the industry's output. Ford acquired from Autolite its trade name, its only domestic spark-plug plant and certain rights to its national distribution organization. The Supreme Court endorsed the lower court's reasoning that this transaction had eliminated Ford as a potential entrant into the spark-plug business and that it had foreclosed Ford as a purchaser from outside sources. The Supreme Court rejected as irrelevant to Section 7 Ford's defense that the acquisition permitted it to compete more vigorously with other major spark-plug producers and that important efficiencies might flow from it.¹⁶⁸

5.4.1.5 Lower Court and FTC Decisions after *Brown Shoe*

In a number of rulings after *Brown Shoe*, in cases of horizontal acquisition and vertical integration, where the parties concerned did not appeal to higher courts, the wider approach adopted in lower-court rulings before *Brown Shoe* is lacking, and both the courts and the FTC adopted in practice the structural-analysis approach of *Brown Shoe*. In the *Lever Bros.* case, the point at issue was the lawfulness of a transaction in which Lever Bros. had obtained from Monsanto the right to make a special detergent for washing machines. Lever Bros. had not succeeded in manufacturing a product of this kind, while Monsanto was losing on sales of its product. The Antitrust Division had filed a complaint on the ground that in the highly concentrated market in detergents the removal of a competitor by merger constituted an infringement of Section 7. The district court, despite the objection of high concentration and the fact that entry of new companies was virtually excluded because of high costs, was not persuaded that the acquisition of manufacturing rights was in conflict with Section 7. The

court defended its attitude by pointing out that the combined market share of Lever and Monsanto before the merger had been bigger than that of Lever after it and that during the same time the total market share of all corporations on the relevant market, other than the three majors, had increased from 10 percent to 12 percent.¹⁶⁹

The FTC, in its *Scott Paper* and *Foremost Dairies* decisions, adopted a much harsher line than the courts. The *Scott Paper* case began when the FTC filed a complaint under Section 7 against Scott, a well-known manufacturer of sanitary paper products which had taken over three competitors between 1951 and 1954. In its final order the Commission found that there was a violation of Section 7 because Scott's expansionary policy had won the company a stronger position in its industry. (Scott had a postmerger market share of 33 percent.) This strengthening of the position of a single corporation by means of mergers in an oligopolistic market was undesirable, so that the business advantages accruing to Scott from the merger were irrelevant.¹⁷⁰ Foremost Dairies had pursued a firm policy of geographic expansion and had acquired a series of dairy companies in other parts of the United States. Foremost had thus become a major company in the industry. In its final decision the FTC ordered Foremost to divest itself of Philadelphia Dairy, its most recent acquisition. This last merger in a whole series was the straw that broke the camel's back. The FTC applied a *Brown Shoe* line of argument, emphasizing factors such as merger activity in the past and the increase of concentration in the industry. In a case like *Foremost* it was of no importance that the acquired company had only a small share of the market: what was important was that the disappearance of Philadelphia Dairy would mean the disappearance of a potential competitor of Foremost in areas where the latter was active. The FTC not only refused to accept the economies realized as a merger defense but even held them against the defendant:

[U]nder 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 overall organization gives it a decisive advantage in efficiency over its smaller rivals.¹⁷¹

¹⁶⁶ *Id.* at 300.

¹⁶⁷ *US v. Pabst Brewing Co.*, 384 US 546 (1966).

¹⁶⁸ *Ford Motor Co. v. US*, 405 US 562 (1972).

¹⁶⁹ *US v. Lever Bros. Co.*, CCH 1963 Trade Cas. ¶ 70 770, at 78 108 (SD NY 1963).

¹⁷⁰ In the Matter of *Scott Paper Co.*, Dkt. 6559, CCH 1963 Trade Cas. ¶ 16 706 (FTC opinion 1963).

¹⁷¹ In the Matter of *Foremost Dairies, Inc.*, Dkt. 6495, CCH 1962 Trade Cas. ¶ 15 877, at 20 687 (FTC opinion and order 1962).

In this and the *Autolite* case discussed above, diversification problems came to the fore. A number of important recent judgments on conglomerate expansion will be discussed in section 4.2 below.

5.4.1.6 *Decisions in Private Injunctive Suits*

In most of the cases discussed hitherto, either the Antitrust Division or the FTC has been involved. Nonetheless, a small number of the suits filed under Section 7 are private actions brought for the most part by the stockholders or managements of acquired corporations in an attempt to resist outside interference in their decision-making processes. The majority of these suits never reach the courts, however, because the challenged corporations fear the uncertainty, delay and expense of litigation in the poorly charted waters of Section 7. Here we shall focus specifically upon certain aspects inherent in cases of this kind.

As has been seen in the discussion of private actions in preceding sections, plaintiff must not only show that a Section 7 violation has occurred but must also bring proof that he will be injured as a result of the merger if he is to obtain relief from the courts. A classic case of a firm bringing a private injunctive suit under Section 7 to prevent a competitor acquiring an influential position on its board was *Hamilton Watch Co. v. Benrus Watch Co.*¹⁷² Benrus, a competitor of Hamilton, was entitled to elect a member of Hamilton's board after purchasing part of its stock. Upon court action, Benrus was enjoined from voting its holdings even though it was virtually impossible for Benrus to assume full control of Hamilton at the time the action was brought. This, however, was no impediment to the court, because there was the possibility that a Benrus representative on Hamilton's board would make confidential information available to Benrus. The same line of reasoning was adopted in other cases as well.¹⁷³

The management of a company that fears takeover will often try to show immediate injury before a takeover bid is discussed at a forthcoming stockholders' meeting. It may argue that its dealers will be badly affected by the knowledge that a merger is imminent,¹⁷⁴ that its sales of its products will be impaired where there is uncertainty whether they will still be manufactured after the merger¹⁷⁵ or that its executives and other employees may be alarmed.¹⁷⁶

5.4.2 **Conglomerate Mergers**

Conglomerate expansion is the expansion of a company into fields and activities in which it has not hitherto been concerned. As we pointed out in Chapter 2, there are three types of conglomerate merger – market-extension mergers,

product-extension mergers and pure conglomerates. Market-extension mergers are between companies that manufacture the same products but sell in different geographic markets. Product extension involves companies that are functionally related in production and/or distribution but sell products which do not compete directly with one another. Finally, pure conglomerate mergers bring together wholly unrelated business entities. Conglomerate mergers have recently become much more frequent than they were in the past (see Chapter 2), and the antitrust case law has accordingly increased in volume and importance.

There are relatively few rulings on *market-extension* mergers. The first Supreme Court decision concerned the acquisition of Pacific Northwest Pipeline Corp. by El Paso Natural Gas Co. El Paso produced and transported natural gas and accounted for about 50 percent of the requirements of California; Pacific, another large natural-gas producer, wanted to enter the California market. El Paso had tried to prevent this, first by concluding agreements with its potential competitor, then by acquisition. When the Department of Justice filed suit against El Paso, the district court found against the government, ruling that the acquired company had not been an actual competitor on the relevant market and had had difficulty in entering it, an application to operate pipelines in California having been turned down by the authorities. On appeal, the Supreme Court rejected this reasoning, noting that the merger eliminated a substantial potential competitor because 'the mere efforts of Pacific Northwest to get into the California market, though unsuccessful, had a powerful influence on El Paso's business attitudes within the state.'¹⁷² The Supreme Court held further that the injurious effect of the merger on competition was strengthened by the meager chance of any future change in the structure of the market (given the long-term supply contracts between producers and buyers).

¹⁷² 114 F. Supp. 307 (D. Conn. 1953).

¹⁷³ *Crane Co. v. Briggs Mfg. Co.*, 280 F.2d 747, 749 (6th Cir. 1960), *affirming* 185 F. Supp. 177 (ED Mich. 1960); *Vanadium Corp. of America v. Susquehanna Corp.*, 203 F. Supp. 686, 694 (D. Del. 1962); *American Crystal Sugar Co. v. Cuban-American Sugar Co.*, 152 F. Supp. 387, 393 (SD NY 1957), *aff'd*, 259 F.2d 524 (2d Cir. 1958).

¹⁷⁴ *Hamilton Watch Co. v. Benrus Watch Co.*, 114 F. Supp. at 314.

¹⁷⁵ *Briggs Mfg. Co. v. Crane Co.*, 185 F. Supp. at 182.

¹⁷⁶ *Vanadium Corp. of America v. Susquehanna Corp.*, *supra* note 173.

¹⁷⁷ *US v. El Paso Natural Gas Co.*, 376 US 651, 658-59 (1964). The Supreme Court remanded the case to the district court with instructions to order divestiture. The Department of Justice proposed a consent judgment requiring El Paso to sell all its holdings in the acquired company and ordering the establishment of a new company capable of competing with El Paso. For ten years El Paso would be prohibited from acquiring any financial interest in the new company. After the district court had issued its order, the Supreme Court returned it for reformulation upon appeal by competitors and buyers of natural gas in the area on the ground that they had not been heard and the order had not been framed to suit their requirements. The district court then handed down a second opinion and order in 1968.

The second, and at the time of writing most recent, Supreme Court ruling concerned the acquisition by Falstaff Brewing Corp., the fourth largest brewer in the United States, of Narragansett Brewing Co., the largest brewer in New England. The government had alleged that the merger eliminated Falstaff as a potential competitor which exerted a substantial competitive influence on the New England beer market. Falstaff replied that though it wanted to be represented in this market the only efficient means of achieving this was by acquisition and not by *de novo* entry. The district court held for the defendants, finding that as Falstaff would not have entered *de novo*, it could not be considered a potential competitor, so the merger did not eliminate substantial competition. The Supreme Court reversed. It was not this alone that determined whether Falstaff was a potential competitor but also the consideration that the company might have a stimulating effect on competition in the market on whose edge it was situated. In referring the case back to the district court, the Supreme Court asserted:

The specific question with respect to this phase of the case is not what Falstaff's internal company decisions were but whether, given its financial capabilities and conditions in the New England market, it would be reasonable to consider it a potential entrant into that market.¹⁷⁸

Another interesting point in this decision was the Court's view that *de novo* entry is equivalent to entry through toehold acquisitions because the expansion of the small acquired firms as a result of the conglomerate's resources could stimulate competition.

The FTC has dealt with market-extension mergers in one of its traditional fields of activity – the dairy industry. In *Beatrice Foods* and *Foremost Dairies* the Commission held that Section 7 is violated if one of the big firms in a concentrated market merges with a substantial potential competitor.¹⁷⁹ Apart from requiring divestiture, the Commission imposed a ten-year ban on further fluid-milk and ice-cream mergers.¹⁸⁰ From our discussion of *Foremost* above it will be remembered that the Commission used the economies from merger as an argument against defendants, considering that these gave it an unfavorable advantage over small competitors. Only where medium-sized dairies make toehold acquisitions (of firms with sales of less than \$10 million) which are not part of an extensive merger program will the FTC refrain from prosecuting.

Finally, mention should be made of the Justice Department's attempts to enjoin mergers of banks with competitors in other areas, basing its case chiefly on the assertion that potential competition between the banks would be diminished, thus substantially lessening competition as well as increasing concentration. The government has won none of these suits (though it has not ap-

pealed as yet) since the courts have generally held that the banks in question would not in any case have become actual competitors of each other because *de novo* expansion would not have been allowed by the Comptroller of the Currency.¹⁸¹

There are a number of important decisions on *product-extension* mergers. In *Alcoa* and *Continental Can* – which from the economic standpoint were really cases of product-extension merger – the Supreme Court's market definition was such that they were decided on grounds pertinent to cases of horizontal merger.¹⁸² These two aside, the first case in which the Supreme Court had to rule on the impact of product-extension mergers under Section 7 was one in which the defendant engaged in reciprocal dealing – a practice whereby a firm requires its suppliers to buy from a company it has newly acquired rather than from that company's competitors. This practice is an old one and of frequent occurrence; it can be a powerful weapon in the hands of major enterprises if they manufacture a broad spectrum of products. The FTC took early action against practices of this kind on several occasions under Section 5 of the Federal Trade Commission Act (banning unfair methods of competition). In these cases the practices concerned were enjoined because they had been employed by dominant firms and because evidence had been submitted to show that the sales of some of these firms' products had increased enormously as a result of reciprocal dealing, while the sales of nondiversified competitors had fallen off steeply.¹⁸³ More recently, both the FTC and the Department of Justice have again acted under Section 7 of the Clayton Act and Sections 1 and 2 of the Sherman Act against these practices where they were employed after an acquisition by a big diversified firm of a company in a relatively small industry. The only case to date that has reached the Supreme Court is *Consolidated Foods*.¹⁸⁴

In 1951 Consolidated Foods Corp., a major food processor, distributor and

¹⁷⁸ *US v. Falstaff Brewing Corp.*, CCH 1973-1 Trade Cas. ¶ 74 377, at 93 741 (US Sup. Ct. 1973).

¹⁷⁹ For a complete review of the FTC's merger approach in this industry, see Willard F. Mueller, 'Merger Policy in the Dairy Industry', 12 *Antitrust Bull.* 73 (1967).

¹⁸⁰ This was also ordered in the case of horizontal acquisitions by Borden Co. and National Dairy Products Corp.

¹⁸¹ *US v. Crocker-Anglo Nat'l Bank*, 277 F. Supp. 133 (ND Cal. 1967); *US v. First Nat'l Bank of Jackson*, 301 F. Supp. 1161 (SD Miss. 1969); *US v. First Nat'l Bank of Md.*, 310 F. Supp. 157 (D. Md. 1970); *US v. Idaho First Nat'l Bank*, 315 F. Supp. 261 (D. Idaho 1970). For a discussion of these cases, see George D. Reycraft, 'Antitrust Problems in Banking – 1971', 16 *Antitrust Bull.* 817 (1971).

¹⁸² Cases cited note 163 *supra*.

¹⁸³ See, e.g., *Waugh Equip. Co.*, 15 FTC 232 (1931); *Mechanical Mfg. Co.*, 16 FTC 67 (1932); *California Packing Corp.*, 25 FTC 379 (1937).

¹⁸⁴ *FTC v. Consolidated Foods Corp.*, 380 US 592 (1965).

retailer, had acquired Gentry, Inc., the country's second largest manufacturer of dehydrated onions and garlic. As a result of this merger, suppliers of Consolidated who were buyers of dehydrated onion and garlic had been warned to purchase from Gentry if they wished to continue selling to Consolidated. This policy was not an unqualified success, however: Gentry's premerger market share of 28 percent for dehydrated onions had risen to 35 percent by 1958, but its 51-percent share of the garlic market had fallen to 39 percent.

In seeking divestiture of the stock and assets of the two firms, the FTC emphasized the fact that mergers between large diversified firms and single-product firms injure competition because of the inherent danger that the larger partner may resort to reciprocal purchases from suppliers. Because of the market shares involved, the Commission judged that the merger thus gave Consolidated the power to foreclose competition from a substantial part of the market for dehydrated onion and garlic, without there being countervailing advantages.¹⁸⁵ Whereas in the Commission's reasoning the postmerger evidence that Consolidated's policy had been unsuccessful was irrelevant, the circuit court, on Consolidated's appeal, concentrated on this aspect, arguing that because reciprocal buying had had no adverse effect on the market position of Gentry's competitors, no case for a violation of Section 7 could be made.¹⁸⁶ The Supreme Court reversed the lower court and upheld the FTC, ruling not only that the court of appeals had given excessive weight to postmerger evidence but that competition was in fact substantially impaired since the market position of Consolidated and Gentry was such as to give them substantial power to insist on reciprocal dealing. The Court remarked that without reciprocity Gentry's share of the market might have fallen still further and quoted with approval the FTC's conclusion that 'if reciprocal buying creates for Gentry a protected market, which others cannot penetrate despite superiority of price, quality or service, competition is lessened whether or not Gentry can expand its market share. . . .'¹⁸⁷

In cases of this type the lower courts have generally taken the same stand as the Supreme Court in *Consolidated Foods*, especially if the merging companies had a substantial share of the relevant market(s), and they have attached little importance to whether reciprocity was actually indulged in or not. This was the case in the *Ingersoll-Rand* rulings, for instance. Ingersoll-Rand was a major manufacturer of heavy industrial machinery that planned to take over three coalmining-machinery companies. After the merger, Ingersoll-Rand would control a market share ranging from 31.1 percent to 63.2 percent in the coalmining-machinery industry, depending on what kind of product market was considered relevant. The issue, however, was not one of horizontal merger, and the circuit court of appeals as well as the district court before it concen-

trated on the drawbacks for competitors that might arise from the dominance of a major concern like Ingersoll-Rand in an industry that otherwise consisted of considerably smaller companies. Ingersoll-Rand's defense that a combination of the three companies would permit better service for the coalmining industry and that its greater financial strength would benefit small coalmining companies in terms of easier credit, better research facilities and so on was rejected. In the first place, Ingersoll-Rand's size put it in a position to buy raw materials more cheaply than its competitors, which gave the company a lead. Secondly, Ingersoll-Rand would be able to offer a complete line of machinery to its customers, more favorable credit facilities, and other advantages. Thirdly, both courts stressed that Ingersoll-Rand, as an important customer of the steel industry, might induce the latter, which in turn was a major purchaser of coal, to buy coal from mines that used Ingersoll-Rand machinery.¹⁸⁸ The district court put this reciprocity point succinctly:

Moreover, the mere existence of this purchasing power might make its conscious employment toward this end unnecessary; the possession of power is frequently sufficient, as sophisticated businessmen are quick to see the advantages in securing the goodwill of the possessor.¹⁸⁹

In line with the foregoing, a district court forbade the acquisition by General Dynamics, a major defense contractor, of the largest producer of carbon dioxide in the United States on the grounds that the opportunity for reciprocal buying had been one of the principal motives for the merger.¹⁹⁰ In another case, a district court refused to prohibit a product-extension merger because it felt that the Department of Justice had not produced sufficient evidence that reciprocal dealing might be practiced.¹⁹¹ Unlike the other cases we have been discussing, however, this one did not involve the acquisition of a leading firm. And in the district court's opinion on the proposed merger between White Consolidated Industries, Inc. and White Motor Corp., both

¹⁸⁵ Dkt. 7000, CCH 1963 Trade Cas. ¶ 16 182, at 20 981-82 (FTC opinion 1963).

¹⁸⁶ 329 F.2d 623 (7th Cir. 1964).

¹⁸⁷ 380 US at 599.

¹⁸⁸ *US v. Ingersoll-Rand Co.*, CCH 1963 Trade Cas. ¶ 70 758 (WD Pa. 1963), *id.* ¶ 70 802 (3d Cir. 1963).

¹⁸⁹ *Id.* ¶ 70 758, at 78 223.

¹⁹⁰ *US v. General Dynamics Corp.*, 258 F. Supp. 36, 59 (SD NY 1966).

¹⁹¹ *US v. Penick & Ford, Ltd.*, 242 F. Supp. 518, 525 (D. NJ 1965). The case concerned the acquisition by Reynolds Tobacco Co. of Penick & Ford, a producer of corn-starch derivatives.

principally engaged in the production and sale of nonelectrical machinery, the reciprocity aspect loomed large as well. The government had charged that there was a danger of reciprocal dealing emerging from the acquisition, that this prospect would encourage other firms to merge and that competitors of White Consolidated would be foreclosed from White Motor as an outlet. Although at the outset the court stated in broad terms that the issue before it was the government's battle against growing overall concentration, it did not in fact go into the 'broader question of aggregate effects' but concentrated instead on those lines of commerce in which the merger would violate Section 7:¹⁹²

Unquestionably, other firms will hesitate to compete too zealously with one division out of fear of antagonizing the entire firm and losing it as a customer for other goods. In particular, the combined steel purchases of White Consolidated and White Motor will aid [the resulting company] . . . in its sales of rolling-mill equipment to the steel industry.¹⁹³

The second group of conglomerate mergers of the product-extension type to have come under attack from the antitrust agencies (more particularly the FTC) are acquisitions by large firms with vast financial resources (graphically described as 'deep pockets') of leading firms in otherwise rather unconcentrated industries. The unanimous 1967 decision of the Supreme Court in *Procter & Gamble* largely subscribed to the reasoning of the FTC, requiring Procter, the leading US manufacturer of soaps and detergents, to divest itself of Clorox Chemical Co., the leading producer of household liquid bleach. As advertising and sales promotion were essential to any sales effort in the homogeneous bleach market, Clorox could benefit from Procter's enormous budget and experience in related fields and would also be able to reduce advertising and promotion costs per unit sold because of the quantity discounts Procter received from the media. This would enable Clorox to increase considerably its already substantial share of the market (48.8 percent before the merger). In its opinion the FTC first made the point that, Procter & Gamble being the most likely entrant into the industry, the form of entry chosen eliminated Procter as a potential competitor. Second, the FTC condemned the consequences of adding Procter's financial strength to that of market leader Clorox. The competitive vigor of Clorox's much smaller competitors would undoubtedly be inhibited by the fact that they lacked the financial backing of a major corporation. Furthermore, entry barriers would be considerably raised since it would only be possible for competitors of the same size as Procter to enter the industry.¹⁹⁴

On appeal, the circuit court rejected the FTC's arguments and dismissed its order,¹⁹⁵ but the Supreme Court reversed the lower court's judgment and instructed it to affirm and enforce the Commission's order. The Court found

that Section 7 was violated because the substitution of the much larger Procter (with its strength in advertising and sales promotion) for the leader of the bleach industry would 'reduce the competitive structure of the industry by raising entry barriers and by dissuading the smaller firms from aggressively competing.'¹⁹⁶ Procter's advertising budget was in fact twice as large as the total sales of the entire liquid bleach industry, and the Court was much impressed by the abortive attempt by one of Clorox's competitors to enlarge its market share after the merger, a move which was promptly defeated by massive outlays for advertising and sales promotion by Clorox. So the Court had reason to presume that fewer firms would be willing to compete with the colossus Procter than with an independent manufacturer. The Court also accepted the Commission's finding that Procter had been a potential independent entrant and that its entry through acquisition had therefore significantly lessened potential competition – an important point in view of the highly concentrated structure of the market.¹⁹⁷

The decisions in the *Reynolds Metals* case concentrate wholly on the 'deep pocket' theory. Reynolds Metals, an aluminum company, had taken over Arrow Brands, a manufacturer of aluminum foil for the florist industry. With a market share of 40 percent, Reynolds was the biggest producer of aluminum foil in the United States, and Arrow, though much smaller in absolute terms, manufactured 33 percent of all florist foil produced in the country. Apart from Arrow, this small industry contained seven other firms. The fact that by the merger Arrow had transformed itself into a company on the scale of Reynolds and thus brought about a considerable structural discrepancy between itself and its competitors played an important part in the decisions of the FTC and the court of appeals.¹⁹⁸ The FTC also emphasized that after the merger Arrow had cut prices below cost, with the result that its sales increased sharply to the

¹⁹² *US v. White Consol. Indus., Inc.*, 323 F. Supp. 1397 (ND Ohio 1971).

¹⁹³ *Id.* at 1398–99. In support of its opinion, the court cited a circuit court of appeals opinion in a private antitrust suit, *Allis-Chalmers Mfg. Co. v. White Consol. Indus., Inc.*, 414 F.2d 506, 518 (3d Cir. 1969), *cert. denied*, 396 US 1009 (1970), that if a merger creates a market structure conducive to reciprocal practices the acquiring company obtains an anticompetitive advantage over its competitors.

¹⁹⁴ In the Matter of *The Procter & Gamble Co.*, Dkt. 6901, CCH 1963 Trade Cas. ¶ 16 673, at 21 574 (FTC opinion and final order 1963).

¹⁹⁵ *Procter & Gamble Co. v. FTC*, 358 F.2d 74 (6th Cir. 1966).

¹⁹⁶ *FTC v. Procter & Gamble Co.*, 386 US 568, 578 (1967). See also *id.* at 571–75.

¹⁹⁷ *Id.* at 581.

¹⁹⁸ In the Matter of *Reynolds Metals Co.*, Dkt. 7009, CCH 1960 Trade Cas. ¶ 28 533 (FTC opinion and order 1960), *Reynolds Metals Co. v. FTC*, 309 F.2d 223 (DC Cir. 1962).

severe disadvantage of its competitors. This, according to the Commission, was clear evidence for a finding that the merger with Reynolds had had undesirable effects on competition. The court of appeals, like the FTC before it, stressed the disproportionate financial power of Reynolds compared with that of the competitors of the acquired company. Unlike the Commission, the court did not find it necessary to adduce as evidence under Section 7 the injurious effect that the merger had already had on Arrow's competitors:

The power of the 'deep pocket' or 'rich parent' for one of the florist foil suppliers in a competitive group where previously no company was very large and all were relatively small opened the possibility and power to sell at prices approximating cost or below and thus to undercut and ravage the less affluent competition. The Commission is not required to establish that Reynolds' acquisition of Arrow did in fact have anticompetitive consequences. It is sufficient if the Commission shows the acquisition had the capacity or potentiality to lessen competition. That such a potential emerged from the combination of Reynolds and Arrow was enough to bring it within Section 7.¹⁹⁹

The court adds to this reasoning the fact that it does not wish to regard 'the mere intrusion of "bigness" into a competitive economic community otherwise populated by commercial "pygmies"' as a *per se* violation of the Clayton Act.²⁰⁰ The court says no more on this point, but on the basis of what we have seen we might be inclined to assume that it would regard a merger creating a big difference in financial power as *per se* violative of the Clayton Act.

Where it can be presumed that a large firm will bring its broad experience and powerful influence fully to bear in order to enhance the market position of a firm it has acquired because of the considerable benefits it expects to reap from so doing, it is clear from the cases discussed above that the acquisition will be held violative of Section 7. The avowed purpose of Alcoa's acquisition of Cupples Products Corp., the biggest fabricator of aluminum curtain wall in the United States, was to boost sales of Alcoa's aluminum to the curtain-wall business. The government took the case to the district court, which found a probability of a substantial lessening of competition, reasoning that as

Alcoa now furnishes their engineering know-how and skill to Cupples, as well as to Cupples competitors, and that new developments are being promoted with all fabricators on an equal basis . . . , there is no assurance that in the future Cupples will not be given advance information on new developments that will render other fabricators powerless to compete with Cupples.²⁰¹

Finally, mention should be made of an FTC opinion on leading-firm conglomerate mergers. Challenging the acquisition of Fram Corp., a manufacturer of

automotive filters, by Bendix Corp., an automotive parts producer, the Commission found that the elimination of Bendix as the most likely entrant into the passenger car filter replacement market violated Section 7 because Fram was a leader in a highly concentrated market. Toehold acquisition of a smaller firm, on the other hand, would not have been held violative of Section 7.²⁰²

In the cases of conglomerate merger we have just been discussing, the enforcement agencies were able to show a direct influence of the merger on competition in one or more markets, which brought it within the reach of Section 7. More recently, the Department of Justice in particular has begun to attack the other remaining type of merger, the *pure conglomerate* merger, under Section 7 too. Although the proceedings instituted to date have caused a considerable stir, they have all ended in consent decrees and not one has come before the Supreme Court. This is all the more unfortunate as the lower-court decisions we do have are unanimous in rejecting the government's view of the applicability of Section 7. In its complaints in these cases the government attacked on two fronts. First, it relied on a number of actual or probable anticompetitive effects such as heightened barriers to entry, reciprocity and foreclosure because of integration aspects. Second, it raised the issue of increased concentration as such, contending that this might at some future date have anticompetitive effects not yet discernible. On this second point the government was departing from the established doctrine, reaffirmed by the Supreme Court in *Brown Shoe*, that Section 7 is concerned with *probable* anticompetitive effects and not with mere possibilities.²⁰³

The government's view was stated clearly in the first of these cases – that of the merger between Ling-Temco-Vought, Inc. and Jones & Laughlin Steel Corp. – in which a consent settlement was reached early in 1970. Here, the government alleged:

[C]oncentration of control of manufacturing assets will be substantially increased, and the trend to further concentration by merger will be encouraged, thereby (i) reducing the number of firms capable of entering concentrated markets; (ii) reducing the number of firms with the capability and incentive for competitive innovation; (iii) increasing the barriers to entry in concen-

¹⁹⁹ 309 F.2d at 229.

²⁰⁰ *Id.* at 230. See also *General Foods Corp. v. FTC*, 386 F.2d 936 (3d Cir. 1967), *cert. denied*, 391 US 1250 (1968).

²⁰¹ *US v. Aluminum Co. of America*, 233 F. Supp. 718, 728 (ED Mo. 1964).

²⁰² In the Matter of *Bendix Corp.*, Dkt. 8739, CCH 1970 Trade Cas. ¶ 19 288 (FTC opinion 1970).

²⁰³ *Brown Shoe Co. v. US*, 370 US 294, 323 (1962).

trated markets; and (iv) diminishing the vigor of competition by increasing actual and potential customer-supplier relationships among leading firms in concentrated markets.²⁰⁴

The courts found for the defendants in the Justice Department's complaints against Northwest Industries, Inc. and against International Telephone & Telegraph Corp. (in respect of three mergers – with Grinnell Corp., Hartford Fire Insurance Co. and Canteen Corp.). In *Northwest*,²⁰⁵ concerning the acquisition by Northwest Industries, which in 1969 ranked among the 130 largest US industrial corporations in terms of sales and among the 55 largest in terms of assets, of B. F. Goodrich Co., which ranked 83d in sales and 86th in assets, the district court held that the government had failed to prove the probability that specific anticompetitive effects would emerge. In the case involving ITT's acquisition of Grinnell,²⁰⁶ the leading manufacturer and installer of automatic sprinkler fire-protection systems, the district court took a similar stand, holding that the government had failed to establish that reciprocal dealing would be facilitated by Grinnell's affiliation with Hartford (another ITT subsidiary) or by Grinnell's alleged access to ITT's experience in communications and electronic devices. Moreover, the court refused to entertain the government's claim that mergers which increase economic concentration be proscribed under Section 7: any such extension of the statutory test was a matter for the Congress, not the courts. Neither the *Grinnell* case nor the other two complaints concerning ITT's acquisitions of Hartford,²⁰⁷ the fourth-ranking company writing property and liability insurance through independent agents, and of Canteen Corp.,²⁰⁸ a supplier of vending and manual food services, reached the Supreme Court, for despite its success in the lower courts ITT entered into consent settlements with the Justice Department on 24 September 1971.²⁰⁹ These provide for divestiture within two years of Canteen and the Fire Protection Division of Grinnell and, ITT preferring to keep Hartford, for divestiture within three years of four other firms belonging to the ITT conglomerate. As was the case with LTV, ITT was obliged to agree to severe limitations on its future growth in the United States through acquisitions of big firms: it was forbidden to acquire any domestic firm with assets exceeding \$100 million or any leading firm in concentrated markets. 'Leading firm' is defined in the decree as a firm having annual sales in excess of \$25 million and a share of over 15 percent in any market where total sales are above \$100 million. 'Concentrated market' is defined as one in which any four firms account for more than 50 percent of total sales. Apart from these general restraints upon ITT's activity, the consent settlement specifically enjoins ITT from acquiring any substantial interest in any US automatic sprinkler company or in any domestic insurance

company with insurance assets exceeding \$10 million and orders ITT and all its subsidiaries to refrain from engaging in reciprocal dealing agreements.

5.4.3 Joint Ventures

With the Supreme Court's ruling of 22 June 1964 in the now celebrated *Penn-Olin* case,²¹⁰ antitrust case law became the richer by a decision on joint ventures. Hitherto, the courts had made occasional remarks on the lawfulness of joint ventures under Section 1 of the Sherman Act; apart from the fact that they often related to something that is not covered by our definition in Chapter 3, these remarks are generally only to be understood in the specific context of the cases concerned. The government had taken the view that joint ventures were to be regarded as pricing and sales agreements and hence as violative of Section 1 – as in the *Timken* case.²¹¹

In *Penn-Olin* the Antitrust Division tried a new approach to joint ventures – through Section 7 of the Clayton Act. It had generally been held from the reference in amended Section 7 to 'corporation engaged in commerce' that while Section 7 applied to the acquisition of an existing corporation it did not

²⁰⁴ *US v. Ling-Temco-Vought, Inc.*, Civil No. 69-438 (WD Pa., filed 14 April 1969). In the consent settlement before this court, LTV agreed to sell Braniff Airways and Okonite, a wire-making company, preferring to keep control of Jones & Laughlin. LTV was also prohibited for ten years from acquiring any significant stock interest in any corporation with assets of \$100 million or more without prior approval. *CCH 1970 Trade Cas.* ¶ 73 105 (WD Pa. 1970).

²⁰⁵ *US v. Northwest Indus. Inc.*, 301 F. Supp. 1066 (ND Ill. 1969).

²⁰⁶ *US v. International Tel. & Tel. Corp.*, 306 F. Supp. 766 (D. Conn. 1969); 324 F. Supp. 19 (D. Conn. 1970), *appeal dismissed per stipulation*, 92 Sup. Ct. 20 (1971).

²⁰⁷ *US v. International Tel. & Tel. Corp.*, 306 F. Supp. 766 (D. Conn. 1969). This opinion denied the government preliminary injunctions to enjoin the proposed ITT/Grinnell and ITT/Hartford mergers. The *Hartford* case did not then go to trial.

²⁰⁸ *US v. International Tel. & Tel. Corp.*, *CCH 1971 Trade Cas.* ¶ 73 619 (ND Ill. 1971).

²⁰⁹ *US v. International Tel. & Tel. Corp.* (Grinnell Corp.), *CCH 1971 Trade Cas.* ¶ 73 665 (D. Conn. 1971); *US v. International Tel. & Tel. Corp.* (Hartford Fire), *id.* ¶ 73 666 (D. Conn. 1971); *US v. International Tel. & Tel. Corp.* (ITT Canteen Corp.), *id.* ¶ 73 667 (ND Ill. 1971).

²¹⁰ *US v. Penn-Olin Chemical Co.*, 378 US 158 (1964), *vacating and remanding* 217 F. Supp. 110 (D. Del. 1963).

²¹¹ *Timken Roller Bearing Co. v. US*, 341 US 593 (1951), *affirming and modifying* 83 F. Supp. 284 (ND Ohio 1949). See also *US v. Imperial Chem. Indus., Ltd.*, 100 F. Supp. 504 (SD. NY 1951); *US v. Minnesota Mining & Mfg. Co.*, 92 F. Supp. 947 (D. Mass. 1950). A survey of the case law is given in John C. Berghoff, 'Antitrust Aspects of Joint Ventures', 9 *Antitrust Bull.* 231 (1964).

reach the joint establishment of a new corporation.²¹² For this reason, the Antitrust Division based its complaint seeking the separation of Penn-Olin Chemical Co. from its two parent companies on Section 1 of the Sherman Act as well as Section 7 of the Clayton Act. However, the Supreme Court held that legislative history and congressional intent showed that joint ventures could be reached by Section 7 of the Clayton Act alone.²¹³

This raises three legal problems, given the three characteristics of joint ventures described in Chapter 3. In the first place, no firm disappears as a result of this type of merger: on the contrary, a new business is set up in addition to the two parent firms, and this may create difficulties as regards interpreting the concept of 'lessening competition.' Secondly, the management of the new entity is controlled by more than one firm – which is not so in any other type of merger. And lastly, the parents remain independent units and there need be no other form of tie between them. Where the joint subsidiary is an existing corporation, it may be difficult to establish at what point, i.e. from what degree of participation, a joint venture may be said to have been engaged in. But this is a problem we shall not go into here.

In 1960 Pennsalt Chemicals Corp. and Olin Mathieson Chemical Corp. had set up a joint subsidiary, named Penn-Olin Chemical Co., with each of them owning 50 percent of Penn-Olin's stock. Penn-Olin had then constructed on its own account a plant to produce sodium chlorate – a product used chiefly as a bleach in paper manufacture. This plant was intended mainly to meet the needs of industry in a fifteen-state area in the southeastern United States, which was defined as the relevant market. Pennsalt also made this product but sold it mostly in other parts of the country; Olin had never manufactured sodium chlorate. Penn-Olin had two bigger competitors in the relevant market, and a number of other producers had decided to build new plants. Finally, demand for sodium chlorate in the area concerned had increased sharply in recent years.²¹⁴

The Antitrust Division claimed that in the absence of a joint venture the two parent companies would have entered the new market separately or that at least one of them would have done so – with the other hard on its heels as a potential competitor. Hence, the creation of the joint subsidiary had lessened competition.

The district court found no reason to pass on the applicability of Section 7 to joint ventures, because even if it were applicable the establishment of Penn-Olin would not be in conflict with the law. The court held that it would be particularly difficult to give an opinion on the possible anticompetitive effects of the formation of Penn-Olin on new competitors because so many factors were involved that could not be assessed at the time of the ruling.²¹⁵ Another

argument of the Antitrust Division – that Olin and Pennsalt would be much stronger financially than their competitors – was dismissed by the district court as unproven. A third argument – that Pennsalt could strengthen Penn-Olin's position by reciprocal purchasing arrangements – was found to be too weak: there was no evidence for this, and Penn-Olin's competitors also made use of the practice. Finally, the setting-up of Penn-Olin would not necessarily lessen potential competition within the meaning of the statute, because it was not shown that both parent companies would have decided to build a sodium-chlorate plant in the relevant market, so that ultimately only *one* new company would have been established. Furthermore, the court found no reason to assume that Penn-Olin would play a less active role on the market than Pennsalt or Olin.²¹⁶

On appeal, the Supreme Court rejected this reasoning. For the Supreme Court, the crucial question in bringing joint ventures under Section 7 was whether it could be established that if one only of the partners had set up a plant the other would have remained a likely potential entrant. The Court considered this potential competition of great importance as a moderating influence on the actions of companies on a market:

There still remained for consideration 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. Just as a merger eliminates actual competition, this joint venture may well foreclose any prospect of competition between Olin and Pennsalt in the relevant sodium chlorate market. The difference, of course, is that the merger's foreclosure is present while the joint venture's is prospective.²¹⁷

²¹² See, e.g., Kingman Brewster Jr., *Antitrust and American Business Abroad* 206 n.100 (New York: McGraw-Hill, 1958); Stanley E. Boyle, 'The Joint Subsidiary: An Economic Appraisal', 5 *Antitrust Bull.* 303, 306, 309 (1960); Berghoff, *supra* note 211, at 241–45. There is no mention of the problem in the legislative history of the Celler-Kefauver amendment.

²¹³ Cf. the ECSC High Authority's ruling in the *Sidmar* case – the first time it had been called upon to rule on a joint venture under Article 66 of the ECSC Treaty. ECSC High Authority, *Eleventh General Report on the Activities of the Community* § 346 (Luxembourg, 1963).

²¹⁴ On the situation on the relevant market, see Robert Pitofsky, 'Joint Ventures under the Antitrust Laws: Some Reflections on the Significance of Penn-Olin', 82 *Harvard L. Rev.* 1007 (1969).

²¹⁵ 217 F. Supp. 110.

²¹⁶ *Id.* at 130.

²¹⁷ 378 US at 173–74.

The Supreme Court accordingly sent the case back to the district court for further findings. The court below was to investigate whether without a joint subsidiary either of the parent companies would have set up a sodium-chlorate plant if it had known that the other would remain as an important *potential* competitor in the market. The Supreme Court went on to list a number of criteria that it considered particularly relevant to such an assessment of joint ventures under Section 7: the number and influence of the firms active on the relevant market, the reasons for their growth, the size of the parent companies, their relations to each other (do their products compete?) and their common competitors, the reasons for setting up a joint venture, the competitive relationship between the joint venture and its parents, the role of anticompetitive practices on the market or markets in which the parent firms are active, the competition that an independent establishment by one of the parent companies on the relevant market would encounter, and the consequences of potential competitive pressure by other companies which have not yet set up their own plants.

On remand, the district court found that on the basis of the facts presented neither Olin nor Pennsalt would have entered the market alone, so there was no violation of the Clayton Act by the joint venture,²¹⁸ and this was affirmed by an equally divided Supreme Court.²¹⁹

The investigation of a joint venture, then, is much more comprehensive than that of other types of merger. This may be because it will be more difficult to prove a transgression of Section 7 as a result of engaging in a joint venture than is the case with other mergers. Moreover, the Court may have been impressed by the clear economic benefits of industrial growth that stem from joint ventures.

Finally, some comment should be made on the application of Section 1 of the Sherman Act. The antitrust agencies saw a violation of Section 1 in the fact that Pennsalt and Olin had agreed to keep each other informed if either of them should wish to set up a sodium-chlorate plant. The Supreme Court did not consider this argument: it simply held that Section 1 had not been violated. Furthermore, we find elsewhere in the ruling the remark that it was not the intention of Pennsalt and Olin to use the joint subsidiary as an instrument to lessen competition or to make further agreements that would do so.²²⁰ From this it can be deduced that only an actual lessening of competition between parent companies and/or with the subsidiary – for instance, if the parents cease to produce in favor of the subsidiary or if they split up the market beforehand in order to protect the subsidiary's interests – is prohibited in the same way as contracts in restraint of trade under Section 1 of the Sherman Act. Something of this kind was the case with the joint operating agreement between the

only two newspapers in Tucson, Arizona, which provided *inter alia* for profit pooling. Moreover, the agreement resulted eventually in a horizontal merger, since the stockholders of one of the papers were given an option to purchase the shares of the other and in fact did so. The government requested and obtained divestiture from the district court, while the agreement had to be modified in order to put an end to price fixing and profit pooling. The Supreme Court affirmed the lower court's decision, finding that price fixing and division of markets constituted a *per se* violation of Section 1 of the Sherman Act and that the pooling of profits also violated the Act in that it reduced the incentive to compete.²²¹ The rejection by the Supreme Court of the failing-company defense will be dealt with in the next subsection of this chapter.

5.4.4 Mergers with Failing Companies

The earliest Supreme Court ruling in a merger case in which the defendants relied on a failing-company defense was handed down in 1930, but it is still of current interest.²²² One of the issues in the case (between the FTC and a major shoe manufacturer) was whether there were any firms other than International that were willing and able to take over McElwain, which was near to bankruptcy.²²³ The FTC and the court of appeals had opined that there were; the Supreme Court, however, found that there were not. If it had not been acquired by International, McElwain would have gone into liquidation, and this would have had undesirable consequences. The Court held:

that the purchase of its capital stock by a competitor, there being no other prospective purchaser, not with the purpose to lessen competition but to facilitate the accumulated business of the purchaser, and with the effect of mitigating seriously injurious consequences otherwise probable, is not in contemplation of law prejudicial to the public and does not substantially lessen competition or restrain commerce within the intent of the Clayton Act.²²⁴

²¹⁸ 246 F. Supp. 917 (D. Del. 1965).

²¹⁹ 389 US 308 (1967).

²²⁰ 378 US at 176.

²²¹ *Citizen Publishing Co. v. US*, 394 US 131 (1969). See also *Northern Natural Gas Co. v. Federal Power Comm'n*, 399 F. 2d 953 (DC Cir. 1968), setting aside an order of the Federal Power Commission authorizing the formation of a jointly owned pipeline company on the grounds that the Commission had not considered its effects on competition and that there was in fact an infringement of Section 7. Furthermore, the court found that the cooperation between the parent companies might well result in market allocation, reciprocal dealing or joint boycott.

²²² *FTC v. International Shoe Co.*, 280 US 291 (1930).

²²³ The Supreme Court's decision is noted chiefly for its interpretation of the substantiality test of Section 7 (see subsection 2.2.1 of this chapter).

²²⁴ 280 US at 302-03.

The reasoning of the Court depends on the fact that there was no other purchaser to save the failing company from bankruptcy by taking it over. This makes the case relatively simple. But even if only one firm is prepared to acquire a failing company, it ought to be investigated whether the corporation that is in financial difficulties cannot be reorganized by some means other than merger with a competitor. If there *is* any such option, or if a company from another industry is a prospective purchaser, either of these solutions must be given preference. It was not until 1969, however, that the Supreme Court gave consideration to this aspect of the issue.

During congressional proceedings before Section 7 was amended in 1950, the House and Senate Judiciary Committees took the view that the Clayton Act did not reach corporations in obvious financial straits.²²⁵ The first time that the failing-company issue came to the courts under amended Section 7 was in the *Diebold* case.²²⁶ The district court held that Diebold's acquisition of a competing bank-vault manufacturer was not violative of Section 7 because the acquired company was in poor financial shape and Diebold was the only firm showing a serious interest in acquisition. On appeal to the Supreme Court, the Department of Justice attacked the reasoning of the court below on two points. First, it argued that the acquired corporation was not in such a bad position: admittedly, sales had declined slightly in recent years and the company had suffered considerable losses, but it had shown vigorous growth in the past. Second, the Justice Department stated that there was another purchaser besides Diebold – a firm from another industry – and acquisition by this firm (though at a lower price) would accord better with the principles of Section 7. This complaint, then, brought two interesting problems to the fore, but the Supreme Court unfortunately remained silent on these issues. In a summary judgment, *per curiam*, the Court sent the case back to the lower court because there was a difference of opinion between the parties on the two points in the complaint. The district court then entered a consent decree requiring Diebold to divest itself of the acquired corporation, though this had to be effected in such a way as to permit its reactivation as an operating business. Diebold was given one year in which to comply. If after this period it should prove, however, that divestiture was not possible, then everything could remain as it was.²²⁷

The first decision by the Supreme Court after the 1950 amendment that clarified the applicability of Section 7 to mergers with failing companies was handed down in 1969 in *Citizen Publishing Co.*, a joint-venture case we have already discussed. As one of the newspapers involved was operating at a loss, defendants sought to justify the joint operating agreement by an appeal to the failing-company defense. This was not accepted by the Court, however, which laid down a number of conditions that have to be satisfied for such an appeal

to succeed. First, the acquired company must be facing the grave probability of a business failure. Second, the acquiring corporation has to be the only prospective purchaser. And third, the prospects of reorganization of the company in financial difficulties as a viable competitor must be 'dim or nonexistent,' which meant in the case in point that the defendants would have had to prove that the allegedly unlawful agreement constituted the only way to preserve the newspaper.²²⁸

In 1971 the Supreme Court applied the same criteria when rejecting a failing-company defense in the *Greater Buffalo Press* horizontal-merger case. The Court held that this defense could not be successfully relied upon unless merger was the only way to prevent a business failure (because the resources of the acquired company were severely depleted and could not be expected to improve) and there were no other prospective purchasers.²²⁹

Whereas the first two criteria enumerated by the Supreme Court in *Citizen Publishing* had already been established in its *International Shoe* decision, discussed above, the third one is new. For that reason, in 1970 the court of appeals remanded a case to the Federal Trade Commission, which had rendered an opinion before the Supreme Court's ruling in *Citizen Publishing*, in order to afford US Steel, the appellant, an opportunity of satisfying the burden of proof on that particular point.²³⁰ The case concerned the acquisition by US Steel, the largest nonintegrated supplier of portland cement in the relevant market area, of Certified Industries, the largest nonintegrated consumer of the product. In its decision the court of appeals specifically observed that the failing-company defense must be measured from the inception of the vertical arrangements between US Steel and Certified – that is, when the cement producer began to

²²⁵ HR Rep. 1191, 81st Cong., 1st Sess. 6 (1949); S. Rep. 1775, 81st Cong., 2d Sess. 7 (1950). Relying on the Supreme Court's *International Shoe* decision, the House Report remarks that 'it is well settled that the Clayton Act does not apply in bankruptcy or receivership cases.'

²²⁶ *US v. Diebold, Inc.*, 197 F. Supp. 902 (SD Ohio 1961), *rev'd per curiam*, 369 US 654 (1962), *consent judgment* CCH 1963 Trade Cas. ¶ 70 738 (SD Ohio 1963).

²²⁷ There were two other points of interest in the consent decree. First, nothing was put in the way of Diebold's taking over a distributor of its products in the future 'if such distributor has been unable to pay its indebtedness to Diebold in the ordinary course of business and faces imminent bankruptcy or would not be able to continue in business.' CCH 1963 Trade Cas. ¶ 70 738, at 77 917. Second, Diebold was prohibited for a period of five years, or – if it had been unable to divest itself of the failing corporation – for ten years, from acquiring any other corporation unless it was informed within thirty days of notifying the Department of Justice that there was no government objection. *Id.* at 77 918.

²²⁸ Case cited note 221 *supra*.

²²⁹ *US v. Greater Buffalo Press, Inc.*, 402 US 549 (1971).

²³⁰ *US Steel Corp. v. FTC*, 426 F.2d 592 (6th Cir. 1970).

assist the ready-mix company in financing its cement purchases – rather than from the point of their final consummation.

Although the three criteria used in the recent Supreme Court rulings conveniently cover the factors that are relevant to weighing a failing-company defense by an acquiring firm, difficulties may sometimes arise as to the applicability of these criteria in practice. One point of potential conflict is the assessment of the prospects for reestablishing a company in serious financial difficulties as a viable competitor. It is a far from simple matter to estimate at their true worth management decisions on the possibility of reorganization, and the FTC, the court of appeals and the three dissenting Supreme Court justices in *International Shoe* took a different attitude to this factor from the majority of the Supreme Court. A question to be looked into here is whether the difficulties encountered by a firm cannot be explained by a recession in the industry concerned.²³¹ A second potential problem is how to proceed if there is more than one prospective purchaser. From the rulings we may deduce that the firm with the largest market share would not be allowed to have its way in such a case.

5.4.5 Remedies

As the courts have been extremely reluctant to grant motions for preliminary injunction, laying a heavy burden of proof on the enforcement agencies, post-acquisition relief has been the normal way of disposing of a Section 7 suit that has been won by the government. The courts have occasionally issued statements on the goals of remedial action in Section 7 cases. One of the earliest and most important of these is to be found in *du Pont* (General Motors), where the Supreme Court says:

But the primary focus of inquiry . . . is upon the question of the relief required effectively to eliminate the tendency of the acquisition condemned by Section 7 The required relief . . . is a remedy which reasonably assures the elimination of that tendency [C]ourts are authorized, indeed required, to decree relief effective to redress the violations, whatever the adverse effect of such a decree on private interests.²³²

And we find much the same reasoning in another recent judgment of the Court:

Antitrust relief should unfetter a market from anticompetitive conduct and 'pry open to competition a market that has been closed by defendants' illegal restraints.'²³³

Even if a violation of the law is found many years after consummation of a merger, this has no influence on the extent of the relief afforded. A case in point is *du Pont* (General Motors), which concerned an acquisition that had

taken place forty years before. This particular point was an issue in a recent Department of Justice case against a merger between two printers of color comic supplements for newspapers that had already been consummated in 1955. The district court felt that even if a merger was found to have been unlawful, divestiture could not reasonably be ordered fifteen years after the event. The Supreme Court disagreed, however, stating that the main purpose of divestiture was to liquidate an illegally acquired market power and the mere passage of time was no reason to refrain from applying the remedy.²³⁴

The ruling of a circuit court of appeals in *Reynolds Metals* is also of interest here as regards its examination of how far relief should go in the case of mergers consummated several years before:

After-acquired properties are not relevant, except in the case where they represent reinvestment of capital realized from the sale of property included in a forbidden acquisition and replacement of that property. . . .²³⁵

We may deduce from these passages that the basic goals of Section 7 relief have been to terminate the illegal relationship and to deprive defendants of the fruits of an illegal acquisition. A structural remedy – divestiture – has generally been considered the most appropriate. In the words of the Supreme Court in *du Pont* (General Motors):

It cannot be gainsaid that complete divestiture is peculiarly appropriate in cases of stock acquisitions which violate Section 7. . . . The very words of Section 7 suggests [*sic*] that an undoing of the acquisition is a natural remedy. . . . Divestiture has been called the most important of antitrust remedies. It is simple, relatively easy to administer, and sure. It should always be in the forefront of a court's mind when a violation of Section 7 has been found.²³⁶

And in the *Ford* (Autolite) case, the Supreme Court went even further:

Divestiture is a start toward restoring the pre-acquisition situation. Ford once again will then stand as a large industry customer at the edge of the market

²³¹ The minority of the Supreme Court in *International Shoe*, for instance, held that McElwain's difficulties stemmed from the recession in the shoe industry in 1920–21.

²³² *US v. E.I. du Pont de Nemours & Co.*, 366 US 316, 325–26 (1961), *affirming in part, and vacating and remanding*, 177 F. Supp. 1 (ND Ill. 1959).

²³³ *Ford Motor Co. v. US*, 405 US 562, 577–78 (1972), citing *International Salt Co. v. US*, 322 US 392, 401 (1947).

²³⁴ Case cited note 229 *supra*.

²³⁵ *Reynolds Metals Co. v. FTC*, 309 F.2d 223, 231 (DC Cir. 1962).

²³⁶ 366 US at 328–31.

with a renewed interest in securing favorable terms for its substantial plug purchases. Since Ford will again be a purchaser, it is expected that the competitive pressures that existed among other spark plug producers to sell to Ford will be re-created.²³⁷

In both cases, the relief granted went very far. The most spectacular divestiture decree is without doubt the one that the Supreme Court handed down in *du Pont* (General Motors). The government's plan required du Pont to divest itself of all its holdings in General Motors. Two thirds of this would be distributed to du Pont shareholders in the form of dividends over a period of ten years, while the rest would be sold. The district court wished to mitigate the effects of heavy taxation on the transactions proposed by the government and therefore approved a decree ordering that the voting rights to the 63 million General Motors shares should be 'passed through' the shareholders of du Pont and the officers and directors of du Pont should have no voting rights in any form. The Department of Justice appealed this decision to the Supreme Court. In a 4-3 ruling the Supreme Court rejected the lower court's plan, whereby the voting rights to General Motors shares would be withdrawn from du Pont's management, as inadequate and directed complete divestiture, because otherwise du Pont's shareholders would retain an interest in a link with General Motors. So the separation ordered by the Supreme Court, which was to be effected within not more than ten years, goes even further than the government's original proposal.

The *Ford* divestiture decree was accompanied by two other remedial measures. First, Ford was ordered for five years to purchase 50 percent of its total annual spark-plug requirements from the purchaser of the divested plant. Second, Ford was barred for five years from using its own trademark on spark plugs and for ten years from manufacturing them itself. In the words of the Court, this additional relief is designed

to give the divested plant an opportunity to establish its competitive position. The divested company needs time so it can obtain a foothold in the industry. The relief ordered should 'cure the ill effects of the illegal conduct, and assure the public freedom from its continuance'. . . .²³⁸

Another type of relief, which goes relatively far toward restoring competitive conditions on the market, consists in requiring the defendants to set up a completely new competitor instead of separating the original merging companies. In the cases in which this was done, the newly established company included no part of the original merger partners, except that the latter were obliged to transfer enough business to the new firm to make it an economically viable entity.²³⁹

In the great majority of Section 7 merger cases, however, a simple divestiture of the original merger partners was ordered and care has generally been taken by the enforcement agencies not to impose unnecessary hardship on the defendants in carrying out the divestiture order, especially where a number of years have elapsed between the original acquisition and the final order requiring divestiture. For the impact of relief upon the defendant then creates problems parallel to those encountered in the dissolution processes under Section 2 of the Sherman Act. A recent study on the effectiveness of divestiture relief under Section 7 in a number of cases has come to the conclusion that the enforcement agencies have allowed themselves much latitude in considering the interests of the defendants, ensuring as far as possible that the relief would not cause them substantial hardship. For instance, there has been considerable flexibility in respect of the deadline for obtaining compliance, defendants have been given freedom to obtain a reasonable price (failing which they need not comply at all), the government has allowed a firm in a comparable competitive position to the original acquirer to buy the company, and defendants have been permitted to choose the most profitable divestiture plan.²⁴⁰

5.5 A SUMMARY OF THE CASE LAW

Section 1 of the Sherman Act, the earliest of the antitrust laws, has hardly been applied at all to acquisitions. This is surprising, because the statute was enacted in order to combat the various forms of industrial combination, which were taking on giant proportions toward the end of the nineteenth century. The considerations set forth in the previous chapter show that the main reason why so few antitrust suits were filed against horizontal mergers was the courts' interpretation of the Sherman Act. The requirement to show an unreasonable restraint of trade made a complete and detailed examination of the consequences of a horizontal acquisition on competition in the relevant market

²³⁷ 405 US at 573-74.

²³⁸ *Id.* at 575, citing *US v. US Gypsum Co.*, 340 US 76, 88 (1950).

²³⁹ See Malcolm R. Pfunder, Daniel J. Plaine and Anne Marie G. Whittemore, 'Compliance with Divestiture Orders under Section 7 of the Clayton Act: An Analysis of the Relief Obtained', 17 *Antitrust Bull.* 19, 63-68 (1972). Such relief was ordered, for instance, in *US v. Third Nat'l Bank in Nashville*, 390 US 171 (1968). Defendants in this case were required to obtain a charter for a new bank, provide it with a specified amount of capital, transfer to it certain business (checking, time and savings accounts, loans and discounts, safe deposit vaults etc.) and obtain qualified management. *Id.* at 65.

²⁴⁰ *Id.* at 42-111.

essential. This was a considerable obstacle to effective enforcement of the law.²⁴¹ Apart from a number of successful proceedings against railroad mergers, scarcely any action has been taken against mergers under the Sherman Act. One of the best-known cases was *Columbia Steel*, in which the Supreme Court affirmed the district court's dismissal of the government's suit because the merger could not be shown to have anticompetitive consequences despite the significant market shares involved.²⁴²

Since the amendment to Section 7 of the Clayton Act came into force in 1950 the Department of Justice has only once challenged a merger under the Sherman Act alone, though it has occasionally joined a complaint under Section 1 of the Sherman Act to one under Section 7 of the Clayton Act.²⁴³ In the first of these cases the Supreme Court found against the merger simply because it involved two important competitors and would lead to the elimination of significant competition. The Court's interpretation of Section 1 of the Sherman Act thus opened the door to attacks on any acquisition of assets not reached by Section 7 of the Clayton Act; but the Department of Justice has not taken advantage of it. In the other cases the issues under Section 1 were not determining factors in the final result. In view of the incidental nature of these suits, too much reliance should not be placed on them as guides to the future orientation of antitrust policy in respect of mergers.

Since 1950, then, Section 7 of the Clayton Act has been the principal weapon used by the two enforcement agencies to combat the growth of concentration in the American economy. The general idea behind the bill to amend Section 7 was to put a brake on the increasing concentration of industry in order to stop the widening gap between big and small businesses, but congressional intent is nowhere clearly specified. All that we can be reasonably sure about is that Congress did not intend to enact a *per se* prohibition in Section 7 nor to leave the way open for rule-of-reason interpretations on the lines of the Sherman Act.

In enforcing Section 7 the antitrust agencies have laid most emphasis on the trend toward increased concentration on the relevant markets or in the economy as a whole. It will be useful at this juncture to examine in some detail the Merger Guidelines issued by the Department of Justice on 30 May 1968.²⁴⁴ In these Guidelines the Department defends the structural approach on the ground that the conduct of the individual firms in a market tends to be controlled by the structure of that market and the primary role of Section 7 enforcement is to preserve and promote market structures conducive to competition. In its structural analysis the government confines itself basically to market share, however, to the exclusion of other relevant economic factors. The government has challenged horizontal mergers even where the firms involved had very small market shares, whereas in cases of integration or con-

glomerate expansion it has taken action mainly where one of the two hundred largest American concerns was involved. The Merger Guidelines are at their most precise where they set market-share standards – for horizontal and vertical mergers. The Department expects to take other than structural factors into account only in certain exceptional circumstances – such as where basic technological changes are creating new industries so that current market boundaries and market structure are of uncertain significance – and in the field of conglomerate mergers.²⁴⁵

The general market definition contained in the Guidelines is 'any grouping of sales (or other commercial transactions) in which each of the firms whose sales are included enjoys some advantage in competing with those firms whose sales are not included.' As regards the product market, this general principle is expressed in terms of two widely divergent criteria which more or less reflect the divergent views of the Supreme Court in *Alcoa* (Rome) on the one hand and *Continental Can* on the other. The Guidelines first state that the relevant product market is constituted by 'the sales of any product or service which is distinguishable as a matter of commercial practice from other products or services . . . even though, from the standpoint of most purchasers, other products

²⁴¹ For detailed discussion of this point, see Chapter 4 *supra*.

²⁴² *US v. Columbia Steel Co.*, 334 US 495 (1948).

²⁴³ Complaint filed under § 1 of the Sherman Act: *US v. First Nat'l Bank & Trust Co. of Lexington*, 376 US 665 (1964); under § 1 of the Sherman Act and § 7 of the Clayton Act: *US v. Philadelphia Nat'l Bank*, 374 US 321 (1963); *US v. Penn-Olin Chem. Co.*, *supra* note 210; *Citizen Publishing Co. v. US*, *supra* note 221.

²⁴⁴ The FTC too has published statements of enforcement policy with respect to cement (CCH *Trade Reg. Rep.* ¶ 4510, Jan. 1967), food distribution (*id.* ¶ 4520, Jan. 1967) and grocery products manufacturing (*id.* ¶ 4530, May 1968) in which sales figures rather than market shares are the principal test (in cement, acquisition of a firm with annual purchases of 50 000 bbl. or more; in food distribution, acquisitions resulting in combined sales in excess of \$500 million a year; in grocery manufacturing, acquisitions resulting in combined assets in excess of \$250 million). However, the FTC statements also contain market-share criteria in that 'strong market position' is defined as 'being one of the top four producers of a product in which the top four companies hold 40 percent or more of the value of shipments' and in that the acquired company is described as one which is 'among the top eight producers of any important grocery product, or has more than a 5 percent share of a relevant market.' More recently, the FTC has published criteria for assessing future mergers in the dairy industry (38 *Fed. Reg.* 17 770 (1973)), based on sales figures for mergers involving national dairies and referring to the Department of Justice Guidelines for acquisitions by major regional companies of dairy companies ranking in the top four in adjacent markets. FTC merger policy guidelines for the dairy industry became necessary after FTC orders barring leading-firm market-extension mergers issued in the course of the 1960s began to expire.

²⁴⁵ *Guidelines* para. 2.

may be reasonably, but not perfectly, interchangeable with it in terms of price, quality, and use.' And then they add that 'the sales of two distinct products to a particular group of purchasers can also appropriately be grouped into a single market where the two products are reasonably interchangeable for that group in terms of price, quality, and use.'²⁴⁶ While the first of these criteria gives a very narrow market definition, comprising only perfect substitutes in the relevant product market, the second enables the government also to attack mergers between firms selling products which are not perfectly substitutable by purchasers. A similar latitude is evident in the Department's definition of the relevant geographic market. The general criterion applied is that the firms involved in the merger make significant sales of the relevant product in any commercially significant section of the country. A larger section need only be taken into account if there are no economic barriers to entry. However, inside a section relevant submarkets may be delineated where a portion of the sales in question is made to 'a group of purchasers separated by a substantial economic barrier from the purchasers to whom the rest of the sales are made.'²⁴⁷ This opens the door to very narrow definitions, such as the Supreme Court in fact employed in its bank-merger and *Pabst* rulings, so that it was easy to arrive at high concentration figures.

With respect to horizontal mergers, the Guidelines state the government's policy in such precise terms as to leave firms with virtually no doubt as to how the Department of Justice will set about enforcing the law. This could be done because market shares have become by far the most important criterion for determining the legality of mergers. The Guidelines distinguish between markets that are highly concentrated, those that are less highly concentrated and those in which there is a significant trend toward increased concentration. In markets in which the shares of the four largest firms amount to approximately 75 percent or more, the Department will ordinarily challenge mergers in which, if the acquiring firm accounts for 4 percent, 10 percent or 15 percent or more of the market, the acquired firm accounts for 4 percent or more, 2 percent or more, or 1 percent or more respectively (other percentages interpolated proportionately).²⁴⁸ So 8 percent is the lowest joint market share that will expose merging firms to action by the Department of Justice. In markets in which the shares of the four largest firms amount to less than approximately 75 percent, the corresponding market shares are: acquiring firm 5, 10, 15, 20 and 25 percent or more, acquired firm at least 5, 4, 3, 2 and 1 percent respectively.²⁴⁹ Finally,

a significant trend toward increased concentration . . . is considered to be present when the aggregate market share of any grouping of the largest firms in the market from the two largest to the eight largest has increased by approximately

7% or more of the market over a period of time extending from any base year 5-10 years prior to the merger (excluding any year in which some abnormal fluctuation in market shares occurred) up to the time of the merger,²⁵⁰

and in such a market setting the Department will challenge any acquisition, by a firm in any such grouping, of any firm whose market share amounts to approximately 2 percent or more.

Apart from these instances, in which action will be taken on grounds of market shares alone, the Guidelines describe two common types of merger that are liable to be challenged despite the fact that they would escape challenge under the market-share standards:

(a) acquisition of a competitor which is a particularly 'disturbing,' 'disruptive,' or otherwise unusually competitive factor in the market; and (b) a merger involving a substantial firm and a firm which, despite an insubstantial market share, possesses an unusual competitive potential or has an asset that confers an unusual competitive advantage (for example, the acquisition by a leading firm of a newcomer having a patent on a significantly improved product or production process).²⁵¹

The only exception to these rigorous standards is the case of merger with a failing company. The Department's definition of failing company ties in with the Supreme Court's criteria in *International Shoe*, and the Department states that it will apply this particular standard only in the clearest of circumstances.²⁵² An efficiency defense, on the other hand, will not normally be accepted as justification for a merger that would ordinarily be challenged because, among other reasons, the potential economies can generally be realized at significantly smaller plant and firm size or through internal expansion, and it is extremely difficult to establish accurately the existence and magnitude of economies claimed for a merger.²⁵³

The Guidelines reflect the current doctrine of the Supreme Court, which has come round more and more frequently to the government's view that firm action must be taken against horizontal mergers by applying the strictest possible standards. In fact, from our discussion of the cases it can be seen that this holds

²⁴⁶ *Id.* para. 3.

²⁴⁷ *Ibid.*

²⁴⁸ *Id.* para. 5.

²⁴⁹ *Id.* para. 6.

²⁵⁰ *Id.* para. 7.

²⁵¹ *Id.* para. 8.

²⁵² *Id.* para. 9.

²⁵³ *Id.* para. 10.

good for all kinds of merger challenged under Section 7. There has been no fundamental change of approach in court rulings since 1968, and that may explain why no formal amendments to the Guidelines have yet been made despite the fact that the Department warned when issuing the Guidelines that they were subject to amendment from time to time.

In *Brown Shoe* the Supreme Court mentioned the degree of concentration, other structural factors (especially the size distribution of firms and past and future changes therein) and opportunity for entry as criteria particularly relevant in judging the horizontal aspects of a merger, but market shares and the trend toward concentration have become nearly the sole criteria whereby horizontal mergers are assessed in the courts. Simply by taking the market shares resulting from horizontal mergers in concentrated markets that the Supreme Court considered excessive in its bank-merger rulings and in its findings on the horizontal aspects of *Brown Shoe*, *Continental Can* and *Pabst*, we arrive at the conclusion that an acquisition by a leading firm (an oligopolist) of a competitor with a share of 3 percent or more in the relevant market that produces a combined market share of 20 percent and over violates Section 7. We should add, of course, that entry barriers to the industries involved in these rulings were not insubstantial, particularly in banking, where very restrictive admittance laws for new banks practically exclude new entry. In this respect it is interesting to note that after the Supreme Court's ruling in *Phillipsburg* the Federal Deposit Insurance Corporation, which is responsible for ruling on most small-bank mergers, announced that control of 15 percent or more of the banking assets in a market area as a result of a merger would be a critical factor in weighing the antitrust aspects of such a merger.²⁵⁴ Even stricter quantitative criteria have been applied where there is a trend toward increasing concentration, as is shown by the Supreme Court's ruling in *Von's Grocery*, in which the Court refers specifically to congressional intent to halt such a trend at an early stage and thus to protect small competitors.

Whereas certain lower courts and the FTC admitted an efficiency defense in some early cases, the Supreme Court has been unwilling to take account of technical and economic advantages arising from corporate combination challenged under Section 7. Current antitrust doctrine considers that if one of the structural factors mentioned above comes into play, a lessening of competition automatically follows since the consumer's choice is thereby restricted; there is no need to investigate how far the consumer can still be supplied from other sources.

The Merger Guidelines also reflect the general principles and specific criteria developed in the case law with regard to vertical mergers. The Department of Justice will generally take action if a vertical acquisition 'tends significantly to

raise barriers to entry in either market or to disadvantage existing nonintegrated or partly integrated firms in either market in ways unrelated to economic efficiency.²⁵⁵ The case law and the Merger Guidelines point up three particular undesirable ways in which vertical mergers raise entry barriers. First, they foreclose equal access to potential customers and thus cut off nonintegrated competitors from sales outlets, so that such firms are either disadvantaged in their efforts to obtain an efficient level of production or obliged to integrate themselves even where this is unnecessary on efficiency grounds. Second, they have a similar foreclosure effect on potential suppliers, with the attendant risk of price or supply squeezes. And last, they afford an integrated firm that buys from and sells to nonintegrated competitors an opportunity of manipulating its prices or other conditions of sale in such a way that those competitors fear for their existence.

In judging actual cases of vertical merger the enforcement agencies and the courts have generally given most consideration to the market shares of the merging companies and to whether there was a trend toward integration in the industry in question. The most typical cases are *du Pont* (General Motors) and *Brown Shoe*. In the first of these, *du Pont* had a very strong position on the relevant market. In the second, though Kinney, the shoe chain that was acquired by Brown, had a market share of only 1.2 percent, the deciding factor for the Supreme Court was the persistent trend toward concentration and integration in the industry. The Merger Guidelines further develop these quantitative tests. First, the Department will ordinarily challenge vertical mergers between a supplying firm with approximately 10 percent or more of the sales in its market and one or more purchasing firms accounting *in toto* for approximately 6 percent or more of total purchases in that market, unless there is clear evidence that there are no significant barriers to entry into the market of the purchasing firm or firms. According to the Department, this applies not only to likely anticompetitive effects of vertical mergers in the supplying firm's market but in general also to those in the purchasing firm's market.²⁵⁶ Secondly,

²⁵⁴ According to Frank Wille, FDIC Chairman, in a communication reproduced in *American Banker*, 7 Oct. 1970, p. 1.

²⁵⁵ *Guidelines* para. 11.

²⁵⁶ *Id.* paras. 12-13. If the purchasing firm's market share is less than 6%, the government will nevertheless challenge 'if the product sold by the supplying firm and its competitors is either a complex one . . . or is a scarce raw material [and] is a significant feature or ingredient of the end-product manufactured by the purchasing firm and its competitors' since in such instances the merged firm can make life extremely difficult for nonintegrated competitors (increased risk of squeezes). A merger will be attacked on these grounds if the 'supplying firm [accounts] for approximately 20 percent or more of the sales in its market [and the purchasing firm accounts] for approximately 10 percent or more of the sales in the market in which it sells the product whose manufacture requires the supplying firm's product.'

apart from challenges under these market-share standards, the Department also challenges acquisitions of suppliers or customers by major firms in an industry with a significant trend toward vertical integration that would probably raise entry barriers or put unintegrated or partly integrated firms at a competitive disadvantage. Although, as with horizontal mergers, the Department does not accept an economies defense as justification of vertical mergers, 'significant economies of production or distribution unrelated to advertising or other promotional economies' may save a vertical merger if it is prosecuted because there is a trend toward integration in the industry concerned.²⁵⁷

The case law on conglomerate mergers – the decisions handed down by the Supreme Court at any rate – has so far been concerned mainly with market-extension and product-extension mergers. Findings against acquisitions of this kind have been based chiefly on one or more of the following considerations: that the merger led to reciprocal dealing where the companies involved commanded a substantial share of the market, that the merger reduced potential competition, or that the appearance of conglomerate power in a market made up of small independent sellers – especially where the acquired firm is one of the market leaders or a particularly active competitor – threatened to entrench or enhance the market power of the acquired firm so that its competitors were inhibited from competing out of fear of retaliation. The only use made of postacquisition evidence in Supreme Court rulings has been to back up conclusions already reached on other evidence. This has also been the case with economies resulting from the merger, which have only been admitted where the agency or the Court saw in them an illustration of the harm that the merger might do to competitors and potential competitors of the acquired company because of the advantage that the merged companies might derive from them in strengthening their market position. If the merger was not a success, however, such evidence has not been considered relevant in the cases.

It is only in the areas of potential competition and reciprocity that the Department of Justice has set quantitative standards. As regards potential competition, the Department will concentrate on mergers between one of the most likely entrants into the market and a leading firm, that is to say:

- (i) any firm with approximately 25% or more of the market; (ii) one of the two largest firms in a market in which the shares of the two largest firms amount to approximately 50% or more; (iii) one of the four largest firms in a market in which the shares of the eight largest firms amount to approximately 75% or more, provided the merging firm's share of the market amounts to approximately 10% or more; or (iv) one of the eight largest firms in a market in which the shares of these firms amount to approximately 75% or more, provided

either (A) the merging firm's share of the market is not insubstantial and there are no more than one or two likely entrants into the market, or (B) the merging firm is a rapidly growing firm.²⁵⁸

The Department also specifies the circumstances in which a firm may be considered a most likely entrant; this depends primarily on 'the firm's capability of entering on a competitively significant scale relative to the capability of other firms ... and ... the firm's economic incentive to enter ...'²⁵⁹ Obviously, these are matters that can only be determined by reference to the facts of each individual case.

Reciprocal buying is described by the Department of Justice as 'an economically unjustified business practice which confers a competitive advantage on the favored firm unrelated to the merits of its product,' and mergers which create 'a significant danger of reciprocal buying' will ordinarily be challenged. Such a danger is considered to be present

whenever approximately 15% or more of the total purchases in a market in which one of the merging firms ('the selling firm') sells are accounted for by firms which also make substantial sales in markets where the other merging firm ('the buying firm') is both a substantial buyer and a more substantial buyer than all or most of the competitors of the selling firm.²⁶⁰

The Department will also ordinarily challenge mergers undertaken for the purpose of facilitating the creation of reciprocal buying arrangements and mergers creating the possibility of substantial reciprocal buying where one of the merging firms has recently practiced reciprocity or attempted to do so or where the merged firm has done so since consummation of the merger.²⁶¹

The third aspect of the conglomerate problem – the issue of market entrenchment of a leading firm in a relatively concentrated or rapidly concentrating market – is one that has scarcely been touched upon at all in the cases. The Department of Justice abstains from laying down specific guidelines but simply gives a few examples of merger types presenting this issue that reflect typical cases that have come before the courts:

²⁵⁷ *Id.* para. 14(a). The Department adds that it will normally challenge a merger that is effected with the sole purpose of hindering unintegrated competitors and potential entrants. Para. 14(b).

²⁵⁸ *Id.* para. 18.

²⁵⁹ *Ibid.*

²⁶⁰ *Id.* para. 19(a).

²⁶¹ *Id.* para. 19(b).

(i) a merger which produces a very large disparity in absolute size between the merged firm and the largest remaining firms in the relevant markets, (ii) a merger of firms producing related products which may induce purchasers, concerned about the merged firm's possible use of leverage, to buy products of the merged firm rather than those of competitors, and (iii) a merger which may enhance the ability of the merged firm to increase product differentiation in the relevant markets.²⁶²

Although the market-entrenchment issue is a possible approach to the problem of pure conglomerate mergers under Section 7, it raises a great number of related issues which are not really reached by the language of Section 7. The suits filed against a few very big mergers of the pure conglomerate type ended in consent decrees. In these cases the government claimed that Section 7 is aimed at halting a mere possibility of anticompetitive effect, despite the strong language of the Supreme Court in *Brown Shoe*. It remains to be seen whether the Court will be willing to go that far in extending the content of the merger law or will consider this to be a domain for congressional action.

Another area which is not yet settled law and is not touched upon in the Merger Guidelines is the status of joint ventures under Section 7. In *Penn-Olin* the Supreme Court put the famous question whether, but for the joint venture, either of the parents would have entered the market while the other waited at the edge of the market as a significant potential entrant, but in the end the Court seemed to be satisfied that it was impossible to determine presumed anticompetitive effects in this manner. Where there are no horizontal relationships between the parent corporations, then, joint ventures are immune under Section 7 – for the time being at least.

5.6 A CRITIQUE OF THE CASE LAW

There are three main areas in the application of Section 7 of the Clayton Act that are prone to criticism, at least in the eyes of a European commentator. In the first place, there are grave objections to the Supreme Court's view that divestiture and dissolution can be ordered under Section 7 in cases where the merger was carried through years ago. In the second place, the criteria applied by the enforcement agencies (mainly the Antitrust Division) and the Supreme Court in order to find against mergers under Section 7 are highly questionable, particularly in the case of horizontal and vertical mergers. A final major criticism has to do with the fact that the courts have despoiled Section 7 of one of its most important functions – that of enabling the government to prohibit mergers and other forms of external growth before they have taken effect – by

putting up insurmountable roadblocks on the way to preliminary injunction and thus taking much of the bite out of the statute.

The Supreme Court's opinion, first enunciated in *du Pont* (General Motors), that what matters in Section 7 suits is the probability of anticompetitive effects at the time of suit and not necessarily at the time the merger was consummated has the major drawback of allowing the government to apply the much easier Clayton Act test where a Sherman Act test would have been appropriate: if the government wishes to break up mergers of this kind, it ought to bring suit under the Sherman Act and assume the much heavier burden of proof that this implies. Another objection is that, since market shares are such an important criterion, finding an infringement of the law years after it has occurred penalizes dynamic firms which have increased their market share by forceful policies, and they are unable to justify themselves because postacquisition evidence has been held irrelevant. Lastly, it is a source of considerable uncertainty if after a merger has been accomplished the government can still attack and spoil the fruits of years of corporate marriage.

In a very general way, a particularly careful determination of the relevant market and of all that goes to make up the competitive environment before the merger is essential to Section 7 proceedings, much more so than in the case of actions brought under Section 2 of the Sherman Act. As for the potential economies from the merger, these should be taken into account only where it is shown that the merger will have hardly any anticompetitive effects. Post-acquisition evidence ought to be accepted as relevant where mergers are attacked some considerable time after they have been consummated. On all these points, however, the Supreme Court has completely disregarded the need for well-founded economic analysis.

There should be a sharp difference in emphasis on the role assigned to determination of the relevant market in Sherman Act cases on the one hand and in Clayton Act cases on the other. Whereas under the Sherman Act the definition of the relevant market is closely linked with the finding of actual cases of abuse of market power, market delimitation under Section 7 of the Clayton Act has to be regarded as an independent item of analysis, covering all aspects of substitutability. Though this difference in emphasis may be found in the case law, the courts have only paid lip service to it in most instances. In a number of rulings meaningful criteria for determining the relevant market were disregarded where application of such criteria would have made the market too big and the position of the merged companies too insignificant to affect competition or

would have resulted in the corporations concerned being situated in separate geographic and product markets. The Supreme Court in particular has often rejected a well-documented and well-considered analysis of the relevant market by a lower court and concentrated instead on groups of market participants which it feared could be disadvantaged by the merger. This has sometimes led to contradictory market definitions, most prominent among them being the Supreme Court's ruling in *Alcoa* (Rome) as contrasted with *Continental Can*.

This method of ascertaining the relevant market is at least partly a consequence of the lawyer's approach to merger. In a number of mergers (for instance, those between integrated or multiproduct firms) the impact on competition may involve only a few products that are made by both firms. For the lawyer, it may suffice in establishing the competitive impact of a merger to concentrate on competition in these particular products since the law states that the lessening of competition may be in *any* line of commerce. The prosecutor picks the type of competition for which he thinks adverse effects can be shown and offers a market concept he thinks suitable to that type. The judge tries to determine its validity for the purpose. And when conflicts in evidence arise, these may be resolved in favor of making the statute more, rather than less, effective.²⁶³ Such an approach, however, is highly contestable from the economist's standpoint. It is for this reason that so much criticism has been leveled against the more recent rulings of the Supreme Court in cases of horizontal mergers in particular.

The treatment of the economic aspects of market delimitation in the case law, then, has been quite uneven, depending on what would offer the best prospects of finding a violation. Not long after Section 7 of the Clayton Act was amended in 1950, discussion arose around the 'peculiar characteristics and uses' test of the Supreme Court in its *du Pont* (General Motors) decision as contrasted with its 'reasonable interchangeability' test in *du Pont* (Cellophane). It is not necessary to go into detail here on the conceptual differences at the basis of the two tests since they were discussed extensively earlier in this chapter. The much narrower *General Motors* test, which would have been more appropriate if applied under Section 2 of the Sherman Act, ignored the fact that automotive and other finishes were not potential but *actual* substitutes for each other outside the automobile industry. Users of automotive finishes were not confined to the automobile industry alone, so other regular users at least should have been taken into account by the Supreme Court.

The product-market-determination tests developed by the Supreme Court in *Brown Shoe* did take greater account of market realities, of the area of effective competition. Within a broad market based on the technical substitutability of the products comprising it, the Court distinguished submarkets based on public

or industry recognition of specific product characteristics – price, quality, distribution networks and specialized production facilities. However, the danger of such an approach, if it is not referred closely enough to economic realities, is that one may go too far with this breakdown into classes differentiated by quality, appeal etc. in respect of products which indeed can be used for the same purpose. Splitting up the shoe market into price categories did seem necessary because consumers do not change very readily from buying cheaper to more expensive models, but the approach adopted by the Supreme Court in *Alcoa* and *Continental Can* gives rise to the fear that market definition along these lines may easily lead to market manipulation. In both cases the Supreme Court ignored the substantial volume of economic evidence reviewed and analyzed by the district court before it, merely because this would have reduced the market shares of the merging firms in *Alcoa* and would have placed the merging firms in separate markets in *Continental Can*. As we observed earlier in this chapter, it is precisely this ambiguous definition that the Department of Justice has used in its Merger Guidelines.

An argument that has sometimes been brought forward by manufacturers in discussing the determination of the market under Section 7 hangs on the 'production flexibility' theory. Stated briefly, the theory is that where identical equipment within the plant can with only slight changes manufacture several related products, everything that this equipment (or plant) can manufacture should be comprised in the relevant market. There is no economic objection to this if the products manufactured by the same plant are largely substitutable as regards the use that can be made of them. Something of this kind was present in *du Pont* (General Motors): several kinds of automotive finishes and fabrics could be produced by the same plant, and they were largely interchangeable. This line of argument, however, cannot honestly be used to make the market cover the whole range of products that a company regards as its contribution to the output of the industry in question; this seems to have been tried in the *Bethlehem Steel* case, for example.

Similarly, we must take exception to those decisions in which the Supreme Court has used the determination of the relevant geographic market to find markets that fit a finding of violation of Section 7. *Pabst* is a case in point. Here the government, followed by the Supreme Court, ignored the fact that most of the beer brewed in Wisconsin was shipped out of state and that con-

²⁶³ Irston R. Barnes, 'Legal Issues and Economic Evidence in Cartel Law', in International Conference on Restraints of Competition (Frankfurt on Main, June 1960), *Cartel and Monopoly in Modern Law* 805, 837 (Karlsruhe: Müller, 1961).

sequently the performance of Wisconsin brewers in their own state was determined predominantly by competitive conditions outside it rather than by the fact that Wisconsin beer drinkers mostly consumed Wisconsin-brewed beer, which was the government's argument. In *Philadelphia* the reasoning ran just the other way round. There it was the fact that the banks in the relevant market area did little business with customers elsewhere that led the government and the Court to choose the four-county market. What they overlooked was the amount of business that banks outside the area did with customers living in the area. This point was not raised by the defendants, and the Court was probably right in giving preponderant weight to the theory that most customers preferred their bank within a small geographic radius. However true this may be in banking, it may not hold for other products and services, so the *Philadelphia* ruling should not be used as a blueprint for other cases.

The language used in the Merger Guidelines in respect of geographic market delineation is most unlikely to clarify the law. For the imprecise definition of 'section of the country' embraces a highly elastic concept of the market. A defendant wishing to challenge the Department of Justice's definition of the market must show either of two things. If he argues for a larger market area than the government finds relevant he must show that there is no economic barrier in the way of sales from outside the market to purchasers inside and that sufficient customers in the market as defined by the government do in fact turn regularly to outside suppliers and/or he must show that a substantial part of the goods or services produced in the area are shipped to customers outside the area. If the defendant argues for a market area smaller than the government's market he has to prove that there is an economic barrier separating the purchasers of some portion of the sales inside the market from the purchasers to whom the rest of the sales are made. Such a barrier may be constituted by transportation costs, lack of distribution facilities, customer inconvenience or consumer preference for products sold in the area.²⁶⁴ This he can prove by pointing to the very small number of buyers and sellers that do or are willing to do business over the geographic boundaries of the market area that he considers relevant. The case law demonstrates that such arguments are not accepted—unjustifiably so. The only avenue then open to the defendant is to produce evidence either that the prices and other conditions of sale of suppliers in the market considered relevant by the government wholly reflect what takes place outside that market or that the government's market is divided into completely noncompetitive areas. However, a defendant will have a hard time presenting such evidence since it would involve principles of cost accounting that the courts are unwilling to consider.²⁶⁵

The Supreme Court has been increasingly inclined to see a violation of

Section 7 in *any* movement toward fewer firms or growth in market shares, irrespective of other aspects of the competitive environment of the firms in question, thus reducing the substantiality test in Section 7 to a few quantitative rules.

The legislative history of Section 7 certainly cannot be said to argue for such simple criteria. Although the legislative history does not make it clear what precise meaning should be attached to the language used in the statute, this should be seen in the light of the fact that Congress did not consider it possible to prescribe simple rules that would meet all the cases. We should therefore support the view that an interpretation of Section 7 that goes beyond the application of simple quantitative rules is definitely not in conflict with congressional intent.

Criticism of the way Section 7 has been interpreted must be tempered to some extent by an awareness of how difficult it is to frame a merger policy. For in giving practical effect to a balanced economic judgment of mergers we come up against the problem that economic science is unable to furnish general rules, because of the uniqueness of each case and because of the difficulty of predicting what effect changes in market structure will have on performance. If the authorities try to accumulate all the evidence available in merger cases, they may fall prey to an indecisiveness that makes all mergers tolerable and a merger policy useless, since *tout comprendre c'est tout pardonner*. Nevertheless, we do feel that a reasonable economic assessment for policy purposes is possible without some kind of economic extravaganza necessarily resulting.

How far is a simplification of the economic criteria for applying Section 7 possible? Merger policy should concentrate primarily on those cases where market power is either created or strengthened as a result of merger. For the definition of market power we should not be averse to relying on market shares, bearing in mind that although it is only a rough guide a merger involving very high market shares does entail a very high risk of anticompetitive effects. Measured by the standards that we set forth in Chapter 3, the market-share

²⁶⁴ *Guidelines* para. 3(ii).

²⁶⁵ We do not agree with the criticism in the *Stigler Report* § III.C that 'an industry may be riddled with the kind of "barriers" cited in the Guidelines and yet still not contain any meaningful local markets.' The Task Force's example of the pricing of steel bars, on which its conclusion is based, seems to ignore the fact that there is always a limit price for a producer or group of producers and that raising a price may be an invitation to potential competitors to enter a market. Only where there have been actual instances of market penetration may such potential competition be included in the relevant market. The reader is referred to Chapter 3 *supra* for a discussion of the issues involved in the determination of the relevant market.

percentages in respect of horizontal and vertical mergers contained in the Justice Department's Guidelines are, however, unjustifiably harsh. The weightiest objection against the horizontal-merger guidelines is that they make it completely impossible even for small companies in already concentrated markets to gain strength against their big competitors. In this respect, merger policy is a hindrance to the emergence of more effective structural conditions for competition on such markets, especially as (for the reasons explained in the preceding chapter) the improvement of market conditions through the dissolution of existing dominant firms is not to be looked for. We would also be unwilling to impose a *per se* ban on mergers with the smaller oligopolists in a market on the basis of the strict market-share percentage rules of the Guidelines: other features of the market environment in which the merger takes place must also be taken into account when assessing the likelihood of anticompetitive effects, and an economies defense should be admitted too. The Merger Guidelines in respect of vertical integration discount the fact that firms may be obliged to integrate if their principal competitors are integrated and that integration produces distinct economic advantages that would be obtained too late by means of internal expansion. To treat vertical mergers as presumptively anticompetitive, which the Guidelines do in essence, is accordingly unacceptable as a general rule. Here again, however, a merger law which is intended to curb monopoly in its incipency cannot be too permissive, and the enactment and enforcement of such a law inevitably implies acceptance of certain economic drawbacks to boot. So we would not reject guidelines based primarily on market-share percentages provided the critical shares are high enough to warrant a presumption of market power. We leave further discussion as to the formulation of merger law to Chapter 7.

How dangerous it would be for a strict market-share percentage standard to be taken as the statutory test under Section 7 in respect of horizontal and vertical mergers is demonstrated by the rulings in *Brown Shoe*, *Pabst* and *Von's Grocery* discussed earlier in this chapter. These cases were concerned with mergers between corporations whose joint market share was relatively modest even after the merger, although a narrowly drawn submarket was considered the relevant section of the country. The Supreme Court stressed the trend toward concentration of which the mergers were symptomatic, but in all three cases the market was in fact far from being concentrated, and economies were not taken into consideration. Although in its *Brown Shoe* ruling the Supreme Court made it plain that Section 7 was designed to maintain competition, not competitors, in *Von's Grocery* the Court seemed to have turned its back on that principle. Justice Potter Stewart's dissent in *Von's Grocery*, properly critical of the majority opinion, can be relied upon to show up the weak points in the

opinion of the Court. He agrees that in enacting Section 7 the Congress intended to protect small businessmen and to arrest mergers while the trend to a lessening of competition was still in its incipency. But he insists that the majority ought to have made at least a rudimentary investigation as to whether there was a reasonable probability that the merger would lead to a substantial lessening of competition. And there were features enough to warrant the conclusion that it would not: the decline in the market shares of the leading grocery chains, the many new grocery chains setting up in business, the formation of cooperative purchasing organizations by small stores, the paucity of barriers to entry and the growth of new forms of distribution competing directly with the big chains.²⁶⁶

The Supreme Court has refrained from examining efficiency defenses pleaded by parties to mergers, not because of any reluctance to admit that important economic benefits may flow from merger but because such benefits were held irrelevant to the appraisal of a merger's legality. The Court, then, has rejected the tradeoff approach. In our discussion of mergers in Chapter 3 we made it clear that we believe this to be the proper attitude, except in borderline cases where the competitive effects of the merger cannot be clearly established. In *Brown Shoe* and *Von's Grocery* an efficiency defense ought to have been admitted. For where a full analysis establishes that a merger will entail no substantial lessening of competition, despite the contrary findings of the enforcement agencies and the courts based on inadequate tests, the decision of the firms involved that merger is a more efficient means of growth than internal expansion must be respected as a matter of entrepreneurial choice in the light of competitive market conditions.

In only one case of a merger in a highly concentrated industry have the courts considered the interesting contention that a merger may be necessary in order to counterbalance the dominance of a competitor by creating a firm of comparable size and power. In view of the proven impotence of the Sherman Act in divesting market leaders in concentrated oligopolies, it might be considered a useful approach to attack their market power by allowing the creation of countervailing power. This promerger argument must be looked at critically,

²⁶⁶ Finally, Justice Stewart cites merger literature in which quantitative criteria for judging horizontal mergers are formulated but where the tolerable bounds of competition are drawn much more widely than in the Court's opinion: Carl Kaysen and Donald F. Turner, *Anti-trust Policy* 133-36 (Cambridge, Mass.: Harvard UP, 1959); George J. Stigler, 'Mergers and Preventive Antitrust Policy', 104 *U. Pa. L. Rev.* 176, 179-82 (1955); Derek C. Bok, 'Section 7 of the Clayton Act and the Merging of Law and Economics', 74 *Harvard L. Rev.* 226, 308-29 (1960).

however, because the final outcome could be the creation of a duopoly, in which market conduct may be even further removed from workably competitive behavior. In *Bethlehem Steel* the district court correctly based its decision on this point. There was no question here of escaping this reasoning by showing that US Steel's competitors had not yet reached their optimum size and could not therefore be considered full-grown competitors. The situation was rather that US Steel was too big and was still suffering to some extent from the financial top-heaviness it had acquired at its birth in 1901. It could not therefore be reasonably asserted that a merger between two smaller steelmakers was a necessary prelude to challenging the efficiency of US Steel. Nevertheless, as we have pointed out before, mergers between small firms not belonging to the group of oligopolists may have procompetitive effects.

The situation was not so clear in *Philadelphia National Bank*, where similar reasoning was employed by the corporations concerned (alluding to their big competitors in New York). In banking it is difficult to speak of optimum corporate size, but most bank specialists do believe that big banks can keep costs lower than smaller banks. This will not be further developed here: the reader is referred to the literature on this point.²⁶⁷ Now both of the Philadelphia banks were viable competitors and very important concerns in the banking life of the city; on the other hand, for the two to join forces could perhaps have ensured more effective competition for large-scale loans. Removal of an important competitor from commercial banking in the Philadelphia area would have led (according to information supplied to the author by insiders) to a perceptible lessening of competition because local services can be provided only by banks already established in the market. Further, these local services accounted for the bulk of the banks' business. However, there would have been a slight increase in competition on the market for major financing, in which – according to well-informed sources – competition was already very strong.

In order to sustain their position in both *Bethlehem Steel* and *Philadelphia National Bank*, the courts advanced the additional argument that approval of these mergers might be used as a precedent by other corporations and thus lead rapidly to a drastic decline in the number of firms in the industries in question. We feel that the repercussions of precedent in the field of merger law are fairly negligible, however, because, unlike cases of resale-price maintenance, exclusive dealing and so on, where general rules of exemption or prohibition are practicable, every merger has its own particular characteristics, at least where criteria other than market share alone are taken into account. If the differences in the relevant factors are given due force, it is very rare for two mergers to present the same characteristics, even when they take place in the same industry. Consequently, approval of one merger need not necessarily constitute a strong

precedent giving the green light to others. The case law under Section 7 shows how extremely difficult it is to reach decisions that can be accepted as standard.

In dealing with conglomerate mergers the government and the courts have concentrated in the main either on reciprocity issues or on the potential-entrant argument. As far as the first point is concerned, our position in Chapter 3 was that *coercive* reciprocity is an evil *per se*. If it can reasonably be expected that a merger will give rise to coercive reciprocity (because it was practiced by one of the acquiring companies before the merger, say) or if postacquisition evidence shows that it is currently being practiced, the merger can be regarded as decisively anticompetitive. That the use of reciprocity has not had the desired effect is irrelevant to a finding that the practice is anticompetitive: on this score we endorse the reasoning of the Supreme Court in *Consolidated Foods*. However, not every vague possibility of reciprocal dealing should be used by the enforcement agencies and the courts as a reason for proscribing a merger – which was tried, for instance, in the *ITT* cases – especially when evidence of coercive behavior is lacking.

The potential-entrant argument has been correctly applied in the market- and product-extension cases that have come before the courts as long as the acquiring firm could really be regarded as a potential entrant (as in *El Paso* and *Procter & Gamble*). However, in *Falstaff Brewing* and in the charges against pure conglomerate mergers this was open to serious doubt. If, as in *Falstaff*, management can show that it will not enter the market except by acquiring an already established firm, the defendant cannot be considered to exercise the same kind of competitive influence as a firm that would have entered by any means; in fact, its competitive influence is much smaller than that of a most-likely entrant. In the pure conglomerate cases the government has bypassed the relevant considerations as to the circumstances under which a firm should be regarded as a most-likely entrant as well – considerations for which the reader is referred to our discussion in Chapter 3. For firms reflecting on pure conglomerate expansion will generally not contemplate setting up production facilities themselves in order to enter the markets in question; their activities are much more akin to the behavior of the investor on the stock

²⁶⁷ See George J. Benston, 'Economies of Scale and Marginal Costs in Banking Operations', *National Banking Rev.*, June 1965, reprinted in *Administrator of National Banks, Studies in Banking Competition and the Banking Structure* 355 (Washington, DC: US Treasury, 1966), and authorities cited therein. See also the articles on the *Philadelphia* case in *Administrator of National Banks*, *op. cit. supra* at 3–96.

market, seeking to increase his fortune as rapidly as possible. Seen in that light, every firm is a potential entrant to every market other than its own, and this conclusion is reminiscent of the relevance of the battle over the consumer's dollar as a factor for consideration in determining the boundaries of a market. Consequently, we think the likelihood dim that ITT would have entered the insurance business otherwise than through acquiring an existing insurance firm. Statements on the most-likely-entrant status of firms in cases of pure conglomerate expansion should not be made until all the relevant motives (especially the potential economies) have been thoroughly investigated, and there was no attempt to do so in the *ITT* and *LTV* cases.

The government's interpretation of the concept 'most-likely entrant' in *Falstaff* and in the pure conglomerate merger cases is not inconsistent with the language of the Merger Guidelines. The interpretation of notions such as the firm's capability of entering and its economic incentive to enter (attractiveness in terms of risk and profit), as used in paragraph 18 of the Guidelines, is susceptible of argument, however. Whereas in cases of market- and product-extension merger business history (as in *El Paso*) or the firm's facilities (as in *Procter & Gamble*) will show without too much difficulty whether a firm is one of the most-likely entrants or not, it will take a thoroughgoing investigation to do so in cases of pure conglomerate merger. The Department of Justice states that it will not, unless there are unspecified 'exceptional circumstances,' accept an economies claim as justification for a merger. In respect of those mergers, then, in which the acquiring firm is far from being the most-likely entrant, the government's standards are inadequate, unless the burden of proof under Section 7 is to be reduced to a requirement to show a mere possibility of anti-competitive effect. As we pointed out in our discussion of the case law, the courts so far have interpreted the words 'may be' in Section 7 as being aimed at halting *probable* anticompetitive effects of mergers. So until there is a clear pronouncement by the Supreme Court, changing its plain holding in *Brown Shoe*, the government's attitude to pure conglomerate mergers must be regarded as legally as well as economically incorrect.

Elimination of a potential entrant by merger may not have unfavorable effects on competition at all if the acquired firm is small relative to its competitors, but the market situation may well deteriorate if the position of a large firm is strengthened as a result. This additional element is covered in paragraph 18 of the Guidelines by the market-share provisions. The question is how far it is economically justifiable to infer anticompetitive effects from such provisions. Referring to the discussion of this point in Chapter 3, we feel that only when the acquired firm is dominant or an oligopolist should the merger be forbidden, since there will then be a reasonable probability that anticompetitive results

will ensue – the more so as there are generally substantial promotional economies involved in market- and product-extension mergers giving the acquired firm an improper competitive advantage over its competitors. While it is acceptable to determine the position of the acquired firm by means of market-share criteria, the percentages need to be higher than those laid down in Guideline 18. We shall be going more deeply into the issue of quantitative tests in merger law in Chapter 7. At the other end of the scale we find what are known as ‘toehold acquisitions.’ The agencies and the courts have given their benediction to this type of market penetration (rightly in our view) because it can become the vehicle for new competitive impetus in the market. In the gray zone in between lie those mergers which it should be allowed to justify by proving that they give rise to clear nonpromotional economies. In these cases the financial strength of the acquiring company may be an additional item for consideration as well, though we do not consider this to be important to a judgment of mergers on their competitive merits since a rich parent who enters other markets through internal growth may have the same impact on competition.

Then there is the question whether it is desirable to take market entrenchment as the sole test of the legality of a pure conglomerate merger along the lines set out in Guideline 20, i.e. by taking market power as the criterion. In accordance with our conclusions in Chapter 3 we believe that in cases such as this there should be a very heavy onus on the government to prove the existence of market power, and quantitative or other simple structural tests should be considered entirely insufficient. This type of intervention should be kept to the bare minimum of exceptional cases since it brings us to the limits of action against mergers through competition policy. The three examples given in Guideline 20 of the kind of merger that will ordinarily be investigated cannot be regarded as satisfying the proper requirements as to burden of proof.

We must also touch upon the Supreme Court’s ruling in the *Penn-Olin* joint-venture case. The Court’s summary of the factors it thought relevant to a judgment of the consequences of the joint venture on competition may be accounted complete. However, undue stress was laid on the question whether either of the parent companies would have set up a plant of its own if it had known that the other would be remaining in the market as a potential competitor. Apart from the fact that this cannot be answered without some insight into what the companies’ managements were thinking, in such a case the pertinent question is how important this particular potential competitor should be considered to competition on the relevant market. And that depends on the number and quality of potential competitors. If there are more than two likely potential entrants, such as seemed to be the case in *Penn-Olin*, the sub-

stitution of a single actual competitor for two potential competitors should certainly not be considered injurious to competition. However, no analysis was made to determine whether Pennsalt and Olin were the only possible entrants into the relevant market. Besides, too critical an attitude to joint ventures would definitely not be an inducement for new business to come into markets on which a corporation would not establish itself without the support of others. For in most of these cases the nonmerger route, via internal expansion, is not practicable, as was already pointed out in Chapter 3. In this connection too, the Supreme Court's ruling in the *Penn-Olin* case is not without its dubious economic aspects.

The last main point of criticism of the case law under Section 7 has to do with the way the government and the courts have treated the question of remedial relief. Though the law was designed to forestall mergers having probable undesirable competitive consequences in their incipency and before consummation, the courts have preferred in practically all cases to enter judgment after the merger has been effected, refusing the government preliminary injunctions. Apart from the fact that it strips the law of its intended preventive character, this course has two major drawbacks. First, a considerable number of years may elapse before a final decision is reached in a merger case, and the position of the merged companies may have changed appreciably because of after-acquired properties. Now in many cases the courts have ordered divestiture of only those assets that were originally combined by the merger. But this does not seem to be a very satisfactory approach when so many new investments may have been made since the merger, for divestiture of some of them may not have the desired effect of removing the acquiring corporation from the market into which it moved when it made the original acquisition. What is more, dissolution in order to restore premerger situations may often be rendered impossible because the acquiring company has wholly or partly dismantled the acquired company. Second, on the basis of whatever evidence is available on this, it appears that in most cases in which divestiture has been ordered enforcement agencies have shown a good measure of flexibility.²⁶⁸ It is not possible to give an appreciation of the relief chosen without an analysis of the impact

²⁶⁸ Notable exceptions to this, of course, are the remedies ordered in *du Pont* (General Motors) and *Ford* (Autolite). A recent study on the relief obtained by the government in a large number of other cases has come to the conclusion that 'government attorneys appear particularly cautious about insisting upon any kind of relief which would appear to impose a hardship on a defendant, even when such relief is appropriate to dissipate the anti-competitive impact of an illegal acquisition. The bias of all parties in Section 7 cases is toward the imposition of relief which does not impose any penalty.' Pfunder, Plaine and Whittemore, *supra* note 239, at 40-41. The reader is referred to this article for more ample information on § 7 relief.

it has had on competitive conditions in the relevant market. However, even without full investigation it may be said that two particular types of relief have gone little or no way toward making the market more competitive than it was when suit was brought – where the acquired firm has been sold to a firm which is in a comparable competitive situation with that of the original acquirer, and where the defendant was able to circumvent the divestiture plan more or less by splitting off only those parts of his business that he wanted to get rid of anyway. More will be said on this in Chapter 6.

PART 3

THE LIMITATIONS OF ANTITRUST IN RESTRAINING CONCENTRATION

In the third and last part of this study we shall try to determine what future antitrust policy has as a means of halting concentration of economic power or restraining its influence. Part 3 consists of two chapters. In Chapter 6 we look at the experience of antitrust prosecution in the United States. In Chapter 7 we discuss how the range of policy instruments might be extended in order to counteract unwanted developments in concentration, both in individual industries and in the economy as a whole, more effectively than can be done with the instruments currently available, leaving aside specifically American circumstances as far as possible.

CHAPTER 6

AN APPRAISAL OF THE IMPACT OF ANTITRUST

We begin this chapter with an analysis of the impact of the antitrust policy pursued so far under the Sherman Act and Section 7 of the Clayton Act on competition in the American economy. This is then appraised from two different viewpoints. First we try to find out how far the objectives of the antitrust laws have in fact been realized, taking as our criterion the intent of the legislative and executive branches. Then we try to establish whether in the light of the criteria set out in Chapter 3 the protection now provided by antitrust against undue concentration can be regarded as sufficient or whether in certain areas the law offers inadequate protection or none at all.

6.1 THE INFLUENCE OF ANTITRUST ON THE PATTERN OF COMPETITION

In trying to assess the influence that antitrust policy has had on competition, we can usefully look first at the situation in industries in which companies have come into conflict with the antitrust laws in the past.

Studies have been made of the consequences of major antitrust suits under the Sherman Act on the pattern of competition in a number of American industries. The results of a number of these inquiries will be discussed below. There is, as far as we know, only one comparable study of divestiture orders under Section 7 of the Clayton Act. Generally speaking, divestiture of already consummated mergers or prevention of planned mergers may stimulate competition provided these mergers have had or would have an anticompetitive impact on their market. However, not much information is available on the effectiveness of divestiture in dissipating the anticompetitive impact of the merger. Apart from that, antitrust policy has undoubtedly had a prophylactic effect that may well have been much wider than its immediate influence. American writers often point out how deeply the idea of antitrust has taken root in the business world: when contemplating an important decision in this field the American businessman does seem to give thought to whether it may

cause him to fall foul of the antitrust laws.¹ We shall also try to subject this indirect influence of antitrust to closer analysis.

6.1.1 The Impact of Government Action

Antitrust policy affects the pattern of competition most directly where the structure of a market is changed by dissolution. In the petroleum and cigarette industries the government's actions clearly had a favorable influence on competitive conditions. The dissolution of Standard Oil in 1911² led to a substantial improvement in the petroleum industry: keen competition rapidly sprang up among Standard's successor companies. Even before 1911, however, other factors had already threatened the position of Standard Oil, such as the discovery of extensive oil fields in the Gulf and Mid-Continent districts in 1901 and the sharp increase in demand for gasoline following the development of the automobile, which gave Standard's competitors a chance. The main result of the antitrust decision, therefore, was probably to accelerate the breakup of Standard's monopoly. The dissolution of the Tobacco Trust in 1911³ must also be considered a success for antitrust: at any rate, it was followed by healthy price and brand competition among the successor companies.⁴ The dissolution of the du Pont explosives monopoly in 1912⁵ is also considered by many writers to have had a good effect on the industry. Nor should we disregard in this connection the beneficial consequences of the prohibition of a number of international cartel agreements involving the restrictive use and cross-licensing of basic patents.⁶

Dissolution in the sleeping-car industry (the *Pullman* case) and in the motion-picture industry (where the major producers were divested of their theater holdings) was less drastic in its impact on the competitive situation in the relevant markets. The decrees in both cases increased opportunity for entry to the markets concerned. Whether divestiture of Pullman's sleeping-car operation⁷ was necessary to restore healthy conditions of competition or whether injunction of contractual provisions preventing the railroads from dealing with other sleeping-car manufacturers would in itself have been sufficient is a question that Whitney does not enlarge upon in his exhaustive examination of the case.⁸ Several economists who have studied developments in the motion-picture industry since the sweeping *Paramount* decision of 1948 approve the court's decree,⁹ though with less exuberance than Walter Adams, who considered it 'the government's greatest economic victory in the sixty-year history of antitrust enforcement.'¹⁰ Michael Conant terms the divorcement of Paramount's theaters a 'correct remedy.'¹¹ Whitney notes the sharp increase in competition from independent producers, who acquired a huge market for their pictures after the enforced disintegration of the major companies. Because the major producers

no longer have any direct interest in exhibition, however, the number of pictures produced by them has declined. Nevertheless, this has improved the quality of pictures and made it possible for smaller American and foreign companies to market their products.¹² Here again, market performance seems to have decidedly improved as a result of the application of drastic dissolution measures.

On the other hand, the partial dissolutions resulting from the rulings in the *International Harvester* case of 1914¹³ (consent decree accepted in 1918) and the *Corn Products* case of 1916¹⁴ and from the 1920 consent decree in the *Swift* case¹⁵ have had little apparent influence on competitive conditions. International Harvester was required to dispose of three of its five lines of machinery. These lines were not the most successful, accounting for only a small proportion of the company's total sales, so that its dominant position was scarcely affected. Another stipulation – that it should have no more than one dealer in any town – also proved to be not much of a blow to International since it had already begun

¹ See, e.g., S. Chesterfield Oppenheim, 'The Federal Antitrust Laws', 50 *Mich. L. Rev.* 1146, 1147 (1952); 1962 *Council of Economic Advisers Ann. Rep.* 185 (Washington, DC: Government Printing Office, 1963); Edward S. Mason in Dexter M. Keezer (ed.), 'The Effectiveness of the Federal Antitrust Laws: A Symposium', 39 *Am. Econ. Rev.* 689, 712 (1949); J. K. Galbraith, 'Monopoly and the Concentration of Economic Power', in Howard S. Ellis (ed.), *A Survey of Contemporary Economics* 119 (Philadelphia: Blakiston, 1948).

² *Standard Oil Co. of NJ v. US*, 221 US 1 (1911).

³ *US v. American Tobacco Co.*, 221 US 106 (1911).

⁴ William H. Nicholls, *Pricing Policies in the Cigarette Industry* 409 (Nashville, Tenn.: Vanderbilt UP, 1951); Richard B. Tennant, 'The Cigarette Industry', in Walter Adams (ed.), *The Structure of American Industry* 391 (New York: Macmillan, 3d ed. 1961).

⁵ Following a circuit-court decision in *US v. E. I. du Pont de Nemours & Co.*, 188 Fed. 127 (CC Del. 1911).

⁶ Simon N. Whitney, *Antitrust Policies* Vol. 1, at 195–96 (New York: Twentieth Century Fund, 1958); Alfred E. Kahn, 'The Chemical Industry', in Adams (ed.), *op. cit. supra* note 4, at 270–74.

⁷ *US v. Pullman Co.*, 50 F. Supp. 123 (ED Pa. 1943), 53 F. Supp. 908, 55 F. Supp. 985 (ED Pa. 1944), *aff'd per curiam*, 330 US 806 (1947).

⁸ *Op. cit. supra* note 6, Vol. 2, at 335–36.

⁹ *US v. Paramount Pictures, Inc.*, 334 US 131 (1948).

¹⁰ 'The Aluminum Case: Legal Victory – Economic Defeat', 41 *Am. Econ. Rev.* 923, 925–26, n.3 (1951).

¹¹ *Antitrust in the Motion Picture Industry* 207 (Berkeley and Los Angeles: University of California Press, 1961).

¹² Whitney, *op. cit. supra* note 6, Vol. 2, at 161–92; William F. Hellmuth, Jr., 'The Motion Picture Industry', in Adams (ed.), *op. cit. supra* note 4, at 413–20.

¹³ *US v. International Harvester Co.*, 214 Fed. 987 (D. Minn. 1914), *petition for additional relief denied*, 10 F. 2d 827 (D. Minn. 1925), *aff'd*, 274 US 693 (1927).

¹⁴ *US v. Corn Prods. Ref. Co.*, 234 Fed. 964 (SD NY 1916), *appeal dismissed*, 249 US 621 (1919).

¹⁵ *US v. Swift & Co.*, Eq. 37623 (Sup. Ct. DC 1920). The original consent decree was finally affirmed by the US Supreme Court in *US v. Swift & Co.*, 286 US 106 (1932).

to rationalize its sales organization to this effect. However, this did enable International's competitors to expand their sales more easily than had previously been possible.¹⁶ Corn Products was also required to sell mills and subsidiaries that had been rather unremunerative. Most of these plants were sold to buyers outside the industry, so that the situation remained much the same as it had been before 1916.¹⁷ The meat packers consent decree of 1920, which prohibited the packers from dealing directly or indirectly in certain specified commodities, aimed at barring them from integrating or diversifying so that they should not overwhelm their nonintegrated competitors, a danger that was more imagined than real, since the production costs of the small packers were rather lower than those of their big competitors.¹⁸ As was observed in Chapter 4, three efforts by the packers to have the decree vacated or modified failed. However, in 1971 the Supreme Court allowed Greyhound to acquire a controlling interest in Armour, one of the packers, despite the fact that Greyhound dealt in some of the commodities that were covered by the 1920 decree. As a result of this, the fifty-year-old decree was modified in December 1971, permitting the packers to engage in manufacturing and wholesaling by internal expansion in all the product lines prohibited in the old decree or by the acquisition of other firms (though under certain restrictions). It was thus believed that the prohibitions of the old decree had sufficiently worked out. Another factor which may have considerably changed the competitive environment of the meat-packing industry in recent years has been the absorption of a number of leading firms through conglomerate merger. Apart from the acquisition of Armour (ranking second) by Greyhound, Wilson & Co. (third) has been acquired by LTV, and AMK has taken over John Morrell & Co. (fourth). Unfortunately, however, no information is available on how these companies have developed since becoming part of conglomerates.

What has been the effect on competition in those cases where dissolution was not ordered? The earliest example is that of the Sugar Trust, the American Sugar Refining Co., which escaped conviction in 1895.¹⁹ Despite further mergers, the market share of the company steadily declined after the dismissal of the government's suit. This was partly the fault of the company itself, for it raised its prices substantially when at the peak of its power, thus attracting a large number of new competitors to the market, and partly because beet sugar began to compete with cane sugar, in which the Trust held a monopoly. Eventually, general economic factors produced the result that the government had tried in vain to achieve in 1895.

Nor did the courts' refusal to order dissolution of American Can and US Steel perpetuate monopoly situations. Monopoly in the metal-container industry ultimately gave way to duopoly with the growth of Continental Can, and the

opportunity to exercise market power was checked by the countervailing power of the two companies' customers – the major food packers. Of greater practical importance for the improvement of competitive conditions than the antitrust suit of 1916²⁰ were two judgments handed down in 1950. These prohibited various obligations imposed by the two major manufacturers in long-term contracts; quantity discounts were also proscribed.²¹ As a result, small can factories obtained greater freedom to seek customers for their products, and a number of large canners established their independence by setting up their own can factories. The immediate consequence of this was keener competition, which made prices fall.²² However, these decrees had no decisive influence on the position of American and Continental.²³ When other packaging materials started to make increasing inroads, the reaction of American and Continental was to begin manufacturing those materials themselves, basically through a number of takeovers of producers in these related fields. The enforcement agencies have already begun to take action against this tendency, but it is too early to predict what influence this will have on competitive conditions in the tin-can industry.²⁴

All kinds of factors, including the policy whereby the biggest producer, US Steel, eschewed monopoly by deliberately halting its initial moves in that direction at the beginning of the century, together with the company's inertia

¹⁶ Whitney, *op. cit. supra* note 6, Vol. 2, at 230–32.

¹⁷ *Id.* at 262–64.

¹⁸ *Id.*, Vol. 1, at 46–49.

¹⁹ *US v. E. C. Knight Co.*, 156 US 1 (1895).

²⁰ *US v. American Can Co.*, 230 Fed. 859, 234 Fed. 1019 (D. Md. 1916).

²¹ *US v. American Can Co.*, 87 F. Supp. 18 (ND Cal. 1949). Contracts obliging customers to buy all the containers they needed and to lease closing machines from one and the same manufacturer were the main practices condemned by the district court in the action against American Can. Continental had agreed to abide by any decision short of dissolution, and identical consent decrees were entered against the two companies in June 1950; they are reported in *CCH 1950–1951 Trade Cas.* ¶¶ 62 679, 62 680 (ND Cal. 1950).

²² This has been pointed out in particular by James W. McKie, 'The Decline of Monopoly in the Metal Container Industry', 45 *Am. Econ. Rev.* 499 (1955, Proceedings).

²³ Charles H. Hession, 'The Metal Container Industry', in Adams (ed.), *op. cit. supra* note 4, at 461–64, emphasizes the point that the big companies still enjoy a substantial technical lead over their smaller competitors, especially in manufacturing closing machines, and the rapid obsolescence of these machines ensured that it was still more economical for them to rent from American and Continental. However, as long as the sale of cans is not tied to these leases (and this was prohibited by the district court), it would seem that the greater freedom between buyers and sellers resulting from the consent decrees cannot but have a good effect on the performance of the industry.

²⁴ The government suit contesting the Continental Can/Hazel-Atlas merger is discussed in Chapter 5 *supra*.

in later years and the activities of its competitors, helped to change the structure of the steel industry from monopoly to oligopoly. Antitrust contributed indirectly to the first of these factors: when the government's case against US Steel reached the Supreme Court in 1920, the company narrowly escaped a dissolution order.²⁵ The Court's ruling made it abundantly clear that corporate expansion should not take this course. But although the industry's structure became oligopolistic, it did remain under the dominant influence of US Steel. More recently, the government has moved successfully against attempted mergers by some of US Steel's competitors under Section 7 of the Clayton Act. After a merger between Bethlehem and Youngstown was held violative of the Act,²⁶ mainly because of concern that the oligopolistic structure of the industry would be intensified, a series of mergers planned by other big steelmakers were abandoned. The *Bethlehem Steel* ruling does not mean that small firms in the industry would also find it more difficult to merge: the enforcement agencies would probably applaud such mergers as a means of building up countervailing power.

The more recent antitrust actions in the steel industry may be justifiable in the light of competitive conditions. Small companies have often been the most active competitors in this industry. It was a small firm, for instance, that introduced the oxygen-converter process (discovered in Europe) to the American steel industry, and small steelmakers were quickest to follow its example while the big companies were still dragging their feet.²⁷ The performance of the big steel producers, prominent among them US Steel, has left much to be desired. One of a series of reports made on US Steel in the late 1930s concluded that it was 'a big sprawling inert giant, whose production operations were improperly coordinated; . . . relying on an antiquated system of cost accounting; . . . slow in introducing new processes and new products. . . . The corporation was apparently a follower, not a leader, in industrial efficiency.'²⁸ The industry would probably not have been in such a plight if US Steel had been dissolved in 1920; to this extent antitrust policy has probably lost an opportunity of improving performance. Despite the fact that the concentration level has been kept more or less static by successful government actions such as its proceeding against the Bethlehem/Youngstown merger, the performance of the American steel industry has shown no sign of clear improvement more recently. This has provoked growing criticism – in both governmental and business quarters – directed mainly against the few very big producers.

For years, competitive pressure had to come from outside the industry. Although in a number of steel's traditional applications substitutes like aluminum and plastics have made certain inroads, interindustry competition has not proved to be an adequate corrective to monopolistic practices. Much more

effective competitive pressure has recently been exerted by foreign steel producers, who have managed to encroach rapidly upon the American market. Imports climbed to a record 18 million tons in 1971 – 18 percent of the market in terms of shipments by US mills plus imports less exports. Foreign competitive pressure was so strong in fact that the American steel industry urged the administration to press for ‘voluntary’ restraints on imports. The first agreements to this effect, signed with steelmakers in Japan and the European Community in 1968, covered the years 1969 to 1971. However, they did not prevent Japanese steelmakers in particular from penetrating further into the American market for specialty steels. Under the threat of protectionist action in Congress and pending quota legislation, Japanese and European steelmakers (the latter including British firms, this time) had to conclude a new three-year agreement which not only provides for a smaller yearly increase in total steel imports but also stipulates specific tonnage limitations for specialty steels which will in fact mean fewer exports in 1972–74 than in 1971. It is, however, doubtful whether the breathing space which these agreements undeniably allow American steelmakers will be used by them to increase productivity. For what happened in effect during the first three-year period was that they considerably widened their profit margins, raising prices five times as much as in the previous eight years, though production in the industry declined and 25–50 percent of the industry’s production capacity was idle.²⁵ Since import competition raises major political issues, then, it is likely to remain only a marginal source of competitive pressure. More pressure might be exerted if Japanese steelmakers’ direct investment in the United States were to be stepped up to any considerable extent.

For reasons outlined above, the consent decree that International Harvester

²⁵ *US v. US Steel Corp.*, 251 US 417 (1920).

²⁶ *US v. Bethlehem Steel Corp.*, 168 F. Supp. 576 (SD NY 1958).

²⁷ *Hearings before the Subcommittee on the Study of Monopoly Power of the House Committee on the Judiciary*, 81st Cong., 2d Sess., Ser. 14, Pt. 4A, at 967 (1950); Walter Adams and Joel B. Dirlam, ‘Big Steel, Invention and Innovation’, 80 *QJ Econ.* 167 (1966).

²⁸ Report by Ford, Bacon & Davis, as summarized by George W. Stocking in *Hearings*, *supra* note 27, at 967. See also Gardiner C. Means, *Pricing Power and the Public Interest* (New York: Harper, 1962). Walter Adams, ‘The Steel Industry’, in Adams (ed.), *op. cit.* *supra* note 4, is particularly critical.

²⁹ See the testimony of Walter Adams before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary, 12 Nov. 1971 (Hearings on *Economic Concentration*). Harry H. Bell has estimated that the first three-year period of voluntary steel restraints raised import prices by about 10%. ‘Some Domestic Price Implications of US Protective Measures’ in *United States International Economic Policy in an Interdependent World*, Papers submitted to the Commission on International Trade and Investment Policy, July 1971, Vol. 1, at 455, 485–86 (Washington, DC: Government Printing Office, 1971).

Co., by far the biggest producer of agricultural machinery at the time, had to conclude with the Department of Justice in 1918,³⁰ whereby the company was obliged to divest itself of a number of product lines, had only a slight beneficial impact on competition in the industry. However, the Supreme Court's refusal to dissolve International³¹ had no adverse effects on competition either. International's market share has shrunk severely over the last forty-five years, and a large number of strong competitors have taken over, Ford among them. International's share in domestic dollar sales of full-line producers fell from 44 percent in 1922 to 28.3 percent in 1929 and 22.8 percent in 1948, where it has remained since. One of the reasons for this was the dynamism of its competitors, who had brought important innovations onto the market. At least as significant, though, was the indirect influence of antitrust policy: Whitney observes that International deliberately slowed down its activities in the agricultural machinery industry so as not to attract too much attention from the antitrust agencies and began to expand into other lines of business.³²

Aluminum was another industry where the authorities did not succeed in bringing the monopolist to his knees with a dissolution order but where continual investigations by enforcement agencies and congressional committees together with the watch kept on Alcoa by the courts over a number of years undoubtedly gave smaller firms and newcomers a chance and thus stimulated competition. Another factor that had the same effect was the disposal of government-owned aluminum plants after World War II: the major objective seemed to be to break the prewar monopoly. The operations of the Surplus Property Administration and the War Assets Administration were prompted by antitrust directives (and much the same occurred later in the case of the General Services Administration and the Defense Production Administration during the Korean War).³³ This policy was not pursued in every industry: in the steel industry, all the important plants came under the control of US Steel. In the aluminum industry, however, the government's disposal policy enabled two newcomers, Reynolds and Kaiser, to build up fully integrated operations; and no firm could exist in this industry without being integrated because Alcoa had hitherto been the sole supplier of aluminum ingot. In later years a number of smaller firms were also able to integrate by concluding long-term contracts for imported ingot. Alcoa's former Canadian subsidiary, now independent, also became a major supplier of the American market. It is the general opinion among students of this industry that the change from monopoly to oligopoly had a favorable effect. Total output of aluminum doubled between 1940 and 1946 and quadrupled between 1946 and 1955; a great number of new applications were also developed for aluminum, by Alcoa among others, whose production policy became more dynamic as a consequence.³⁴ We can take it,

then, that antitrust brought about a change for the better in the performance of the aluminum industry.

The 1946 ruling in *American Tobacco*³⁵ did not provide for dissolution either, but it did enjoin all sorts of exclusionary practices by the major manufacturers. This seems to have had a beneficial effect on competitive conditions: the big firms being less inclined to indulge in unfair competitive practices, their small competitors have had greater opportunities – a factor which has had a major influence on the downward adjustment of profit margins in the industry.³⁶

To conclude this survey of court orders under the Sherman Act, we take the actions by the antitrust agencies in the *United Shoe Machinery* case. The aim of the 1953 ruling³⁷ was to 'recreate a competitive market' by prohibiting various restrictive clauses in the contracts under which United leased its machinery to shoe manufacturers, particularly those requiring exclusive use of United's machines, by directing United to grant licenses under its patents, and by obliging the company to sell as well as lease its machines. Not much information is available on the effects of this ruling on performance. Whitney, who devoted some attention to the matter, felt that a typical consequence would be to make things difficult for small shoe factories in particular, which would have financial difficulty in purchasing machines and would no longer be able to use United's free repair service.³⁸ Competition between shoe manufacturers was, however, no longer distorted by the supply policy of the manufacturer of machinery. Upon reexamination of the 1953 judgment before the courts, the defendant and the Department of Justice held completely opposing views as to whether workably competitive conditions had been restored. The government petitioned for additional relief, which was ultimately granted by the Supreme Court in 1968,³⁹ after which United Shoe was given two years to divest itself

³⁰ Following the district court's ruling in *US v. International Harvester Co.*, *supra* note 13.
³¹ 274 US 693 (1927).

³² *Op. cit. supra* note 6, Vol. 2, at 235 & Table 90.

³³ Full details can be found in Merton J. Peck, *Competition in the Aluminum Industry 1945–1958* (Cambridge, Mass.: Harvard UP, 1961); Robert F. Lanzillotti, 'The Aluminum Industry', in Adams (ed.), *op. cit. supra* note 4, at 185–200; Whitney, *op. cit. supra* note 6, Vol. 2, at 85–112.

³⁴ See authorities cited note 33 *supra*. Donald H. Wallace, *Market Control in the Aluminum Industry* 189–203, 331–52 (Cambridge, Mass.: Harvard UP, 1937), asserted that the existence of more aluminum producers would surely have led to a useful expansion of capacity without any sacrifice of economies of scale.

³⁵ *American Tobacco Co. v. US*, 328 US 781 (1946).

³⁶ Whitney, *op. cit. supra* note 6, Vol. 2, at 39–41; Tennant, *supra* note 4, at 387–92.

³⁷ *US v. United Shoe Mach. Corp.*, 110 F. Supp. 295 (D. Mass. 1953).

³⁸ *Op. cit. supra* note 6, Vol. 2, at 137–44.

³⁹ 391 US 244 (1968), *reversing* 266 F. Supp. 328 (D. Mass. 1967).

of sufficient assets to reduce its market share to 33 percent at most.

Criminal penalties under Section 1 of the Sherman Act seem not to have had much effect in actions against collusive behavior in oligopolies. The basic reason would appear to be that the fines are generally very moderate – at least compared with what is possible under the competition provisions of the EEC Treaty – and imprisonment is rarely imposed. The increase in profits that may stem from collusive behavior may be substantially higher than these fines. The risk of treble-damage actions by private plaintiffs may be a much more effective deterrent.⁴⁰

Given the limited application of the Sherman Act to market dominance, evidenced by the small number of proceedings instituted, the direct contribution made by the Act to stemming the rising tide of concentration in US industry has been a very modest one. Section 7 of the Clayton Act has been applied much more widely, and a growing number of already consummated mergers have been broken up – either through court orders or because of consent settlements. However, only a few hundred of the more than a thousand mergers that are consummated each year in the United States are questioned, and only some of these (roughly an average of 1 percent of the total number of mergers) become the subject of court proceedings. The restoration of premerger structural conditions in these cases depends essentially upon the effectiveness of the relief. Only in two cases, *du Pont* (General Motors) and *Ford* (Autolite), did the government obtain relief that completely restored such conditions. The relief obtained is probably satisfactory also in those instances where the merging partners were ordered to set up a completely new competitor. However, a recent investigation of a number of divestiture orders under Section 7 has shown that where the relief ordered was confined to mere separation of the original merging companies, the effectiveness of the remedy finally obtained was very limited.⁴¹ Among the most important factors adduced in this study to explain why the relief ordered was not enough to restore the premerger situation, the following are particularly interesting. First, in a number of cases the split-off was realized by sale to a firm that had a comparable competitive position on the market to the original acquirer, so that in fact very little changed as a result of the divestiture ordered. Second, the determination of the assets to be divested has in some cases been such as to make it difficult to find a suitable purchaser. Third, the fact that a defendant feels that he may not get a sufficiently interesting price from prospective purchasers has meant in a number of cases that the obligation to divest was never complied with. Finally, the result was often insufficient where the defendant was left considerable discretion in selecting what assets to divest: naturally, those parts of the merged firm were split off that were least profitable and would have been sold anyhow.⁴² One of the most

effective remedies in merger cases – preliminary injunction – has scarcely been applied in the Section 7 case law, for reasons set forth in Chapter 5. Had it been used, this would have obviated many of the complicated problems that arise when a merger carried out years ago has to be dissolved. The complexity of these problems is in fact the major reason behind the instances of insufficiently effective relief.

6.1.2 The Prophylactic Influence of Antitrust Policy

Prohibition of exclusionary practices and unfair conduct toward competitors has traditionally been a major aim of antitrust policy, which appears to have had an influence in this area. Broadly speaking, the competitive methods of the big firms in particular appear to be at any rate less flagrant than they were before the war. It is now only sporadically that we hear of boycotts, attacks on another firm's good name, bogus independents and other unfair practices designed to silence a troublesome competitor. Much improved communications and the power of public opinion (a sensational trial can ruin a firm's reputation) have certainly not been without effect in bringing this about. The question still arises, however, whether the leading firms would not have mended their ways even if there had been no antitrust laws. Much the same situation has developed in Europe, where big business has adopted a new code of behavior over the last twenty years without government intervention. But even if big firms now prefer to settle for non-aggressive conduct, this does not imply that they have abandoned either unfair methods of competition or the less overt kind of exclusionary tactics too. Antitrust enforcement under the Sherman Act in more recent years has focused on these types of behavior, and Sherman Act procedures have definitely had a prophylactic influence on such competitive strategies. The FTC's recent actions under Section 5 of the FTC Act in respect of oligopolistic behavior may, if endorsed by the courts, exercise a substantial prophylactic influence of their own.

⁴⁰ See Roger D. Blair, 'The Sherman Act and the Incentive to Collude', 17 *Antitrust Bull.* 433, 440, 444 (1972). However, Blair adds that in about 80% of those suits in which the government was able to prove collusive behavior, subsequent private suits for treble damages were nearly impossible: since the companies either pleaded *nolo contendere* (in criminal actions) or settled by consent decree (in civil actions), private plaintiffs could not rely on a court's finding of illegality but had to bear the burden of proving violation themselves.

⁴¹ Malcolm R. Pfunder, Daniel J. Plaine and Anne Marie G. Whittemore, 'Compliance with Divestiture Orders under Section 7 of the Clayton Act: An Analysis of the Relief Obtained', 17 *Antitrust Bull.* 19 (1972).

⁴² The reader is referred to the many interesting examples given in Pfunder, Plaine and Whittemore, *supra* note 41.

Rulings under Section 2 and 3 of the Clayton Act, which have not been discussed in this study, have had a much more direct influence on certain forms of market conduct in American business than the Sherman Act. This is particularly true of the rulings under Section 2, as amended by the Robinson—Patman Act. By outlawing quantity and functional discounts, amended Section 2 virtually removed the opportunity for big firms to use this method of acquiring a cost advantage over their smaller competitors in distribution by buying at lower prices. A similar influence on the market conduct of big companies was probably exercised by decisions on exclusive dealing and tying agreements under Section 3 of the Clayton Act, since these practices seem to be judged by stricter standards when they are employed by large firms.⁴³

The threat that restrictive business practices by dominant firms or groups of firms may be prohibited and those employing them punished by complete or partial dissolution has surely had a restraining effect on industry concentration as well: a firm that knows it dare not use its power will obviously be less inclined to seek power. This has definitely had a positive effect on competition in that complete monopolization has been avoided. A classical example of this is provided by US Steel, whose market strategy of avoiding monopoly is said to have cost millions in lost monopoly profits.⁴⁴ However, the corporation was 'rewarded' for this behavior when it was saved from dissolution by the Supreme Court in 1920.⁴⁵ Partly because of its abandonment of aggressive policies, US Steel's share of its market declined steadily after 1920. On the other hand, this threat may have damped down the vigor of competition somewhat in that leading firms may have abstained not only from using abusive tactics to drive their smaller competitors out of the market but also from using hard but fair competitive methods. An example of this is where leading firms have preferred to adopt an attitude of 'live and let live' toward their smaller competitors – by holding, for instance, a price umbrella above their heads, thus giving them an opportunity to operate at a profit. If such behavior leads to excess profits by the leading firms (as defined in Chapter 3), the workability of competition is at stake and a case of joint monopolization may be present.

The most important instrument of antitrust policy for combating concentration has become the Celler-Kefauver Act (amending Section 7 of the Clayton Act). While the increasing number of suits to be filed might have been expected to have some sort of influence on the process of concentration, particularly in more recent years as the application of the merger provisions has become more vigorous, it is not really possible to say whether antimerger policy has slowed down the merger movement in any appreciable degree. We do not know what would have happened in the absence of antimerger policy or under alternative policies, because mergers are embarked upon for a variety of reasons, as was

observed in Chapter 2, and respect for merger rules may be only one of the factors that are taken into account by those contemplating merger. This may be illustrated by pointing to the large number of corporate mergers during years of intensive merger-law enforcement. The slowdown in the early 1970s has been mainly due to tight capital markets and high interest rates, which make it difficult to raise the capital needed to purchase firms, and to low stock prices, which make it difficult for potential acquiring firms whose stock has fallen to offer attractive stock swaps. This situation has hit mergers of the unrelated or pure conglomerate type particularly hard.

It may well be, however, that the policy pursued by the antitrust authorities up to 1968 – one of energetic enforcement of the law in respect of horizontal and vertical mergers – led a considerable number of firms to abandon plans to strengthen their position on their traditional markets and induced large companies in particular to seek new outlets where their market share would be inconspicuous. Some indication may be derived from the sources discussed in Chapter 2, in which it was noted that the combined share of horizontal and vertical mergers in total assets acquired may well have fallen below 10 percent recently, after having been 50 percent in 1951–54. The growth of pure conglomerate mergers accounts for practically all the difference, the part played by product- and market-extension mergers remaining pretty well unchanged.⁴⁶ Some further insight could be gained by examining market concentration and overall concentration, though it has to be borne in mind that such statistical exercises have basically only limited value as evidence since the current degree of concentration or changes in the pattern of concentration may be affected by a great number of factors, of which antitrust policy is only one, and there may be no way of examining each of them separately. Then there are the statistical complications involved in measuring concentration, which we mentioned in Chapter 1. Underlying a number of these difficulties is the fact that concentration ratios are calculated from Census of Manufactures statistics, but Census industry groupings do not necessarily coincide with markets in an economic sense, so that the concentration ratios based on them may understate or over-

⁴³ See Milton Handler, 'Problems of Antitrust', 62 *Colum. L. Rev.* 930, 935 (1962).

⁴⁴ 13 *Fortune* 157 (March 1936), cited by Adams, *supra* note 28, at 147.

⁴⁵ *Supra* note 25.

⁴⁶ The sources used in Chapter 2 were Federal Trade Commission, *Conglomerate Merger Performance* Chs. 1 & 2 (Nov. 1972), *Current Trends in Merger Activity, 1971* (May 1972) and *Economic Report on Corporate Mergers* (Washington, DC: Government Printing Office, 1969); Cabinet Committee on Price Stability, *Staff Studies*, Study Paper No. 2: 'Industrial Structure and Competition Policy' 71–78 (Washington, DC: Government Printing Office, 1969).

state the actual level of concentration. Some of these problems may be avoided, however, by considering only statistics for the largest industries with nationwide markets and taking average ratios weighted by the value added by industry groups. Nevertheless, a degree of caution is required in interpreting concentration figures covering a number of years.

Writers have not invariably come to comparable conclusions concerning the development of concentration in American manufacturing industries after studying the concentration ratios published by the Bureau of the Census, principally because of differences in the sample taken and the concentration index selected. Some have found some increase in sales concentration ratios from the beginning of the 1950s until 1966,⁴⁷ whereas another inquiry, covering the years 1947 to 1966, finds that 'average market concentration of manufacturing industries has shown no marked tendency to increase or decrease,' though there was a slight decline in average industry concentration until 1958, followed by a slight increase thereafter.⁴⁸ Using weighted aggregate concentration coefficients based on value of shipments, one student of industrial organization observes a downward trend of concentration for the period 1958 to 1963, but he finds a slight rise in concentration for the same period if the four-firm concentration ratio for each individual industry is weighted by the value added originating in that industry. However, for the years between 1963 and 1966 almost no change in concentration is found by this method.⁴⁹ Finally, it can be seen from the Census value-of-shipments statistics that there were fourteen more highly concentrated industries in 1970 than in 1947. In forty industries the concentration ratios remained virtually unchanged over these years. Excluding those industries that entered or left the group of highly concentrated industries, the number of increases and decreases in the concentration ratio balanced out (thirty-four on each side). The great majority of increases and entries of new industries into the group occurred before 1963, after which concentration ratios generally increased only slightly, if at all.⁵⁰ Antitrust policy in the merger field may have had an influence on this in that enforcement under the Celler-Kefauver Act took some time to get under way and then became gradually more rigorous.

More detailed analysis of the statistics by type of industry does appear to confirm the suppositions expressed above regarding the influence of antitrust policy. Concentration in highly concentrated industries that have known antitrust intervention in the past, for instance (mostly producer-goods industries), did not generally increase, whereas there generally were increases in concentration in consumer-goods industries, which had been fairly unconcentrated and had had relatively little contact with antitrust enforcement agencies.⁵¹ Out of twenty-one producer-goods industries that were 'very highly concen-

trated' in 1947 (four-firm concentration ratio over 75 percent), only twelve were still in that category in 1966. The number of 'highly concentrated' consumer-goods industries, on the other hand (four-firm concentration ratio between 50 and 75 percent), rose from eleven to fifteen.⁵² And the Census value-of-shipsments statistics suggest that the situation has not changed since 1966.

The statistics on market or industry concentration, which reflect horizontal merger activity more especially, need to be compared and contrasted with the trend of aggregate or overall concentration. Does the latter reflect the increase in the share of conglomerate mergers in total merger activity? One way of measuring this is by reference to total assets of the two hundred largest American manufacturing corporations. Statistics show that these firms' share increased from 48.1 percent in 1948 to 58.7 percent in 1967, and by 1967 the hundred largest corporations held about the same share of assets as was held by the two hundred largest in 1948.⁵³ A similar trend is discernible from other statistics and investigations in this field that use the same basis of measurement

⁴⁷ Joe S. Bain, 'Changes in Concentration in Manufacturing Industries in the United States, 1954-1966: Trends and Relationships to the Levels of 1954 Concentration', 52 *Rev. of Economics and Statistics* 411, 416 (1970); F. M. Scherer, *Industrial Market Structure and Economic Performance* 63 (Chicago: Rand McNally, 1970). For evidence on the years 1947 to 1958 see the Statement of Morris A. Adelman in *Economic Concentration*, 88th Cong., 2d Sess., Pt. 1: 'Overall and Conglomerate Aspects', at 224, 335 (Table 1) (1964).

⁴⁸ Cabinet Committee on Price Stability, *op. cit. supra* note 46, at 58; the Committee's main source on this point was Federal Trade Commission, *Industry Classification and Concentration* (Washington, DC: Government Printing Office, 1967). For the years 1954-58, Betty Bock and Jack Farkas, *Concentration in Manufacturing* (New York: National Industrial Conference Board, 1966), also found that the four-firm concentration ratio was constant or declining, depending on the unit of measurement used.

⁴⁹ David R. Kamerschen, 'Changes in Concentration in American Manufacturing Industries', 127 *Zeitschrift für die gesamte Staatswissenschaft* 621, especially Table 3, at 626, & Table 6, at 633 (1971). If highly concentrated industries only are used in the sample, the trend becomes more pronounced, as is shown in Table 5, at 632.

⁵⁰ Bureau of the Census, *Annual Survey of Manufactures, 1970: Value-of-Shipments Concentration Ratios, M70(AS)-9* (Washington, DC: Government Printing Office, 1972).

⁵¹ See for the period 1947-58 the Statement of Dr. Lee E. Preston in *Economic Concentration* Pt. 1, at 67-68, and for the study that covers the period 1947-66 Cabinet Committee on Price Stability, *op. cit. supra* note 46, at 58-61. See also Willard F. Mueller, *The Celler-Kefauver Act: Sixteen Years of Enforcement*, Staff Report to the Antitrust Subcommittee of the House Committee on the Judiciary, 90th Cong., 1st Sess., 15-20 (1967).

⁵² Cabinet Committee on Price Stability, *op. cit. supra* note 46, Appendix Table 15, at 98.

⁵³ *Id.*, Appendix Table 1, at 92. Figures given in Federal Trade Commission, *Economic Report on Corporate Mergers*, *op. cit. supra* note 46 (from an earlier edition of which the Committee's staff obtained their figures), are as high as 60.1% for the top two hundred companies in 1969 and 48.2% for the top hundred.

but cover earlier years.⁵⁴ However, value added is a better measure of concentration: figures based on assets are inflated by US companies' investment abroad and by their acquisitions in industries other than manufacturing. According to the information provided by the Bureau of the Census, the share of total value added by manufacture accounted for by the largest manufacturing companies increased rapidly from 1947 to 1954. From 1954 to 1970 their share increased much more slowly: for the fifty largest from 23 to 24 percent, for the hundred largest from 30 to 33 percent and for the two hundred largest from 37 to 43 percent.⁵⁵ Other sources too reveal a slowdown in merger activity by the biggest American firms, as is recognized in the Report of the White House Task Force on Antitrust Policy.⁵⁶ The shift of emphasis from horizontal to conglomerate expansion as a result of the government's animosity toward horizontal mergers is no doubt one important reason for the slower growth of the traditional big firms, balanced on the other hand by the vigorous growth of completely new, pure conglomerate giants. The relative decline of these conglomerates over the last few years cannot be attributed to antitrust, though: the reason must primarily be sought in a combination of monetary factors (tight money, etc.), psychological factors (conditions on Wall Street) and business factors (disappointing trading results). However, the suits recently brought against pure conglomerate combinations involving very large firms and the consent settlements already obtained (see Chapter 5) give the impression that this form of corporate growth is no longer beyond the reach of antitrust and that large firms are beginning to realize this. A characteristic example of this was the fact that in 1968 the proposed merger between the American Broadcasting Co. and ITT was abandoned upon simple notification that the Department of Justice would challenge. Whether any of this will be reflected in the degree of overall concentration in the United States in the years ahead depends on how far the courts hold to their present course and how firms react (perhaps by stepping up their expansion overseas).⁵⁷

Antitrust policy has no doubt had most prophylactic influence on restrictive agreements between competitors: it seems indeed to have led to the virtual disappearance of such agreements in the United States. But for antitrust policy there would probably have been a cartelization of United States industry,⁵⁸ as did in fact happen when the antitrust laws were suspended under the National Industrial Recovery Act from 1933 to 1935. The extension of *per se* prohibition to unwritten agreements of all kinds, as in the rulings in the Philadelphia electrical cases,⁵⁹ has had an even greater effect on relations between competitors: officers of competing firms now try to avoid meeting even by accident! However, we should not overlook the fact that the complete prohibition of restrictive agreements may have driven firms into merger. As information of

this kind is generally kept inside the firms involved, it is impossible to ascertain whether this did in fact occur.

6.1.3 Summary and Conclusions

Antitrust policy under the Sherman Act and Section 7 of the Clayton Act has had both a direct and a prophylactic influence on the structure of a number of markets in the United States and on the conduct of the firms operating on these markets. Antitrust has directly influenced the number of firms in the market where the courts have ordered dissolution of existing firms or of mergers that had been constituted in violation of Section 7 and where merger plans were

⁵⁴ See, e.g., *Economic Concentration* Pt. 1, at 120–21, which shows that the share of the hundred largest manufacturing corporations in total corporate assets increased from 40.2% in 1950 to 45.7% in 1962; Norman R. Collins and Lee E. Preston, 'The Size Structure of the Largest Industrial Firms, 1909–1958', 51 *Am. Econ. Rev.* 986 (1961), according to whom the share of the assets of all industrial corporations accounted for by the hundred largest firms in manufacturing, mining and distribution rose from 25.5% in 1929 to 29.8% in 1958 – a 17% increase; Gardiner C. Means, 'Thoughts on Concentration', 1962 *Proceedings of the Business and Statistical Section of the American Statistical Ass'n*, who found that the share of manufacturing assets held by the eighty-two largest corporations rose 30% between 1929 and 1958 – from 39.7% to 52%.

⁵⁵ *Op. cit. supra* note 50, Table 1. Betty Bock has remarked that the role of the largest corporations should be appraised in the light of an evaluation of the historical development of any constant group of companies over the years. If this is done, then the change in concentration is much less spectacular. *Statistical Games and the '200 Largest' Industrials: 1954 and 1968* Table 1, at 10 (New York: National Industrial Conference Board, 1970).

⁵⁶ *Neal Report* 5. Mueller, *op. cit. supra* note 51, at 33, finds that the share of the two hundred largest manufacturing corporations in total acquisitions fell from 1962 to 1966.

⁵⁷ Scherer, *op. cit. supra* note 47, at 490, cites a study by John J. McGowan ('The Effect of Alternative Antimerger Policies on the Size Distribution of Firms', 5 *Yale Economic Essays* 423, 468 (1965)) according to which a complete ban on mergers for the hundred largest industrial corporations would have reduced their aggregate asset share by somewhat more than 10% (compared with no restriction on mergers at all) and concludes 'that the effect of the Celler-Kefauver Act on aggregate concentration has not been overwhelming.' In another study comparing the merger activity of the hundred largest firms in the United States, the United Kingdom, Australia and France for 1950–64, 'International Comparisons of Merger Activity', 14 *J. of Law and Economics* 233, 237–38 (1971), McGowan also observes that in spite of US antimerger policy 'the typical leading US firm made more than six times as many acquisitions as the typical non-leading firm while the divergence between leaders and non-leaders in this respect was much less in other countries. . . . There is, thus, no evidence that antitrust policy restrained the acquisition activity of large US firms relative to their foreign counterparts. . . .'

⁵⁸ Corwin D. Edwards, *Maintaining Competition* 294 (New York: McGraw-Hill, 1949); George J. Stigler, 'The Economic Effects of the Antitrust Laws', 9 *J. of Law and Economics* 225 (1966).

⁵⁹ *US v. General Elec. Co.*, CCH 1962 *Trade Cas.* ¶¶ 70 438, 70 488, 70 501, 70 502, 70 503, 70 527 & 70 582 (ED Pa. 1962).

found violative of the law and were not consummated. The courts have been rather reluctant to order dissolution in suits brought under the Sherman Act, at least in cases (unlike those involving the early trusts) where this remedy was not thought practicable in view of the injurious macroeconomic consequences it might have if efficiency, research effort or other growth determinants should be impaired as a result. The dissolution remedy has been regularly decreed under the Clayton Act, on the other hand, criticism being waved aside with the observation that internal expansion was always a possible alternative growth route. However, as a factor directly influencing the concentration movement in American industry the contribution of antimerger policy can be only very modest since the number of suits totals only about one percent of mergers consummated.

Apart from their structural impact, the antitrust laws have directly influenced market conduct in all cases in which particular forms of conduct were outlawed – those that constituted a hindrance to small businesses' activities, that prevented new firms from entering the industry or that were designed to exclude competition from certain domains in some other way.

Much more important than the direct consequences of antitrust action to date has been its prophylactic influence. In this respect we have noted that single-firm monopolies have almost disappeared – chiefly because horizontal and vertical mergers between firms having some importance on the market have been virtually proscribed – so there is no doubt that the current level of concentration in most sectors of the American economy is lower than it would have been without antitrust policy. This should not lead us to conclude, however, that antitrust enforcement is a predominant factor in determining the structure of US manufacturing industry.

The fact that the concentration ratio has declined in a number of industries and has at least failed to increase in others does not at all imply that industry concentration is no longer a predominant feature of the American economy. Although industries with single-firm dominance are now very few, there are still an impressive number of oligopolies which are very highly concentrated, i.e. with over 75 percent of total shipments accounted for by the four largest firms. And industries with a four-firm concentration ratio of over 50 percent are in fact extremely common, as we saw in Chapter 1.⁶⁰ Overall concentration, moreover, is high and is still on the increase.

6.2 ANTITRUST JUDGED BY ITS OBJECTIVES

How far do the achievements of antitrust as outlined above measure up to its objectives and to what has been expected of it in the United States? It will be convenient briefly to recall these objectives here. Although there were many considerations which led to the enactment of the antitrust laws, the basic principle on which they were founded is free competition, an ideal connoting rejection of any restraint on a firm's freedom of action, whether by private or by governmental intervention. For that part of antitrust policy which is discussed in this book, this has always meant prevention of the creation or maintenance of economic power in private hands if in some way or other it was linked with unlawful conduct toward other market participants. This is not to say that the legislature ignored the economic goal of satisfactory market performance; that has been considered inherent in the basic philosophy that the desired economic effects will automatically accompany the attainment of a system of free competition. The courts, in cases tried under the Sherman Act and Section 7 of the Clayton Act, have thus confined themselves almost exclusively to condemning market power or mergers on grounds of actual or potential exclusion of competitors, though the legal tests have been appreciably amplified and refined over the years. The courts have never weighed against one another the benefits for market performance of a given firm size and the firm's influence on the position of competitors on the relevant market. Nor have they regarded the acquisition or retention of economic power as illegal *per se* if not accompanied by evidence of actual or potential damage to other market participants.

If we compare these basic principles underlying the American antitrust laws with the accomplishments analyzed in the preceding section, we may conclude that the policy pursued so far has largely satisfied the requirements made of it. This view seems also to be held by most Americans,⁶¹ except perhaps those who

⁶⁰ In addition to the statistics contained in the works cited in Chapter 1 *supra* (nn. 11–13), some older information and comment on the extent of oligopoly in the United States can be found in Carl Kaysen and Donald F. Turner, *Antitrust Policy* Ch. 2 & Apps. (Cambridge, Mass.: Harvard UP, 1959); this, however, gives no indication as to whether competition functions correctly or not in these industries, a point that we discussed amply in Chapter 3 *supra*. See also David Schwartzman, 'The Economics of Antitrust Policy', 6 *Antitrust Bull.* 235, 238–39 (1961), for a criticism of the definitions of oligopoly suggested in the literature.

⁶¹ See, e.g., Edwards, *op. cit. supra* note 58, at 294; Galbraith, *supra* note 1; A. D. Neale, *The Antitrust Laws of the United States of America* Ch. 15 (Cambridge: Cambridge UP, 2d ed. 1970); Jesse W. Markham, 'United States Antitrust Policies: How Effective Have They Been?' 26 *Southern Economic J.* 58 (1959); Keezer (ed.), *supra* note 1; *Att'y Gen. Nat'l Comm. Antitrust Rep.* (Washington, DC: Government Printing Office, 1955).

consider the independence and continued existence of small business to be the major concern of antitrust. In general, it may be admitted that in the great majority of cases competition may have been stimulated as a result of antitrust action and that through its prophylactic influence this effect may have been considerable. But what of the continued persistence of highly concentrated oligopolistic market structures and overall concentration? There appears to be little support in Congress just now for an extension of antitrust policy to these two areas, despite the great efforts made in recent years by Senator Hart and his Subcommittee on Antitrust and Monopoly to have the Sherman Act amended. A number of reasons can be advanced to explain why antitrust policy has not penetrated this area. First, the general mood of the public in the United States may be said to be pro big business. Then there is the reticence in government circles about applying the law too vigorously – to some extent induced by the pressure brought to bear by powerful groups whose interests could be harmed by active enforcement. One such group is, of course, big business itself, a frequent target of antitrust attack. There have been many occasions in the past on which the interests of this group coincided with the ambitions or personal views of political leaders. Up to the end of the NIRA period and the revival of the antitrust idea in government quarters, the enforcement agencies' budgets were minimal. Particularly in the early years (during the Harrison, Cleveland and McKinley administrations) the government was not very interested in applying the law too strictly to the big combinations. With the onset of a period of more vigorous enforcement, business interests began to be directed more toward influencing the selection of cases. A point to remember here is that in its attempts to keep out of trouble with the antitrust agencies big business commonly enjoys the support of organized labor, which would much rather negotiate wage increases and improved fringe benefits with a few big firms than with a multiplicity of small ones, not only because this saves time but also – and mainly – because big firms are much more prepared to make concessions to the unions in order to ensure continuity of production. The American labor movement, therefore, is by no means kindly disposed toward dissolution of big enterprise. And the numerous small-business pressure groups are chiefly interested in the prohibition of certain practices injurious to their interests rather than in the actual dissolution of giant firms, which might result in the resurgence of keen competition between their successor companies.⁶²

There are also reasons that induce the government itself to refrain from instituting proceedings against big business, for such actions can keep it occupied for years. A certain amount of activity has to be deployed if annual budgets are to be approved, and this constitutes a recurrent problem that the enforcement agencies generally solve by filing the greatest possible number of

small suits that will take up relatively little time. The government is thus obstructed from launching any radical attack on dominant positions.⁶³

All these reasons for the shortcomings of antitrust, which are for the most part inherent in the enforcement of any law (but especially a law purporting to regulate matters economic) and consequently difficult to do anything about, are less important than the difficulties involved in extending the scope of the existing body of law. In order to win a case under the Sherman Act against a firm that has a monopoly position on the market the government has to prove that its conduct points to an element of intent. Proof of violation is even more difficult where a firm does not yet have complete or near monopoly, for *specific* intent must then be shown. This raises particularly knotty problems of proof where oligopolistic market behavior is concerned. The courts have concentrated on deciding whether conscious parallelism can be proved by instances of encroachment on the freedom of weaker market participants, ignoring performance aspects of oligopolistic competition. Quite apart from the need for lengthy investigations that this entails, the essential role that abuse in relation to other market participants plays as an element of proof has also meant that the antitrust agencies do not normally frame a charge unless competitors, suppliers or customers have sent in complaints about the firm concerned. But such complaints will be somewhat infrequent because businesses that are dependent in one way or another on the dominant firm usually lack the courage to protest for fear of reprisals.

Judged by its objectives, then, the fact that antitrust policy has had so little influence on competitive conditions in oligopolistic markets cannot be held to show that it has failed. If the problems of competition in such markets are to be tackled more effectively through antitrust policy, the traditional approach to competition embodied in the antitrust laws will have to be abandoned and a more economically oriented concept of competition must be written into the law.⁶⁴

⁶² See, e.g., Philip A. Hart, 'A Forecast of Antitrust Policy Regarding Economic Concentration', 10 *Antitrust Bull.* 51 (1965), and the interesting observations on the difficulties with which Franklin D. Roosevelt was confronted in 1935 in Thurman W. Arnold, *The Folklore of Capitalism* (New Haven, Conn.: Yale UP, 1937).

⁶³ Mark S. Massel, *Competition and Monopoly* 320-22 (Washington, DC: Brookings Institution, 1962).

⁶⁴ See our treatment of the Sherman Act case law in Chapter 4 *supra* and, e.g., Arthur Robert Burns, *The Decline of Competition* 17-21, 523-26 (New York: McGraw-Hill, 1936); Edward S. Mason, *Economic Concentration and the Monopoly Problem* Ch. 15: 'Monopoly in Law and Economics'; idem, *Preface* to Kaysen and Turner, *op. cit. supra* note 60, at xiii-xiv; Kaysen and Turner, *op. cit. supra* note 60, Ch. 4; Joe S. Bain, *Industrial Organization* 561-62 (New York: Wiley, 2d ed. 1968).

6.3 FURTHER ASPECTS OF COMPETITION ON CONCENTRATED MARKETS

To gain a better idea of the scale of the problem of highly and very highly concentrated oligopolistic industries in the United States we need to look at more than concentration ratios. What further information is available on the structure of American markets that might help us to assess how competition is working? As was explained in Chapter 3, structural factors other than the degree of concentration which affect competitive behavior in a market include size distribution within the group of leading firms and the stability of the group's position within the industry as a whole. To establish size distribution we need to know the individual shipment figures – or, better still, the figures on value added. Census disclosure rules generally withhold this information, however; the only available sources are two FTC reports.⁶⁵ The data in the earlier report relate to the assets of the biggest firms in twenty-six important industries only in 1947, showing substantial size disparities; the later publication covers the thousand biggest manufacturing companies. For the average of all industries investigated in this second report, an 'index of disparity' (of size among the four leading firms) gives a value corresponding to a market structure in which each firm is about double the size of the next largest.⁶⁶ As one observer quite rightly has remarked, this is 'sharp asymmetry by any standard.'⁶⁷ In those oligopolies at least where asymmetry is even sharper, then, behavior based on dominant-firm leadership may be expected.

Unfortunately, we have but little information about mobility among the leading firms in concentrated oligopolies. In an extensive study covering the period 1947–54 in the United States, Michael Gort found that leading-firm shares did not change much in most of the industries investigated and that only in industries where concentration was relatively low (such as clothing, lumber and furniture) was it possible to discern mobility on any appreciable scale.⁶⁸ Comparable evidence can be found in another study in this field.⁶⁹ These observations were confirmed in a more recent study of turnover among the largest firms in eleven manufacturing industries over the period 1919–64, which established that despite substantial technological changes most of the largest firms in 1919 were still among the largest in 1964.⁷⁰ This can be considered *prima-facie* evidence of rigid market structures in those industries, but without more knowledge of the way in which these firms reacted to technological change it cannot be taken as evidence that workable competition did or did not exist.

Business size mobility or turnover should also be taken into consideration in evaluating the influence of the nation's largest firms on the economy. Kaplan was the first to attempt a quantitative approach to the mobility of the big firms.

One of the things he established was that of the hundred leading manufacturing companies in 1909, only thirty-six were still among the first hundred in 1948. From this he deduced that there was considerable mobility among the biggest firms and that they must therefore be under severe pressure from competition.⁷¹ Kaplan's conclusions have been the occasion of lively debate in the United States, the consensus being that he was rather too optimistic. Collins and Preston, for instance, who have made an extensive study of the phenomenon, reach different conclusions concerning the years up to 1958: they believe that the mobility of the biggest firms has become much less than it was in most of the years studied by Kaplan – both mobility within the group as such and entry to and exit from the group. Moreover, a slight tendency can be observed for the gaps in size between the biggest firms to decrease. Collins and Preston draw the important conclusion that opportunity for entry to the group is very slight and shows no sign of increasing since the biggest firms have thoroughly consolidated their positions.⁷² A similar conclusion is drawn by Boyle and McKenna from a more detailed industry analysis, based on the turnover of the largest manufacturing firms from 1919 to 1964. They report only slight mobility among these firms, especially after 1931, and find that it was specifically the result of the changing significance of industries and carried through by mergers.⁷³ More research is needed to determine whether these phenomena were induced by competitive forces and what their influence has been on competition in these industries.

To what extent can this substantial degree of industrial concentration, which has thus far remained virtually unaffected by antitrust policy, be justified on grounds of above-normal performance? This is not a question that can be answered with the aid of such studies as are now available in this field. It is

⁶⁵ *Report on the Concentration of Productive Facilities, 1947* (Washington, DC: Government Printing Office, 1949); *Industrial Concentration and Product Diversification in the 1000 Largest Manufacturing Companies, 1950* (Washington, DC: Government Printing Office, 1957).

⁶⁶ 'The index of disparity is the average deviation of the value of shipments among [the four] leading firms, expressed as a [ratio to a] tenth of the average value of their shipments.' *Op. cit. supra* note 65, at 131.

⁶⁷ William G. Shepherd, 'On Appraising Evidence About Market Power', 12 *Antitrust Bull.* 65, 69 (1967).

⁶⁸ 'Analysis of Stability and Change in Market Shares', 71 *J. Pol. Econ.* 52 (1963).

⁶⁹ Shepherd, *supra* note 67, at 70–71.

⁷⁰ Stanley E. Boyle and Joseph P. McKenna, 'Size Mobility of the 100 and 200 Largest US Manufacturing Corporations: 1919–1964', 15 *Antitrust Bull.* 505, 517–18 (1970).

⁷¹ A. D. H. Kaplan, *Big Enterprise in a Competitive System* 141–44 (Washington, DC: Brookings Institution, 1954).

⁷² *Supra* note 54, at 989.

⁷³ *Supra* note 70, at 506–15, 518.

not only that the number of industry studies (even in the United States) is limited: there is also the point, mentioned earlier in this chapter, that the performance data contained in certain of these studies are relatively meager. This is hardly surprising, however, in view of the difficulty of making a proper assessment of performance; the yardsticks at our disposal are not only far too few, as we saw in Chapter 3, but they also leave much too wide a margin of uncertainty. Nor should we forget that a meaningful answer to our question cannot be confined to the industry or industries involved but must also take into account macroeconomic targets.

Now there have been commentaries over the years on a number of aspects of the performance of American big business, especially in comparison with the situation in other countries, but these offer no new insights into the complex of problems we are concerned with here. For although Galbraith and many other economists praise the performance of American industry highly, particularly that of the big firms, pointing to their contribution to the continuing growth of the economy, and conclude that there is no cause to reinforce the powers of antitrust,⁷⁴ their arguments on this last point are not convincing. In the first place, we cannot generalize about the performance of big business as long as there are so many instances of major technical innovations being first applied by small companies, with their big competitors obviously lagging far behind. Apart from those mentioned in the first section of this chapter, other examples of this are to be found in the oil industry (catalytic cracking), telecommunications (radios and portable television sets), aircraft (the jet engine), the aluminum industry and the drug industry.⁷⁵ Secondly, a firm's performance can only be evaluated in the environment in which it takes place, so that the effect of factors extraneous to the firm must be discounted. An important illustration of this is furnished by the impact of government assistance in the field of research and development. The performance of big firms in this area may not be the result of their own initiative born under competitive pressure but may largely be a direct consequence of government action, particularly in the United States.⁷⁶ Without going any deeper into the subject, which would take us beyond the scope of this study, let us simply recall the fact that the bulk of the American government's R & D expenditure goes to the nation's largest corporations.⁷⁷

It is a pity that, particularly in a number of industries which are very highly concentrated, no information is available on the effectiveness of competition. Although we have argued that joint dominance constitutes less of a threat to the quality of performance than does single-firm dominance since oligopolists are more likely to have to face competition arising either inside or outside the oligopoly, the risk nevertheless remains that the competition will be much too

weak to provide a sufficient corrective to the oligopolists' conduct. In view of the criteria for workable competition developed in Chapter 3, concentration may be considered sufficiently high in a number of oligopolies in American manufacturing industry to confer upon them substantial discretionary power in making price and other market decisions.

This analysis – imperfect as it may be – should be enough to induce us to think about the suitability of a change in the antitrust laws on market power so as to introduce a concept of competition that is better adapted to the problems of concentrated markets. Perhaps what is needed is a set of completely different instruments. The same may be said of the other problem which the present antitrust laws in the United States are not really equipped to deal with: overall economic power.

⁷⁴ J. K. Galbraith, *American Capitalism* 91 (Boston: Houghton Mifflin, rev. ed. 1956); Kaplan, *op. cit. supra* note 71; idem, 'Influence of Size of Firms on the Functioning of the Economy', 40 *Am. Econ. Rev.* 74 (1950, Proceedings); Business Advisory Council, *Effective Competition* (Washington, DC: Department of Commerce, 1952); Clare E. Griffin, *An Economic Approach to Antitrust Problems* (New York: American Enterprise Ass'n, 1951). Griffin, however, subsequently modified his position, as he explained in a contribution to the Discussion on the Report of the Attorney General's Committee on Antitrust Policy, 46 *Am. Econ. Rev.* 501 (1956, Proceedings). See also David Lilienthal, *Big Business: A New Era* (New York: Harper, 1953); Simon N. Whitney, 'The Economic Impact of Antitrust: An Overview', 9 *Antitrust Bull.* 509 (1964); Joseph A. Schumpeter, *Capitalism, Socialism and Democracy* 84 (New York: Harper, 3d ed. 1942); Mason, *op. cit. supra* note 64, Ch. 5: 'Schumpeter on Monopoly and the Large Firm'; Notes, 68 *Yale LJ* 1627 (1959). This was also the tenor of the inquiries of Ferguson discussed in Chapter 3 *supra*. In Europe similar ideas have been developed by François Perroux, *Le progrès économique* (Paris: Presses Universitaires de France, 1967); Jacques Austruy, 'La réglementation des ententes et les pouvoirs compensateurs dans le Marché commun', 11 *Revue économique* 770 (1960).

⁷⁵ See, e.g., Richard Caves, *American Industry: Structure, Conduct, Performance* Ch. 6 (Englewood Cliffs, NJ: Prentice-Hall, 2d ed. 1967); Adams and Dirlam, *supra* note 27, at 188; Peck, *op. cit. supra* note 33; Lanzillotti, *supra* note 33. Betty Bock, *Concentration Patterns in Manufacturing* 53 (New York: National Industrial Conference Board, 1959), makes the general comment that three fifths of all highly concentrated industries in the United States are not expansive. See also Corwin D. Edwards, *Big Business and the Policy of Competition* Ch. 3 (Cleveland: Western Reserve UP, 1956).

⁷⁶ See, e.g., C. Freeman, 'Research and Development: A Comparison between British and American Industry', *National Institute Economic Rev.*, May 1962, p. 21, 29.

⁷⁷ Testimony of Richard J. Barber, Professor of Law, Southern Methodist University, Hearings before the Joint Economic Committee, 87th Cong., 2d Sess., *State of the Economy and Policies for Full Employment* 861 (1962), cited by Estes Kefauver, *In a Few Hands* 244–45 (Harmondsworth, Middlesex: Penguin, 1966).

CHAPTER 7

STANDARDS FOR A POLICY TOWARD CONCENTRATION

The very high concentration in a number of industries in the United States gives rise to the presumption at least that market power is prevalent. However, only limited antitrust action has been undertaken in these industries, despite the stringent statutory provisions on which the American antitrust agencies can rely, backed up by the relatively weighty enforcement apparatus at their disposal and the fact that their actions generally have enjoyed strong public support (three factors which make American antitrust unique). What are the capabilities and limitations of antitrust policies in dealing with economic power, either in an individual industry or in the context of the entire national economy? This question, which will be dealt with in section 1 of this chapter, arouses constant interest in the United States. And we feel that it is of more than academic significance for Europe too. A number of European industries are becoming more and more highly concentrated, and there is no legislation specifically concerned with economic power anywhere in Europe other than the ECSC Treaty, the Fair Trading Act 1973 in the United Kingdom and the German Act against Restraints of Competition. In section 2 we shall go on to discuss how much of a solution would be offered by utilizing economic policy instruments other than competition policy to regulate market power. However, we shall refrain from discussing the feasibility of using instruments that would introduce or extend public ownership as a means of controlling economic power. Discussion in these two sections will nonetheless make it clear that within a free-enterprise system competition policy has its clear limitations when it comes to finding a way of restoring competition if the market is wholly or partly prevented from functioning by economic power. For this reason the main accent of antitrust policy should be on forestalling the emergence of power blocs in the national economy. In section 3 we shall discuss what merger policy can accomplish in this area. As the scope of merger policy in particular and the facilities available to enforcement agencies in countries other than the United States are far less impressive, we may appropriately draw in this field of competition policy on the law as applied in the United States (outlined in Chapter 5) and see where its impact may

be extended. After a brief description of competition policy in Europe in section 4, we shall consider the feasibility of extending current policies relating to market power in that part of the world. Our general conclusions will be summarized in section 5.

In discussing the pros and cons of strengthening competition policy, however, we do not consider the implications of a reinforcement of the agencies responsible for ensuring compliance with the law. Nor do we consider whether the ultimate decision in antitrust cases should rest with the government or with the courts – and whether with the ordinary courts or with a specialized administrative tribunal – or whether a change in the present situation might have a favorable impact on the enforcement of the law. These are matters that lie largely outside the scope of economic theory.¹

7.1 MARKET POWER: THE LIMITATIONS OF ANTITRUST

The success of any effort to cope with existing market power depends to a large extent on the definition of the phenomenon that is used in the law. The efficacy of competition policy in this field depends also, however, on the scope of the penalties that can usefully be imposed. As regards penalties which affect the actual position of the firm, we shall see in subsection 2 how far dissolution – especially in cases of joint dominance – can be considered an appropriate remedy. This point is particularly relevant for the United States because dissolution has so far been ordered only in the case of single-firm monopolies. In subsection 3 we shall discuss how far restrictions can be placed on the conduct of dominant firms. In subsection 4 we shall go into the policy problems of conglomerate power not linked with power in specific markets.

7.1.1 The Notion of Market Power and the Law

Before embarking upon a discussion of the reach of competition policy in respect of market power, let us first summarize some of the notions of market power contained in the relevant laws. As will be recalled from what was discussed at length in Chapter 4, the notion of monopoly power under the Sherman Act refers basically to the power to exclude competitors, but in the cases this has been defined chiefly in terms of market share. In the United Kingdom the Fair Trading Act 1973 also employs market-share criteria, but it is wider in scope, defining monopoly as a situation in which at least one quarter of all the goods or services of a specified description which are supplied in the country are supplied by or to one and the same person or by or to members of one and the same group of companies or of persons

who behave in a restrictive manner.² In Germany the Act against Restraints of Competition, as recently amended, defines market dominance in terms which, besides the classic case of firms encountering no competition of any significance, also embrace firms which have a much stronger position on the market than other firms (*überragende Marktstellung*). This last notion is defined by reference to structural criteria: market share, financial power, access to suppliers and sales outlets, corporate interlocks and barriers to entry. The law defines joint dominance as a situation in which there is no substantial (*wesentlich*) competition between two or more firms which together meet the tests for single-firm dominance. Market-share criteria play a decisive role, however, because single-firm dominance is presumed if the firm's share of the market is at least one third (though not if its sales in the last business year were less than DM 250 million). Joint dominance is presumed either when three or fewer companies together have a market share of 50 percent or over or five or fewer companies have two thirds or more of the market (though not if the sales of the firms involved were less than DM 100 million in the most recent business year).³

The European Commission defines the concept of dominance by reference to the sort of influence that a firm or group of firms can exert on a given market. In a memorandum presented to the governments of the member states on 1 December 1965 and later published as a study in its Competition Series, the Commission remarks that market dominance cannot be defined solely in terms of market share or other quantitative features of a particular market structure but is primarily a matter of economic power – a firm's ability to exert a substantial and generally predictable influence on the operation of the market.⁴ In its more recent proposal for a Council regulation on the control of concentrations between undertakings, the Commission has adopted the test of 'power to hinder effective competition in the common market or in a sub-

¹ Extensive discussions on the organization of antitrust law enforcement in the United States can be found in Carl Kaysen and Donald F. Turner, *Antitrust Policy* (Cambridge, Mass.: Harvard UP, 1959); in the *Neal Report*; and in the *Stigler Report*. The two reports, commissioned by Presidents Johnson and Nixon respectively, give an evaluation of current antitrust policies. For European circumstances see B. de Gaay Fortman, *Theory of Competition Policy* Ch. 5 (Amsterdam: North Holland, 1966), and the literature he cites.

² Fair Trading Act 1973, c. 41, §§ 6 & 7. This Act superseded the Monopolies and Restrictive Practices (Inquiry and Control) Act 1948, 11 & 12 Geo. 6, c. 66, and the Monopolies and Mergers Act 1965, c. 50.

³ Gesetz gegen Wettbewerbsbeschränkungen, 27 July 1957, § 22, [1957] Bundesgesetzblatt I 1081, as amended by Act of 3 Aug. 1973, [1973] Bundesgesetzblatt I 917.

⁴ Commission de la Communauté économique européenne, *Le problème de la concentration dans le marché commun* 25 (Brussels, 1966).

stantial part thereof.⁵ In practice this means that reference has to be had to the following criteria: the extent to which suppliers and consumers have a possibility of choice, the economic and financial power of the undertakings concerned, the structure of the markets affected and supply-and-demand trends for the relevant goods or services.⁶

If the concept of market power is to be incorporated in the law, two requirements must be satisfied: it must admit of economically acceptable interpretation and must be defined as clearly as possible in the interests of certainty as to the law. But in a sense these are conflicting requirements. Our observations on the first of them in Chapter 3 showed that quantitative criteria which are easy to apply, such as market share, can serve as *definite* proof of market power only in a very limited number of cases – those involving firms which occupy quasi-monopoly situations for a number of years at least.

In their draft antitrust statute, Kaysen and Turner propose the possession of a market share of 50 percent or more for five years or more as a test of single-firm dominance, and of at least 80 percent for the same space of time by four or fewer companies as a test of joint dominance.⁷ The White House Task Force on Antitrust Policy appointed in December 1967 puts the figure for joint dominance at 70 percent 'during at least seven of the ten and four of the most recent five base years.'⁸

The test of single-firm dominance suggested may constitute sufficient proof of market power in itself in industries with moderate to high barriers to entry if, as we said in Chapter 3, the following conditions are fulfilled: the industry as a whole must not be declining, a large part of the rest of the market must not be in the hands of a single firm (because this would be oligopoly), and one or more of the competitors must not be backed by a firm with substantially greater financial resources than the firm that would be deemed dominant on the basis of the test. If any of these conditions is not satisfied, the corrective influence that actual or potential competition has on a firm's actions cannot be ascertained except by analyzing market behavior and performance. These considerations apply *a fortiori* to oligopoly situations, in which joint dominance has to be shown. Market-structure tests to determine the degree of competition in an oligopoly need to take account of such important indicators as the height of entry barriers or the size and power relationships inside the oligopoly. On their own, quantitative criteria of the kind contained in these proposals can do no more than lead to a presumption of joint dominance. And it is only in the Task Force's proposed Concentrated Industries Act appended to its report that changes in the average market share of the four largest oligopoly firms are taken into consideration.⁹ In many cases, then, we have to pay heed to conduct and performance aspects of the relevant

market in order to determine whether market dominance exists.

With regard to the requirement of certainty in the law, however, there are material limitations to the use of performance criteria. To refer back once again to what we found in Chapter 3, many of the dimensions of workable performance are not sufficiently determinate, which implies that except where performance is extremely poor they do not provide definite proof of the existence of market power. The most practicable criterion was felt to be the size of the profit margin. For evidential reasons we can point with certainty to market power as the cause of anticompetitive performance only where a firm or group of firms has taken profits which lie well above the average return of firms in roughly similar but competitive industries over a relatively long period, and thus above the rate required to attract needed capital, without losing market share to any appreciable degree. This presumes that neither fluctuations in demand or costs nor the persistence of substantial excess capacity influences the firm's pricing policy, which is only possible if the normal functions of the market are inoperative. The requirement that observation should cover a long period is intended to make allowance for innovators enjoying high profits for a limited period of time as a reward for their risk-taking or inventiveness.

⁵ 16 *Official Journal of the European Communities* No. C 92, 31 Oct. 1973, Art. 1(1).

⁶ *Ibid.* Comparing the concept of dominant position under Article 66 of the ECSC Treaty with the notion of monopoly power under the Sherman Act, René Joliet, *Monopolization and Abuse of Dominant Position* 225 (Liège: Faculté de Droit; The Hague: Nijhoff, 1970), concludes that both relate to 'power to fix prices and exclude competition' and can therefore be equated. As 'there is no reason to believe that the draftsmen of the Paris Treaty and of the Rome Treaty would have adopted a different concept of market domination,' all three notions must be presumed to come to the same thing. We consider, however, that the more recent thinking of the Commission is more elaborate and reflects current economic views more accurately.

⁷ *Op. cit. supra* note 1, at 98, 267 (Draft Antitrust Law § 2(b)). We disregard such drastic and simplistic proposals for limiting corporate size as have been put forward by Fred I. Raymond, *The Limitist* (New York: Norton, 1947); this 'underworld literature' (Keynes, cited by Kaysen and Turner, *op. cit. supra* note 1, at 50 n.4) has quite rightly failed to gain general approval.

⁸ *Neal Report* App. A – Concentrated Industries Act § 4 (a) (i). The term 'base year' is defined as 'one of the ten calendar years, the most recent of which ended more than six months and not more than eighteen months prior to the date on which any proceeding is instituted . . .'. *Id.* § 4 (g).

⁹ *Id.* § 4 (a): 'The term "oligopoly industry" shall mean a market in which . . . (ii) the average aggregate market share during the five most recent base years of the four firms with the largest average market shares during those base years amounted to at least 80% of the average aggregate market share of those same four firms during the five preceding base years, but shall not include any market in which the average aggregate sales of all firms during the five most recent base years declined by 20% or more from such average sales during the preceding five base years.'

Actual instances of such suboptimal performance will be relatively infrequent, however. They are most likely to occur in cases of single-firm dominance, for in oligopolies there will always be *some* competition, however weak. But clear cases of persistent suboptimal performance without the firm in question losing its market share will probably be found only where the firm either (a) is backed by all kinds of natural barriers (including patents) or artificial barriers (particularly excessive product differentiation) and/or by a substantial degree of integration in both buyers' and sellers' markets or (b) has intercorporate relationships of some kind with potential competitors. If a firm lacks such a protective wall around its position, or if it considers the protection insufficient, it will no doubt opt for a policy of keeping its market share and contenting itself with a more moderate profit level rather than attract new competitors through a vigorous exploitation of its market position. Less obvious deviations from a competitive profit margin may well be taken as indicative of market power provided the situation is maintained for a number of years. It should be added, however, that application of profit standards in the borderline cases (which will be numerous) may lead to much uncertainty in the law.

It is even more difficult to find clear instances of extremely poor performance pointing to joint dominance by oligopolists because there is always some basis for competition in an oligopoly. Apart from competitive pressure which may come from outside, depending on the height of entry barriers, and from small firms in the market, there are also inherent competitive stimuli at work among the oligopolists themselves, even if oligopolists generally do prefer to compete by means other than price. Now this competitive potential may not materialize – for instance, when there are very high outlays for sales promotion. Apart from that, oligopolists have many opportunities for regulating competition other than by restrictive agreements. But it is only when complaints are made by customers about the quality of the oligopolists' performance, or by marginal competitors or others about uncompetitive behavior, that a detailed investigation of performance in heterogeneous oligopolies has any chance of success. Restrictive agreements do occur more frequently, however, in homogeneous oligopolies, where the opportunities for firms to use competitive strategies other than price are limited. In such cases it may be preferable to take action through restrictive practices legislation than to search for a poor performance record as a basis for action against market power.

Introducing the notion of market power into the law, then, implies that a number of complex economic issues have to be considered. This will not satisfy the lawyer in search of easily applicable tests.¹⁰ Moreover, this approach will not bring within the reach of the law many more cases than are already

caught by it. Any simplification of the tests – by incorporating market share as a criterion, for instance – does extend the scope of the law, but at the same time it takes us out of the domain of economic evidence into the area of mere presumption of market power.¹¹

The degree of proof of market power that is required in a law on concentrated market structures depends in the last analysis on the severity of the penalties to be imposed. There can be no question of far-reaching structural reorganization unless there is very strong evidence of market power. To extend the reach of this penalty to cases where market power is only presumed – as is sought in the quantitative proposals – is legally unacceptable. The proper remedy in cases of presumed market power should seek to correct behavior deemed uncompetitive. The final choice as to the direction the law on concentrated market power should take, then, depends on the penalties we are willing to accept.

7.1.2 The Enforceability of Direct Restraints on Market Power

Ideally, where market power is prevalent, its elimination through dissolution (breaking up a business unit into a number of parts), divorcement (separating the units in a combination) or divestiture (requiring disposal of assets) is the most effective remedy. For prohibiting a dominant firm or group of firms from abusing its power or simply from exercising it to the detriment of other market participants does not remove the cause of bad conduct and poor performance. What is more, legislation against abuse does not reach all cases of abuse, and before action can be taken considerable harm may already have

¹⁰ Mark S. Massel, *Competition and Monopoly* 167 (Washington, DC: Brookings Institution, 1962), comments: 'Above all, economists must realize that in order to be employed in antitrust, their tools of analysis must be operational – tools that fit the requirements of the legal system.' Helmut Henrichs, 'Die Abgrenzung des relevanten Marktes im Licht der neueren Rechtsprechung zum Antitrustrecht', 17 *Wirtschaft und Wettbewerb* 254, 273 (1967), asks for simplified tests. See also Kingman Brewster Jr., 'Enforceable Competition: Unruly Reason or Reasonable Rules?', 46 *Am. Econ. Rev.* 482, 484 (1956, Proceedings); Ward S. Bowman Jr., 'Toward Less Monopoly', 101 *U. Pa. L. Rev.* 577 (1953).

¹¹ Kaysen and Turner, *op. cit. supra* note 1, at 27 & Statistical App. Table 2, judged that according to their criteria market power was apparent in 108 out of a total of 164 industries studied. 'As our dividing point we have adopted, somewhat arbitrarily, a market share of one third of total market sales for the eight largest sellers, because in the majority of markets with which we are familiar, a smaller number of firms with larger shares of the market generally accompany, to a significant degree, the kind of behavior indicated above. Beyond such a dividing point, the majority of markets ... do not appear to function in this fashion.' *Id.* at 27. This has no conclusive force, however, since they did not attempt to show that competition in the industries concerned was not or had not been working satisfactorily.

been done to market relationships. But the question has to be asked how practicable a remedy dissolution is.

Dissolution will be most successful where the plants making up the firm in question are autonomous technical and commercial units and there are no preponderant economic factors justifying the combination. So when a combination is formed with a view to market dominance, with hardly any regard for economic reasons, as was the case with the early trusts in the United States, we may find, as was shown in Chapter 6, that dissolution has a good effect on competition.

Dissolution may solve much less in practice when applied to firms which have not grown solely from merger. First, there are the problems of feasibility. For instance, firms whose output emanates from a single plant or whose various plants are highly specialized, each producing different parts of a single product, cannot be dissolved without creating insurmountable technical problems. Problems arise also if a multiproduct firm has to be dissolved into several companies producing related products. If the research department cannot be split up and is attached to one of the successor firms after dissolution, this may be too heavy a financial burden on that firm and some innovational effort may be lost. But even if the agency responsible for working out a suitable reorganization plan does not have to face problems of this kind because a number of fully developed new firms can be set up and joint services such as sales and research can be split up, inherent economies of size and organization may still be lost. However, some loss of efficiency may be a low price to pay in order to be rid of market power. The only limitation on the use of dissolution or divorcement as a suitable remedy is where the loss becomes so substantial that the successor firms would no longer be competitive or would even be unable to survive. A second point is this: in those cases in which a split-up is possible, this will most often be done by separating the different departments or product groups that originally made up the company. But there is no guarantee that the successor companies will become competitors. There may have been no competition before the split-up, but there will be none afterwards either if the successor companies act in collusion. If there *was* competition between the various departments inside the original firm before dissolution, it may well be that the only positive result of dissolution will be to bring that competition into the open. At any rate there is a fair chance that some trace of the original dominance will remain and prove impossible to destroy. The likelihood of this happening and – if it does – the extent of the dominance that is left over are factors that need to be borne in mind when the effectiveness of dissolution in a given case is being assessed.¹² Finally, when dissolution plans are being drafted, care

should be taken that their sole result will not be to enable firms to discard less profitable units that for one reason or other they had not sold already. Obviously, dissolution that has this effect may even enhance market power; to say the least, it cannot be termed a serious attempt to bring it to an end.

The purpose of dissolution in oligopolistic markets is to eliminate collusive behavior. As more than one firm is involved, this may multiply the problems enumerated in the foregoing paragraph. Technically, dissolution in oligopolies may raise additional problems where the absolute size of the firms is not very large, so that only certain of the oligopolists may be candidates for a split-up. Apart from the element of arbitrariness that this introduces, a program of partial dissolution may fall short of creating the conditions for non-collusive behavior in the market if the total number of firms making up the oligopoly is not considerably enlarged.

In the light of these very clear limitations, it is remarkable that a number of economists and lawyers in the United States have declared themselves in favor of dissolution as an appropriate remedy for concentrated oligopolies in recent years.¹² Since most of the people in question are also advocates of a considerable extension of the notion of market power in the law in that they favor the introduction of market-share criteria, the implication is that they recommend dissolution in a substantial number of industries in the United States. In 1959 Kaysen and Turner estimated, as we remarked above (note 11), that 108 of the 164 industries they had studied could be considered

¹² See Donald R. Dewey, *Monopoly in Economics and Law* 254–56, 306 (Chicago: Rand McNally, 1959); J. M. Clark, *Competition as a Dynamic Process* 461 (Washington, DC: Brookings Institution, 1961); Simon N. Whitney, 'The Economic Impact of Antitrust: An Overview', 9 *Antitrust Bull.* 509, 512, 522–27 (1964).

¹³ George W. Stocking and Myron W. Watkins, *Monopoly and Free Enterprise* 563–64 (New York: Twentieth Century Fund, 1951); Corwin D. Edwards, *Maintaining Competition* 131–32 (New York: McGraw-Hill, 1949). A change in Edwards's views, however, can be seen in his *Big Business and the Policy of Competition* Ch. 4 (Cleveland: Western Reserve UP, 1956). See also Edwards, 'Public Policy and Business Size', 24 *J. Bus. U. Chi.* 280 (1951), and 'Large Enterprises and Antitrust Policy', in National Industrial Conference Board, *Public Policy Toward Competition: New Antitrust Directions* (New York, 1962); George J. Stigler, in 'Report of the Attorney General's Committee on Antitrust Policy – Discussion', 46 *Am. Econ. Rev.* 507 (1956, Proceedings); Kaysen and Turner, *op. cit. supra* note 1, at 46, 113–19, 269; Joe S. Bain, *Industrial Organization* 652 (New York: Wiley, 2d ed. 1968); Andreas G. Papandreou and John T. Wheeler, *Competition and Its Regulation* (New York: Prentice-Hall, 1954); Walter Adams and Horace M. Gray, *Monopoly in America* (New York: Macmillan, 1955); William H. Nicholls, 'The Tobacco Case of 1946', 39 *Am. Econ. Rev.* 284 (1949, Proceedings); Eugene V. Rostow, 'Monopoly under the Sherman Act – Power or Purpose?', 43 *Ill. L. Rev.* 745 (1949); Louis B. Schwartz, 'New Approaches to the Control of Oligopoly', 109 *U. Pa. L. Rev.* 31 (1960); George W. Stocking, 'The Rule of Reason, Workable Competition and Monopoly', 64 *Yale LJ* 1107 (1955); *Neal Report*.

unreasonably highly concentrated. Given the trend of concentration since then, the figure could presumably be somewhat lower now. And if congressional approval were to be gained for a bill under which market power would be determined by market share, a number of firms could be expected to try to bring their market share below whatever figure became the statutory criterion. However, the number of industries open to attack would still be appreciably higher than is possible under the current interpretation of the law.

The most detailed proposals along these lines have been put forward by Kaysen and Turner and by the White House Task Force on Antitrust Policy. Whereas Kaysen and Turner do not say exactly how far dissolution or divestiture should go, the Task Force specifies that in oligopoly industries as defined in its Concentrated Industries Act concentration should be reduced so that 'the market share of each oligopoly firm in such oligopoly industry does not exceed 12 percent.'¹⁴ Both proposals make provision for technical exceptions in that division of the assets of a single plant will not be allowed, and relief will also be forbidden when it would result in a probable permanent loss of substantial economies or in one or more of the successor firms being deprived of reasonable prospects of survival. Both proposals also suggest that a firm should not be ordered to dissolve if some other remedy such as prohibition of specified business practices for a trial period might have a better impact on performance. However, the authors consider that the actual exceptions involved would not be very numerous. Kaysen and Turner doubt that there would be many cases of dissolution causing a substantial loss of efficiency as a result of the departure of skilled staff and the loss of economic advantages in large-scale buying, selling or financing. The Task Force observes that superior management talent or other unique resources may be transferred; it also points out that even if there were some loss of efficiency in the process of reducing concentration this would not unfavorably affect market performance since 'efficiencies belonging to or achieved by a firm with some degree of monopoly power may be reflected only in higher profits rather than lower prices,' so that dissolution or divestiture 'would increase the chance that such efficiencies would be passed on to consumers through competition.'¹⁵

Apart from the fact that these proposals seem largely to ignore the basic practical difficulties involved in dissolution as spelled out before, any extension of the scope of the law to cases in which market power is not definitely proved but only presumed (and this, as we have shown, is implicit in the proposals) raises serious problems of legal and economic desirability.¹⁶ For a complete reorganization of major parts of industry by a large-scale dissolution program could scarcely be effected without incurring important temporary or permanent losses of efficiency on a national scale which would not be offset

by better performance in other dimensions. Consequently, extensive dissolution might have serious macroeconomic repercussions as well. For if efficiency diminishes substantially as a result of dissolution – even though this may only be a transitory phenomenon until the newly created firms begin to operate satisfactorily – growth in production may lag behind that of other industries. If this should occur frequently or in vital industries, not only may the current growth rate of GNP, the level of unemployment and the domestic price level be adversely affected but also the balance-of-payments position if export industries are involved. Rigorously limiting the permissible size of market shares may impede future growth too if expansion is barred that would be desirable in view of the employment situation, for instance, or if it leads to inertia in management policy.¹⁷ The mere fact that uncertainty is inherent in any kind of attempt to exert political influence on economic life, as certain proponents of enlarging the scope of the law assert,¹⁸ is not sufficient reason for ignoring these potential economic repercussions.

The only firms possessing market power that may escape dissolution under these rigorous proposals are those whose power was created and maintained either by economies of scale or by lawfully acquired and lawfully used patents or by 'low prices or superior products attributable to the introduction of new processes, product improvements or marketing methods, or to extraordinary efficiency of a single firm in comparison with that of other firms having a substantial share of the market.'¹⁹ Since a successful appeal to these 'justifications' would be the only way in which a firm could evade dissolution, they would occasion sharp conflicts of interpretation. Kaysen and Turner themselves construe them narrowly, believing that not many firms challenged would

¹⁴ *Neal Report* App. A – Concentrated Industries Act § 1 (e). On the other hand, the *Stigler Report* § III. B refuses to endorse any attempt to engage in a program of extensive dissolution in oligopolistic industries.

¹⁵ Kaysen and Turner, *op. cit. supra* note 1, at 269 (Draft Antitrust Law § 3 (b)), 116–18; *Neal Report* II-11.

¹⁶ For a good discussion of the *Neal Report* and the economic issues involved in such structural proposals (see also Chapter 3 *supra*), see Lucile S. Keyes, 'The Proposed Concentrated Industries Act: A Critique', 15 *Antitrust Bull.* 469, 472–76 (1970).

¹⁷ This aspect is mentioned in Edith T. Penrose, *The Theory of the Growth of the Firm* Ch. 2 (Oxford: Blackwell, 1959); Corwin D. Edwards, Review of Kaysen & Turner, *Antitrust Policy: An Economic and Legal Analysis*, 50 *Am. Econ. Rev.* 1102 (1960).

¹⁸ Edward S. Mason, *Preface* to Kaysen and Turner, *op. cit. supra* note 1, at xx-xxi; Kaysen and Turner, *op. cit. supra* note 1, at 98; Mason, 'Market Power and Business Conduct: Some Comments on the Report of the Attorney General's Committee on Antitrust Policy', 46 *Am. Econ. Rev.* 471 (1956, Proceedings), reprinted in *Economic Concentration and the Monopoly Problem* Ch. 19 (Cambridge, Mass.: Harvard UP, 1957).

¹⁹ Kaysen and Turner, *op. cit. supra* note 1, at 78–79, 268.

escape under the relevant clauses of their draft statute.²⁰ We agree with what they say as far as single-firm dominance is concerned. The number of dominant firms, excluding natural monopolies, that have maintained their market power over the years solely by means of the factors set out in these escape clauses is surely very small. With oligopolies this may well be different, since the competition inherent in heterogeneous oligopolies in particular means that there will always be instances of very good performance to which the oligopolists can point.

Nor is it to be expected, in view of the restraint hitherto exercised by judges in ordering dissolution as a remedy under the Sherman Act, that they will look unfavorably on claims by defendants that their market power is justified. Such an attitude is especially to be looked for when a judge has to decide whether firms in high-technology industries should be dissolved; the great difference between the tone of the judgment and the actual remedy ordered in more recent cases under Section 2 of the Sherman Act – except where technically simple products and services such as central alarm systems and movie theaters were involved – that we encountered in analyzing the case law is significant.²¹ The fact that the new act proposed by the Task Force on Antitrust Policy, unlike existing legislation, makes no provision for criminal penalties or for private actions seeking treble damages does not in our view invalidate this point.

However, where firms appeal to these escape clauses, there will be lengthy submissions by the parties concerned, with or without testimony from expert witnesses, and the courts may have to weigh difficult issues of management policy. Cases of this kind may then take as much time as do cases under the existing Sherman Act, which drew the following remarks from Judge Wyzanski in *Grinnell*:

This Court is mindful that in recent years antitrust litigation, particularly government civil actions alleging violations of Section 2 of the Sherman Act, have involved an enormous, nearly cancerous, growth of exhibits, depositions, and *ore tenus* testimony. Few judges who have sat in such cases have attempted to digest the plethora of evidence, or indeed could do so and at the same time do justice to other litigation in their courts.²²

As well as the proposals put forward by Kaysen and Turner and the Task Force on Antitrust Policy, a number of bills have been introduced in both House and Senate of the United States Congress. These have been aimed chiefly at existing oligopoly and monopoly situations, it being felt that enforcement of the present antitrust laws fell short in this respect and that the best solution would be to make specific regulation in contrast with the general

language of the Sherman Act in this area. At the moment there are three bills pending for hearing in the appropriate congressional committees, two of them introduced at the end of 1971 (S. 2614 by Senator Fred Harris and HR 12004 by the then House Judiciary Committee Chairman Emanuel Celler) and one introduced in June 1972 and reintroduced in March 1973 by Senator Philip Hart, Chairman of the Subcommittee on Antitrust and Monopoly of the Senate Judiciary Committee (S. 1167). All three bills draw substantially on the conclusions of Kaysen and Turner and of the Task Force. The Hart bill, the fruit of years of study on the problems of concentration in the Subcommittee chaired by the Senator and his predecessor Senator Kefauver, is the most interesting, and we shall briefly examine this particular proposal.

Hart sees a direct link between inflation and unemployment in the United States economy and the existence of many concentrated markets. His bill – the Industrial Reorganization Act – would outlaw monopoly power in any line of commerce in any section of the country or with foreign nations and provides for its elimination. There would be a ‘rebuttable presumption’ that monopoly power is possessed:

- (1) by any corporation if the average rate of return on net worth after taxes is in excess of 15 per centum over a period of five consecutive years out of the most recent seven years preceding the filing of the complaint [by a Commission provided by the bill], or
- (2) if there has been no substantial price competition among two or more corporations in any line of commerce in any section of the country for a period of three consecutive years out of the most recent five years preceding the filing of the complaint, or
- (3) if any four or fewer corporations account for 50 per centum (or more) of sales in any line of commerce in any section of the country in any year out of the most recent three years preceding the filing of the complaint.

A corporation possessing monopoly power would escape divestiture if it can

²⁰ They assume that ‘scale economies . . . to the firm in the relevant size range . . . are not widespread’ (*id.* at 116); they agree that ‘the patent office is applying far too loose a standard of patentability’ (*id.* at 171) and consider that the ‘basic patents’ and ‘superior product’ categories are ‘quantitatively unimportant’ (*id.* at 79).

²¹ See District Judge Wyzanski’s observations on this point in *US v. United Shoe Mach. Corp.*, 110 F. Supp. 295, 345 (D. Mass. 1953), quoted in Chapter 4 *supra* (text accompanying note 186).

²² *US v. Grinnell Corp.*, CCH 1964 Trade Cas. ¶ 71 298, at 80 245 (D. RI 1964).

show that its power 'is due solely to the ownership of valid patents, lawfully acquired and lawfully used' or that 'a divestiture would result in a loss of substantial economies.'²³

Enforcement of the law would be entrusted to a new agency, the Industrial Reorganization Commission, whose functions and powers would be transferred after fifteen years to the Federal Trade Commission. The new Commission would take action after studying the structure, performance and control of seven industries deemed to have the greatest impact on inflation and to contribute the most to unemployment problems, i.e. chemicals and drugs, electrical machinery and equipment, electronic computing and communications equipment, energy, iron and steel, motor vehicles, and nonferrous metals. In addition, the Commission would study collective bargaining practices in these industries to determine the effects of those practices on competition and would make recommendations to Congress.²⁴ Another novelty of the bill is the institution of a specialized administrative court – the Industrial Reorganization Court – that would have all the powers of a federal district court. The Court would determine whether a corporation or corporations do possess monopoly power, as maintained by the Commission, and whether or not the proposed reorganization plan would restore effective competition. Orders of the Court could include but would not be limited to (1) requiring a corporation to terminate an agreement with another corporation or to modify a contract or its methods of distribution, (2) requiring a corporation to grant licenses (with or without provision for the payment of royalties) under any patent, copyright or trademark it owns, or dispose of any patent, copyright or trademark, or share technical information with others, or (3) requiring a corporation to divest itself of particular assets, including tangible and intangible assets, cash, stock, securities, accounts receivable, etc. An appeal from an order of the Industrial Reorganization Court would go direct to the Supreme Court.²⁵

Although the general purpose of the bill certainly accords with the wishes of many who would like to see an economically more correct approach to existing economic power in American antitrust legislation, it is likely that its enforcement would come up against the same kind of difficulties as we observed in respect of Kaysen and Turner's proposed law and the Task Force's Concentrated Industries Act. But quite apart from these problems of substance, it seems highly improbable that such far-reaching proposals stand a chance of being passed by the Congress against opposition from the influential big-business lobby. Big business is currently attempting to convince members of Congress that the antitrust laws ought to be relaxed rather than strengthened, stressing increased import competition and alleging that the laws hamper American firms in competing with foreign companies.

To summarize, we see no chance of direct restraints being enforceable except where the existence of market power is shown beyond peradventure and there are no technical obstacles to splitting up the apparatus of production and service departments without occasioning substantial loss of economies. Although this might still permit the use of dissolution on a rather larger scale than at present, the remedy can never achieve the currency envisaged by the draft antitrust statutes we are considering here. Moreover, the practical consequence of accepting proposals of this type would be that the courts would have to concentrate on the escape clauses, and the simplification that the new statutes are designed to bring about in the enforcement of the law would prove to be illusory.

7.1.3 The Enforceability of Restraints on Conduct

A second major antitrust approach to market power is to mitigate its impact by forbidding acts deemed to be abusive. This approach has much less support in the United States than it has elsewhere because economic power in the United States is fairly readily regarded as suspect in itself. The remedy generally prescribed under the Sherman Act is to break up positions of power which have been created or maintained unlawfully, whereas other countries confine themselves to outlawing abusive practices. Then there is the other difference that although certain interpretations of the notion of monopolization compare with what in Europe, for instance, is prohibited as abuse of economic power, this notion in American law is limited to exclusionary behavior.²⁶ In the competition laws of the European Community and its member states, the principal emphasis is on performance aspects of dominant-firm behavior such as price policy and production policy (restriction of output). For reasons pointed out earlier in this chapter, remedial action in the form of prohibition of abuse has the major initial advantage that suit may be filed

²³ S. 1167, 93d Cong., 1st Sess., § 101 (1973).

²⁴ *Id.* § 203.

²⁵ *Id.* §§ 303-04.

²⁶ Proposals have been made, however, to extend the current statutory test of monopolization to include instances of unsatisfactory market performance. See Clare E. Griffin, *An Economic Approach to Antitrust Problems* (New York: American Enterprise Ass'n, 1951); Business Advisory Council, *Effective Competition* (Washington, DC: Department of Commerce, 1952); S. Chesterfield Oppenheim, 'Federal Antitrust Legislation: Guideposts to a Revised National Antitrust Policy', 50 *Mich. L. Rev.* 1139 (1952); Blackwell Smith, 'Effective Competition: Hypothesis for Modernizing the Antitrust Laws', 26 *NYUL Rev.* 405 (1951); Robert H. Bork, 'The Rule of Reason and the Per Se Concept: Price Fixing and Market Division', 74 *Yale LJ* 775 (1964) and 75 *Yale LJ* 373 (1965).

on a *presumption* of market power. In practice, this means that market-share criteria can usually be adopted because they are generally ready to hand and easily manageable without special knowledge of economics. Market-share criteria such as those set forth by Kaysen and Turner in their draft antitrust law and by the White House Task Force on Antitrust Policy in its proposed Concentrated Industries Act may serve as a guide to the administration or the courts, but it would seem less appropriate to incorporate such criteria expressly in actual statutes because certain market situations where competition does not function properly might then fall beyond the reach of the law – apart from the fact that companies might deliberately attempt to keep their market share below whatever quantitative indicium of market power were written into the law.

There are two possible ways of defining abuse by dominant firms. The first is to regard the public interest as the test; the other is to enumerate specific forms of market behavior. Reference to the public interest undoubtedly gives the law the flexibility that is needed, since the meaning of this concept will change in the course of time along with the political views of the community concerned. On the other hand, the administration and the courts may entertain different ideas as to what constitutes the public interest, and this is assuredly not conducive to certainty in the law. A more serious objection to this test is that it gives the government very wide powers to judge the most varied aspects of corporate policy, and that might well result in permanent supervision with all its attendant drawbacks (including the risk of arbitrary decisions). The better of the two approaches, then, would appear to be to specify in the law reprehensible types of conduct by dominant firms. Here too, however, difficulties may arise. If the law defines the forbidden categories too precisely, a firm will generally be able to work out a new strategy not mentioned in the law that will permit it to achieve the purpose it was aiming at when employing the practices now prohibited. Too broad and imprecise a definition, however, may conflict with the need for certainty in the law. We saw in Chapter 3 that there are relatively few types of market behavior by a dominant firm which can be considered *per se* abusive; the abusive nature of many other business practices can only be established on the basis of evidence concerning their impact on competition. The best way to proceed is by a general formula combined with a nonexhaustive enumeration of examples of reprehensible behavior in the law.

What kinds of market behavior by a dominant firm can be reached by such legislation? First, all sorts of typically exclusionary practice. As we observed in Chapter 3, conduct that is reprehensible in all circumstances is a rare category nowadays, the most current examples being geographic price discrimi-

nation, abuse of integration, forced merger and abuse of a patent monopoly. Certain practices occurring as a consequence of integration are particularly reprehensible if they lead to harsh practices such as price squeezing or outright refusal to deal. But there are more subtle ones that discriminate against competing nonintegrated firms, such as charging higher prices and/or quoting long delivery dates without clear economic justification. Outright interdiction of integration, which would mean complete divestiture of the already integrated parts, would be too severe a penalty, however, and would only be warranted if market dominance were definitely proved. The preferred approach here, therefore, would be to forbid in general terms such use of integration as discriminates against nonintegrated competitors, with a possible reference to some of the practices mentioned above by way of example. The abusive character of forced merger can be seen not only in the harm done to the firm that is taken over but also on occasion in the injury caused to the competitiveness and growth potential of other firms, which may eventually lead to the disappearance of competition on that part of the market that is not under the dominant firm's control. It is of primary importance that those competition laws which, unlike the American antitrust laws, have no provisions on merger should prohibit absorption of the remaining competitors in highly concentrated industries.

More numerous and more frequent – and therefore more important – than the *per se* abuses are those forms of behavior which, though not reprehensible taken by themselves, may, when used by a dominant firm in a certain way, substantially foreclose other market participants' means of evading the power of the dominant firm. This second category of abusive behavior by dominant firms includes a large number of practices which were described in some detail in Chapter 3. Some of them lend themselves to extremely precise definition in the law. This is the case, for instance, with exclusive dealing agreements, tying contracts, refusals to deal and resale-price maintenance, which should be forbidden outright if entered into or practiced by a dominant firm. Likewise, all sorts of discrimination toward customers, be it by charging different prices or by imposing different terms of sale without clear economic justification, constitute abuse when employed by a dominant firm and should accordingly be prohibited. Considerable influence can also be exerted on competition by means of trademarks. Finally, reciprocal buying should be forbidden when either a parent or an affiliated company uses its purchasing power to insist on the practice.

But then there are a number of practices for which it is more difficult to draft precise criteria in terms of abuse, particularly with cases of poor performance that are the result of market power. In Europe both national and

supranational legislation includes examples of poor performance as categories of abuse. Article 86(b) of the Rome Treaty, for example, specifically refers to the limitation of production, sales or technical advance to the prejudice of consumers as an instance of abuse. This does not imply, incidentally, that the Treaty considers poor performance the only kind of abuse – a view that has been advanced by some who feel that the drafters of the Treaty were indifferent to how market power had been secured or retained and were concerned solely with the exercise of market dominance to the detriment of buyers and sellers.²⁷ This view seems hardly tenable since it is precisely the influence of competitors (actual and potential) on the dominant firm which determines its freedom of action toward buyers and sellers. According to this theory, the Treaty would tolerate a restriction of competitive influence motivated solely by the lust for power and would only intervene if it resulted in exploitation of other market participants. If we accept the theory, moreover, direct control of the performance of dominant firms is the only way left to intervene. The logical assumption surely is that exclusionary behavior does come within the scope of Article 86(b).

The incorporation of poor performance as a category of abuse in competition legislation raises problems of its own, however. Extension of the administration's powers under the law to cases of unworkable performance must be considered a precarious exercise because it may possibly encroach upon the normal operation of the dominant firm.²⁸ In Chapter 3 we repeatedly made the point that a firm's conduct is closely linked with the position it occupies in its market or industry, in the country's economy as a whole, or even beyond the national frontiers. We can hardly expect a company with a dominant market position to behave as if it were facing strong competition. And not every act of a dominant firm must necessarily be unacceptable, must always be worse than an act accomplished in competitive circumstances. But if the whole range of a dominant firm's behavior is to be subjected to such a test, the government can easily make it impossible for the firm to function, which amounts to a *de facto* prohibition of dominance. For this reason, only a limited number of performance categories should be incorporated in the law. Even then, the borderline between acceptable and unacceptable performance is generally hard to define because it is very difficult to compare the actual with a hypothetical situation, so it may be inevitable that a voluminous case law will develop on the statutory tests of abuse. Finally, problems arise as to the kind of penalty to be imposed if performance is found to be unsatisfactory. If a repetition of unworkable performance is to be avoided, there will have to be virtually permanent government supervision of all the firm's operations, including control of the funds allocated to technical im-

provements and innovation. Such a policy is clearly outside the proper sphere of antitrust.

The policy guidelines outlined above apply both to single-firm dominance and to jointly held market power. As was shown in Chapter 4, American antitrust policy on oligopoly has focused on finding instances of collusion or conspiracy. The enforcement agencies have made various attempts, not always endorsed by the courts, to extend this to typical acts of conscious parallelism resulting in uncompetitive behavior. President Nixon's Task Force on Productivity and Competition has suggested going further in this direction by instituting proceedings against leading firms under Section 1 since 'collusion that can be incontrovertibly inferred from behavior . . . should not bring immunity from the Sherman Act . . .'.²⁹ Such an approach might of course avoid many of the difficulties enumerated above and thus shorten the length of trial. However, as we saw in Chapter 4, the history of intervention in oligopolies under Section 1 has not been very promising. For it raises insurmountable problems of penalizing conscious parallelism which is a direct consequence of the structure of the market.

We may conclude from the foregoing that a competition policy designed to prohibit abuse by dominant firms will have to concentrate on cases of abusive market conduct with the particular aim of keeping alive whatever competition remains in that part of the market not controlled by the leading firms. If the enforcement agencies are to be empowered to take action where there are departures from the performance one would expect in a workably competitive environment, these should be strictly limited to only a few categories of performance that is so poor as clearly to suggest the absence of workable competition which do not raise too many problems of fact-finding. At any rate, the government's case should be based on an investigation of the firm's pricing and production policies. For, as was shown in Chapter 3, the height of prices or profit margins should primarily be assessed on whether production costs properly reflect the efficiency attainable. Challengeable types

²⁷ This interpretation is vehemently defended by Joliet, *op. cit. supra* note 6, at 125-33, 241-52.

²⁸ See Jean-Pierre Dubois, *La position dominante et son abus dans l'article 86 du traité de la CEE* 9 (Paris: Librairies techniques, 1968), and the *Preface* by Berthold Goldman, who considers that the concept of abuse should be extended to cover all cases in which a dominant firm derives benefits from its dominance that it would not have obtained otherwise. See also A. Marchini-Camia, 'La concentration industrielle, les positions dominantes sur le marché et le droit antitrust: l'expérience américaine et les problèmes européens', 7 *Revue trimestrielle de droit européen* 353 (1971), who likewise agrees with the views outlined here.

²⁹ *Stigler Report* § III. B.

of abusive behavior might include those enumerated in Article 86 of the EEC Treaty (imposition of unfair prices or limitation of production, sales or technical development to the prejudice of consumers) and excessive forms of product differentiation, since these provide oligopolists with many ways of keeping potential competitors at a distance while the costs inherent in it raise prices unnecessarily without benefiting consumers. Again, where single-firm dominance may produce these results, it may be less easy to find them in an oligopolistic market setting. But mentioning these practices in the law may have a preventive effect as well: firms will at least make sure that they do not provide manifest examples of uncompetitive behavior.

7.1.4 Conglomerate Power and the Antitrust Laws

As long as there is no conclusive proof that conglomerate bigness as such is interfering with market mechanisms, antitrust policy may only intervene where one of the affiliates of a conglomerate firm is engaged – alone or with others as part of an oligopoly – in uncompetitive behavior in its market. Now most of the instances of anticompetitive behavior mentioned in Chapter 3 that are generally considered to be the typical outflow of conglomerate power boil down to cases of abuse of market power by one or more of the firm's affiliates. One of the instances of abuse most frequently cited in competition theory is that conglomerate firms are in a position to apply predatory pricing tactics. In practice, however, such tactics have only seldom been shown to occur, and if they do occur they are not possible unless the conglomerate is in a position to make monopoly profits somewhere and to transfer them. The antitrust problem, then, is to eliminate the monopoly segment of its organization or to prevent the affiliate with the strong market position making such profits. Another frequently voiced complaint of anticompetitive effects flowing from conglomerate bigness as such is that there is a community of interest between conglomerate firms meeting as actual or potential competitors in a number of markets. However plausible this may be if the firms are in strong market positions, proof that anticompetitive effects have flowed from it is essential before any indictment can be made under competition laws. Such proof is virtually impossible to supply except where it can be shown that agreements restraining competition between the conglomerates or management interlocks exist. Under certain circumstances, jointly owned subsidiaries may constitute a meeting place for discussing joint interests other than the running of the subsidiary's business, though it may be difficult to infer evidence of agreement or conspiracy from such discussions. However, apart from management interlocks, interlocking directorates held by banks in several actually or potentially competing conglomerates should be of concern to en-

forcement agencies also, since this may give the banks the potential for exerting an anticompetitive influence on decision-making in these corporations. Another business practice that is more particularly related to conglomerate bigness is reciprocal buying. But we have seen from theoretical considerations and from actual experience (*Consolidated Foods*) that the practice may not be sufficiently successful to create anticompetitive effects under all circumstances.³⁰

Finally, there is the charge sometimes leveled at conglomerate firms that even without operating from a dominant position on some of its markets the affiliate of a conglomerate nevertheless has an advantage over competitors that do not have the backing of a financially powerful parent company and is thus able to distort competition. The Federal Trade Commission had to consider a case of this nature in *Procter & Gamble*, where a major point was whether the heavy advertising outlays that Clorox could afford after it had been acquired by Procter & Gamble were permissible as long as its competitors had no such links with other big manufacturers.³¹ Although there was some indication in this case that Clorox's sales strategy might clearly disadvantage its competitors after the acquisition, there may be innumerable other cases in which an indictment would be at the outer limits of the reach of competition policy – on the borderline between competition that is hard but still fair and competition that is unfair, and on the borderline beyond which the danger becomes palpable that measures of competition policy protect competitors rather than competition. It is a matter of opinion whether, apart from instances of abuse mentioned in the foregoing section, we regard any action by a financially powerful firm designed to reinforce its position as harmful to competition because it may threaten competitors with smaller pockets. If we accept this standpoint, then in fact we oblige the biggest firms to freeze their present position, removing any incentive for them to develop their growth potential.

From the competition viewpoint, any policy action aimed at limiting the power of conglomerate firms must be very circumspect until more information is available on the influence of conglomerate strategies on performance. Here lies a particularly fruitful field of research for economists and lawyers alike.

³⁰ *FTC v. Consolidated Foods Corp.*, 329 F. 2d 623 (7th Cir. 1964), *rev'd*, 380 US 592 (1965). This case is discussed in Chapter 5 *supra*. For further evidence regarding the apparently limited extent of reciprocal dealing, see F. M. Scherer, *Industrial Market Structure and Economic Performance* 280–82 (Chicago: Rand McNally, 1970), and the literature he cites.

³¹ In the Matter of *The Procter & Gamble Co.*, Dkt. 6901, CCH 1963 Trade Cas. ¶ 16 673, at 21 574 (FTC opinion and final order 1963).

The importance of research in this field becomes all the more apparent when the great impact that mammoth enterprise may have on the attainment of macroeconomic goals and in the social and political sphere is taken into account.

7.2 MARKET POWER: THE LIMITATIONS OF INSTRUMENTS OTHER THAN ANTITRUST

In view of the clear limits to what antitrust policy can achieve by way of remedying instances of unworkable competition on concentrated markets, we should consider whether other instruments of economic policy or other governmental activities – such as procurement and sale of goods – or other means of exerting political influence on competitive conditions cannot offer some way of tackling the problems of market power that are not amenable to solution by the antitrust approach. So many different factors come into play here that it would be impossible to go into the matter in any great detail. We shall simply make a few observations on aspects of these policies that could be strengthened or modified in order to bring them more closely into line with the goals of competition policy without embarking upon an inquiry into the consequences of alternative policies in these fields on the pursuit of macroeconomic goals.

Trade policy is of major importance in this respect because of the very great role that actual imports or the threat of imports may play in limiting the influence of dominant firms. For trade barriers have proved to be among the most effective barriers shielding markets from the rigors of competition. There are many examples of the beneficial influence of removal of trade barriers on competition. A prominent one is the elimination of import duties between EEC member countries, which has caused firms enjoying a monopoly position in their own country to lose it. Then there is the spectacular rise of imports in the United States in recent years, which have made serious inroads not only into relatively unconcentrated industries such as shoes and textiles but also into highly concentrated ones such as automobiles, steel and consumer electronics. Although certain imports, especially from Asia, have doubtless benefited from low wages in the exporting country, there are other factors of equal importance that go to explain their success. First, there is the fact that a number of these industries are lagging in introducing more efficient production methods and more dynamic management methods whereas the foreign producers have adapted to the most efficient techniques. And it is against these industries that the Asian and European import drive is directed – not

toward those advanced-technology sectors (such as industrial electronics and aerospace) in which American industry still has a decisive advantage. Another factor, if only in the highly concentrated industries (particularly steel), has undoubtedly been oligopolistic pricing methods, leading to downward price rigidity and fairly high profit margins. However, the import drive has also been assisted by the successive cuts in import duties agreed during the Kennedy Round. As this is not the place to investigate these influences thoroughly, interesting though such an exercise might be, let us sum up by observing that since trade policy can be dictated by the interests of specific industries and not by overall welfare considerations, enhanced opportunities for foreign producers may well turn against them as new trade barriers are erected (prominent among them quantitative restrictions and nontariff barriers). The American scene offers interesting examples of this. So trade policy has great potential as an instrument for effectively undermining market power, provided the ultimate use that is made of it is in conformity with a policy of promoting workable competition and provided it concentrates on keeping markets open as far as possible to fair competitive opportunities from outside.

If it is not practical politics – at least, not in the short term – to lower entry barriers by easing import restrictions, other means of doing so should be sought. The possibilities are manifold, though not all are practicable in the near future. One area in which entry barriers could be lowered is the way patent laws are applied. The influence of patent laws on performance is a matter of controversy. Opinions may differ about the pros and cons of lengthy patent protection, but it is undeniably a formidable weapon that can be used by big firms to maintain a lead in their field. The German approach of granting full-term patents on basic inventions only and charging a steeply rising annual renewal fee may remove some of the drawbacks inherent in the long life of the patent right. There is also room for considerable discussion on the desirability of compulsory licensing under certain circumstances: though often proposed in the United States, compulsory licensing has not gained congressional approval, as it has in other countries, and in fact it has been decreed by the courts only as a result of antitrust suits.³² However, as a means of ensuring that cross-licensing does not make it impossible for smaller firms to keep up with and put into practice modern technical developments, the recommendation made by the White House Task Force on Anti-

³² Cases are summed up in the Staff Report of the Subcommittee on Patents, Trademarks and Copyrights of the Senate Committee on the Judiciary, 86th Cong., 2d Sess., *Compulsory Patent Licensing Under Antitrust Judgments* (1960).

trust Policy – ‘legislation to establish the principle that a patent which has been licensed to one person shall be made available to all other qualified applicants on equivalent terms’³³ – deserves serious attention because exclusive licensing is a current practice. It has also been suggested in the United States that provisions should be included in the corporation laws that would set a limit to one company’s holdings in another company and would oblige very big firms to disclose in their annual reports more details concerning their assets and activities than is generally required at the moment.³⁴ Other countries already require obligatory reporting, though the requirement extends also to medium-sized businesses and is predominantly designed to keep stockholders, workers and, of course, creditors informed. Product differentiation, especially where backed by large advertising campaigns, may also constitute an insuperable obstacle to entry. The question is, however, what strategies designed to maintain product differentiation should be opposed and what policies for combating it should be pursued (one of the options being taxation of advertising expenditure above a specified limit).

The entry of small and medium-sized firms could be facilitated by a policy aimed either at helping them to reach a suitable plant size or at affording them some of the advantages normally enjoyed by larger firms only. However, such a policy should not be directed toward prospective entrants alone: it should be particularly concerned with the position of the smaller firms already established in highly concentrated industries. Without going into the background of current policies to protect small business, we should perhaps make a few remarks as to how its role as a competitor of the big firms could be reinforced. From the standpoint of workable competition such policies are desirable chiefly in industries where the smaller firms constitute an indispensable curb on the giants’ opportunities of exercising power. Basically, there are two fields in which it would be most fruitful to strengthen the position of these firms – access to sources of finance and research. In extremely capital-intensive industries, a category which includes many of the highly concentrated basic industries, the lack of facilities for raising funds is a major bottleneck, and many problems would be solved for small firms if the bottleneck could be cleared. Small companies generally lag behind their big competitors in respect of research facilities too, and it would help them to cope in a number of cases, depending on entrepreneurial preparedness, if they were allowed to set up joint research centers or otherwise exchange technical experience through cooperation agreements. While legislation in Europe offers considerable scope for this, the American antitrust laws, particularly Section 1 of the Sherman Act, may stand in the way of agreements for this purpose; this is not conducive to the creation of workably competitive conditions. On both of these

points it would be wise not to limit action to the smallest firms only but to include medium-sized firms as well.

Efforts to strengthen the position of small and medium-sized firms in the economy should also be directed toward ensuring that the treatment they get in the allocation of government procurement contracts is as nearly equal as possible to that accorded the big firms and toward ensuring that the laws, especially tax laws, do not discriminate against them. The influence that certain forms of government procurement – buying capital goods (particularly for defense purposes) and spending on research – exercise on economic life and indirectly on the structure of the economy is very great. Here, the big firms will generally be in the best position to fulfill major contracts quickly, whether for goods or for research. And as a by-product of research a firm may well make discoveries for which it can find an application. This undeniably increases the lead that big firms have over their small competitors, which lack production and research facilities on a large enough scale. While we are unaware of any study that has been made of the impact of government procurement on the structure of the economy in Europe, its influence will surely be much less than it is in the United States, particularly in the field of defense contracts, on which the United States government spends much more than European governments, and in space activities.³⁵ However, a discussion on how smaller firms may more actively participate in these fields of government procurement policy lies outside the scope of our study.

Discrimination against small firms may be inherent both in indirect and in direct taxation. The cascade system of indirect taxation, for instance, is to the advantage of integrated firms, and a changeover to the system of taxation on value added such as has been effected in the European Economic Community obviously removes this discrimination. As for direct taxation, the facility of setting losses in one part of the business off against profits in another part not only favors multiproduct and conglomerate firms but also constitutes an important motive for merger. Further, profits plowed back into a company are either taxed just as heavily as dividends or, in Germany, Belgium and France, are taxed considerably more heavily (though there are technical differences between the German system and the Belgian and French). Because

³³ Neal Report 7.

³⁴ Edwards, *Big Business and the Policy of Competition*, *op. cit. supra* note 13, at 119–20, and 'Large Enterprises and Antitrust Policy', *supra* note 13, at 15.

³⁵ See our comments in Chapter 6 *supra* and Kaysen and Turner, *op. cit. supra* note 1, at 221–29 (and the literature they cite).

of the difficulties that small and medium-sized firms encounter in borrowing funds, they are obliged to rely on reinvestment of earnings as their major source, but tax treatment of this kind can have an appreciable impact on their scope for reinvestment. On this last point it should be observed, however, that making it financially attractive for firms generally to retain earnings has the major macroeconomic drawback of channeling still more funds outside the regulatory function of the capital market, which is not consistent with a policy aiming at a reduction of economic power.

A third major field in which government policies may affect dominant firms' freedom of action is short-term economic policy. Assuming that price policy is the most suitable instrument with which to supplement antitrust policy (admittedly an arguable assumption), there is still the question whether it is a useful instrument for improving the performance of monopolistic industries, and the evidence here seems not very convincing – at least not as far as general price controls in peacetime are concerned. Further, a policy of price stabilization can be evaded by product differentiation (with or without quality changes), but this creates a new product that can only be sold in sufficient quantities if enough money is spent on advertising, and that is easier for big firms. So the only field in which price controls may serve a useful economic purpose and be effectively employed is in homogeneous oligopolies, as is shown by the occasional presidential ban on price increases in the American steel industry. Another short-term-policy instrument is credit restrictions. In practice, however, these often discriminate against small and medium-sized firms since big firms can find numerous ways of evading their impact, either because they are in a strong financial position with substantial facilities for drawing on retained earnings or because they can raise funds through affiliates in countries which are not restricting credit.

Antitrust policy can be supplemented or corrected by other forms of political influence on market conditions too. There are various possibilities within the present social and economic system. First, there are the opportunities offered by countervailing power.³⁶ As a practical alternative to high seller concentration in specific markets, concentration on the other side of the market as a means of activating competition will work only in the retailing sector of the economy through department stores, voluntary chains and purchasing combines. But it seems not to provide any significant check on the power of big sellers advertising on a national scale. Moreover, the distribution side is often more highly concentrated than the production side, at least in regional markets for nondurable consumer goods, so that it is not at all certain that the consumer will benefit from whatever economies may flow to retailers because of their countervailing power.³⁷ In manufacturing industry there is

much less need for countervailing power – not only because the expertise of the industrial buyer is far greater than that of the final consumer but also because he can often turn to alternative sources of supply. Nor is it proved that the other forms of countervailing power enumerated by the theorists – power exercised by the labor unions and by government – are necessarily conducive to macroeconomically more satisfactory solutions. For the groups which are supposed to exercise this countervailing power may have interests that are by no means opposed to those of the industrial monopolies, while those who do not belong to one or other of these various power groups may tend to get overlooked.³⁶

Other ways of influencing market conditions within a free-enterprise system include encouraging the formation of consumers' associations, increasing the glare of publicity on leading firms and bringing moral suasion to bear. Subjecting the position and conduct of leading firms in highly concentrated markets to appropriate publicity will make them loath to pursue aggressive policies toward weaker competitors, customers and suppliers and may make them more dynamic. This can be done by publicizing reprehensible conduct and mediocre or bad performance either through government press releases or by congressional hearings. That a great deal can be achieved in this way is shown by the reactions to the regular hearings of House and Senate antitrust subcommittees in the United States or to reports issued by the Monopolies and Mergers Commission in the United Kingdom and occasionally by the government in Germany.³⁹

In sum, though the theoretical possibilities of intervention in the market mechanism by policies other than antitrust are manifold, our excursion into these fields has also shown us the real difficulties involved in pursuing them effectively. The reason for this is that these various kinds of government policy

³⁶ The economic theory of countervailing power, developed by Galbraith, was discussed in Chapter 3 *supra*. See J. K. Galbraith, *American Capitalism* (Boston: Houghton Mifflin, rev. ed. 1956), and 'Countervailing Power', 44 *Am. Econ. Rev.* 1 (1954, Proceedings).

³⁷ See Bain, *op. cit. supra* note 13, at 465; Scherer, *op. cit. supra* note 30, at 241–42.

³⁸ See, e.g., George J. Stigler, 'The Economist Plays With Blocs', 44 *Am. Econ. Rev.* 7 (1954, Proceedings); Simon N. Whitney, 'Errors in the Concept of Countervailing Power', 26 *J. Bus. U. Chi.* 238 (1953).

³⁹ An example of a report which aroused considerable reaction in Germany is Deutscher Bundestag (ed.), *Vorläufiger Bericht der Kommission zur Untersuchung der Gefährdung der wirtschaftlichen Existenz von Presseunternehmen und der Folgen der Konzentration für die Meinungsfreiheit in der Bundesrepublik*, Bundesdrucksache V/2403 (Bonn, 1967). See also Erich Arndt, 'Kartelle und Ordnungspolitik', 1 *Hamburger Jahrbuch für Wirtschafts- und Gesellschaftspolitik* 85 (1956).

are by no means all designed to the same extent to combat excessive economic power. So once industries have become highly concentrated, we have to live with the idea that firms belonging to them may substantially influence performance to their own advantage without our being able to take corrective action in any appreciable degree.

7.3 THE LIMITATIONS OF MERGER POLICY

In view of the difficulty of regulating market power once it exists by means of antitrust or other policy instruments in such a way as will ensure that the resultant net welfare loss remains small, a policy of preventing certain kinds of merger would appear to be required. As the prevention of market power should be the goal of any merger policy, mergers that would either lead to the creation of a dominant firm or to the establishment of joint dominance or result in existing market dominance being strengthened should be forbidden outright. The emphasis in a merger law should therefore be on prevention: the enforcement agencies should be empowered to forbid mergers before they are consummated. The specific difficulty of such a preventive merger policy resides in the element of uncertainty involved in judging the merger before it has been carried through. In order that policy decisions may be based on maximum probability as to the expected outcome, we should take into account as much evidence as is available and relevant – information on the structure of the relevant market, on the conduct of the merging partners and on the background to the merger – though we made it clear in Chapter 3 that efficiencies that may flow from a merger should generally be disregarded where a leading firm (one of the firms belonging to a highly concentrated oligopoly) is one of the partners in a merger. However, in those cases in which no leading firm is involved or in which it is not clear on the basis of market share alone whether the firm in question is one of the oligopolists, application of these economic tests will really amount to a case-by-case approach.

The language of Section 7 of the Clayton Act with its substantiality test seems to be sufficiently adaptable to changing circumstances and thus the best fitted to a case-by-case approach. However, both government and courts have consistently moved toward a wider construction of the Act (at least as far as horizontal and vertical mergers are concerned), first showing reluctance to take account of the economies resulting from a merger, then steadily reducing the number of structural factors on which judgment was based and finally drastically lowering the market-share limit above which mergers may be considered unlawful. Our discussion of merger case law in Chapter 5 indicated

that the administration and the courts have shown growing hostility toward mergers involving firms which are among the biggest in their industry, irrespective of whether they are small in absolute terms or are among the nation's largest companies. Mergers between firms belonging to a highly concentrated oligopoly and any other firm (including marginal producers) have been outlawed practically *per se*.

Although from an economist's point of view the use of simple quantitative tests for judging whether a merger impairs competition is an inadequate basis on which to reach proper conclusions, there are noneconomic aspects as well that have to be taken into account in framing an adequate merger law, especially when the merger phenomenon is so widespread and industrial concentration is at so high a level as in the United States. Narrowing discretionary margins for government and courts serves both certainty in the law and, though this is much less important, the need to cut down to the minimum the length of proceedings. Hence the great value of premerger notification.

The disadvantages of long trials are particularly apparent where suit is filed just after a merger has been consummated and before the merging firms have become fully integrated. For while a trial is pending the merged companies will prefer to refrain from implementing their merger completely in case they should subsequently be ordered to split up, a situation that is all the more unwelcome if the trial drags on. If the firms involved have not yet consummated the merger before they are challenged by the antitrust agencies and if the resultant proceedings last a long time, the firms may abandon their plans to merge because economic circumstances have changed in the meantime. This, though also undesirable, may be considered only a minor defect inherent in all systems of premerger notification. The weight of these two factors – certainty in the law and brevity of proceedings – makes it a defensible proposition to clothe the assessment of proposed mergers in fewer guarantees than might be offered by a full economic analysis and instead to apply quantitative guideline tests indicating the point beyond which a merger will lay itself open to antitrust attack. The tests may be framed with reference to market share, to a maximum permissible absolute size (in terms of sales or assets) of the merging firms, or to a combination of the two. Incorporating such quantitative criteria in a merger law does not, in our opinion, constitute a departure from the approach suggested for competition policy in already concentrated industries. Although prohibiting firms from engaging in a merger is itself a far-reaching policy measure, it is much less drastic than dissolution, divorcement or divestiture of a going concern – remedies which affect the continuity of a firm and *do* call for a full economic analysis.

The introduction of quantitative tests should not, however, be taken as an

opportunity to prescribe unnecessarily stringent criteria which would virtually amount to a *per se* ban on mergers. There is first the basic reflection that the more rigid market-share tests we formulate, the more probable it is that trade-offs between increased efficiency and the likelihood of uncompetitive behavior will become unfavorable in macroeconomic terms – a point extensively developed in Chapter 3. But considerations of what constitutes a balanced competition policy have to be borne in mind as well. If the courts are apparently unwilling to interpret the Sherman Act more rigorously and order dissolution more readily without further directives from Congress, then an extremely rigorous attitude toward mergers (a quasi *per se* prohibition with very narrow market definition) is misplaced because it would also affect small firms and rob them of any opportunity to measure up to their big competitors. To some extent this would freeze the existing oligopolistic or monopolistic power relationships in a large number of industries. So a sensible antimerger policy will have to find a balance between these considerations and those set out in the preceding paragraphs. As we showed in detail in examining the law on mergers in Chapter 5, the provisions of the Merger Guidelines relating to horizontal and vertical mergers are too strict. They are based too closely on recent rulings handed down in a number of suits which we criticized as being primarily inspired by small-business motives rather than by concern for the smooth and efficient operation of the competitive system. And though the test for the relevant geographic market is very loosely formulated in the Guidelines, it would certainly be construed restrictively in conformity with the case law. Further, they go into too much detail to be considered appropriate for inclusion in a merger law. Application of stringent quantitative criteria should focus on mergers involving a dominant or leading firm or on mergers which threaten to reinforce an oligopolistic structure and open the way to joint market dominance. Taking this into account, we consider that a practicable approach was that proposed fifteen years ago by Kaysen and Turner. They suggested banning horizontal mergers wherever the acquiring firm has 20 percent or more of the relevant market or where the joint postmerger share would reach this figure. Vertical mergers should be prohibited where a firm with a 20-percent market share acquires a relatively substantial supplier or customer. We make no comment as to whether these particular percentages are the right ones. If an approach of this kind should ever be embodied in legislation, quantitative limits should only be set in the light of a thorough examination of the structure and need for integration of the most concentrated industries about the time that legislation is introduced. The percentages should also be subject to review after a number of years since market-share rules may easily become too strict or too loose depending on changes in the boundaries of the

market. Kaysen and Turner's proposal provides also for an escape clause: such mergers would be justifiable on grounds that major economic benefits accruing from the merger could not be attained in any other way or that the acquired firm was in financial straits.⁴⁰ The incorporation of some escape clause seems proper when the law is framed on quantitative criteria, but the clause must be strictly applied. For in cases of this kind there will be no need for long discussions on potential economic benefits because the quantitative criteria laid down in the law would be such that a weakening of competition would in all probability result if mergers involving firms with larger market shares were allowed. Apart from this, firms will produce as much evidence as possible during trial in order to convince the judge that they qualify for the escape clause. And although in Kaysen and Turner's proposal the burden of proof is with the firms, this is a field of which they have most knowledge and where the opportunity for misinformation may be considerable. If too much latitude is given for interpreting the escape clause, a voluminous case law and lengthy trials may result, and this is precisely what we want to avoid. As to the failing-company defense, if there is only a remote chance of the acquired firm ending up in failing circumstances, the defense should not be allowed. It is possible that some mergers with potential adverse effects on competition will escape attack whereas mergers without these effects will be prohibited, because the finding of adverse effects will still depend in a number of cases on factual and theoretical judgment that is highly speculative.⁴¹ However, this too is a drawback which must be accepted in a well-balanced legislation.

Finally, we should deal with the reach of a merger statute in respect of pure conglomerate mergers, in which firms producing wholly unrelated products come together. The Task Force on Productivity and Competition declines to recommend legislation to counter the conglomerate movement until more evi-

⁴⁰ Kaysen and Turner, *op. cit. supra* note 1, at 133. Similar rules had already been suggested by George J. Stigler, 'Mergers and Preventive Antitrust Policy', 104 *U. Pa. L. Rev.* 176, 182 (1955). At the time, a number of articles advocating this kind of approach were published. See Mason, 'Market Power and Business Conduct', *supra* note 18; Ward S. Bowman Jr., 'Incipency, Mergers and the Size Question: Section 7 of the Clayton Act', 1 *Antitrust Bull.* 533, 537 (1956); Friedrich Kessler and Richard H. Stern, 'Competition, Contract and Vertical Integration', 69 *Yale LJ* 1 (1960). See also Turner's testimony in Hearings before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary, 84th Cong., 1st Sess., *A Study of the Antitrust Laws* 248, 262, 263 (1955). However, the *Stigler Report* makes no mention of these proposals, simply recording (§ III. C) that it favors 'levels of concentration modestly lower than those now used.'

⁴¹ Here we agree with the conclusions of the *Neal Report* (at II-9), which point in the same direction.

dence is available.⁴² The Task Force on Antitrust Policy considers rightly that the present wording of Section 7 and the fact that its interpretation by the administration and the courts is only just beginning – focusing on the probability that a potential competitor may be prevented from appearing on the market, on the likelihood that reciprocal dealing might emerge and on the ‘deep pocket’ argument discussed in Chapter 5 – make successful prosecution rely on speculative findings. However, the latter Task Force feels also that in view of our relative ignorance of the phenomenon, and because conglomerates can be an effective stimulus to competition, a *per se* ban on all conglomerate mergers by the largest firms in the country is not desirable. It proposes a Merger Act which would prevent any large firm from merging with a leading firm in any market in which it too is a leading firm.⁴³ The Act would define a large firm as a firm whose sales totaled over \$500 million or whose assets exceeded \$250 million in the most recent base year. A leading firm would be defined as one whose market share is more than 10 percent and which is one of the four firms in an industry which have an aggregate market share of more than 50 percent.⁴⁴ We would agree with this proposal since it may channel the conglomerate activity of large firms in such a way as to minimize the risk of anticompetitive effects emerging without imposing a limit that would substantially restrict corporate freedom. Exceptions to the prohibition proposed would seem to be unnecessary since it is highly unlikely that very large firms will enter each other’s markets to any great extent when these markets feature excessively high barriers to entry. In order to eliminate noneconomic motives for conglomerate mergers as far as possible, however, statutory provisions (in corporation and tax law, for instance) which encourage firms to merge should be repealed or amended.

The approach to mergers in Europe, though of much more recent date than that adopted in the United States, seems capable of avoiding two major shortcomings of the American system. First, it strikes the right balance between the use of quantitative and other criteria. Second, prior notification is an essential element of merger control in the European Community. In the next section of this chapter, after a brief survey of the historical development of competition policies in Europe, we shall examine this approach to the merger problem in more detail.

7.4 COMPETITION POLICY IN EUROPE: THE PRESENT POSITION AND FUTURE PROSPECTS

In Europe, as we have already observed, industrial concentration has been

recognized as a problem for a relatively short time only. This has had its effect on our knowledge of the extent and growth of concentration here, which is still very sketchy. The basic reason why many European governments have hitherto concerned themselves only marginally with the dangers to which concentration may give rise is that they have generally been preoccupied with the idea that their companies were too small to compete with success on world markets. One aspect of concentration that has for many years drawn attention in Europe almost to the exclusion of all others is the generally striking difference in absolute terms between the size of companies of American and European origin competing against each other on world markets.⁴⁵ As we pointed out in Chapter 2, most of these American companies have grown out of mergers – either at the turn of the century or during the merger wave of the twenties – and now form part of very highly concentrated oligopolies. However, differences in size are also apparent in the medium-size-firm range, many of these firms being much bigger in the United States than in Europe. According to a comparative study of international differences in industrial structure made by Bain, the percentage of firms with plants producing on a suboptimal scale is much higher outside than inside the United States.⁴⁶ These differences should be attributed chiefly to the differences in the geographical extent of the European and American markets. For a very long time, entrepreneurial dynamism in Europe has been checked at national frontiers constituting the boundaries of comparatively small markets, each presenting different characteristics. In a larger market, where flows of goods are unhampered

⁴² *Stigler Report* § III. C.

⁴³ *Neal Report* App. B – Merger Act § 1 (a) and Pt. III.

⁴⁴ Section 2 (a) & (b).

⁴⁵ See, e.g., Union des industries de la Communauté européenne, *L'Europe face à la concurrence des entreprises mondiales* (Lausanne: Centre de recherches européennes, 1965); 'Second programme de politique économique à moyen terme', 12 *Journal officiel des Communautés européennes* No. L 129, 30 May 1969, Ch. 2, Politique d'adaptation structurelle des entreprises (at 15–26) (presented by the Commission 20 March 1968, adopted by the Council and the Governments of the Member States 12 May 1969).

⁴⁶ The study is based on a sample of industries in the USA and seven other countries. Bain concludes that the mean scale of the largest 20 plants in a manufacturing industry is 60–75% smaller than in the USA in all these countries except the UK and Sweden, and the picture is not much altered if the largest 4 or 8 or 50 plants are referred to. The measures are in terms of plant employment, as distinct from capacity or output, and this – given the differences between Europe and the USA in technology, capital intensity in production and worker productivity – tends to understate relative plant size in the USA as compared to Western Europe. Bain's data relate chiefly to the 1950s and early 1960s. Joe S. Bain, *International Differences in Industrial Structure* 34–42, 55–66, 136–37 (New Haven, Conn.: Yale UP, 1966).

by such frontiers, what may be relatively large market shares in the purely national context may prove to be much smaller – and this is what is now happening as the nations forming part of the European Communities move toward economic union. A real merger wave has been under way in Europe since about 1965, many of the mergers involving companies which are among Europe's biggest, and this has started to cause alarm in some quarters – both national and supranational. In the light of what we have said in discussing concentration in previous chapters, we should consider whether the process can be allowed to continue without the risk of permanent harm to competition and in what way government should intervene in order to prevent any undesirable turn of events.

Although there are no detailed statistics available, it can be assumed that in Europe the current degree of industry concentration and of overall concentration is generally lower than that obtaining in the United States. However, this assumption is by no means sufficient to warrant the conclusion that the merger movement now under way in Europe is really without danger for competition. If the process of concentration leads to firms whose size is closer to the optimum needed for a big market, to firms which have a broader financial base and can therefore adapt more easily to technological advance and stand up to international competition, it ought to be looked upon with approval.⁴⁷ But the process can easily go beyond this laudable goal and help to create economic power. Studies undertaken by the European Commission, or at the Commission's request, show that in a number of industries in the original six member countries the merger wave has substantially increased concentration to a point where only a very small number of suppliers are left (in some cases the four largest firms controlling up to 90 percent of the common market as originally constituted), so that any increase in concentration would probably lessen competition even further. The structure of a large number of industries in Britain shows similar features, though the biggest British firms are often rather smaller in scale than their continental competitors.⁴⁸

What means are available to competition policy in Europe – whether national or supranational – to deal with the implications of the merger wave now in progress? And are they sufficient? Undeniably, less emphasis is still put on the role of competition policy in Europe than in the United States – at the national level at least. This is explained by the attitude, which differs fundamentally from that held in the United States, that the goals of competition policy should be dictated by the overall targets of economic policy and that in case of conflict the latter must predominate. This is why the government's attitude toward big business is considerably more indulgent in Europe than it is in the United States. The attitude is to some extent a consequence

of the economic crises of the 1930s and the subsequent years of recovery from World War II, but much of it also has its origin in the importance of just a few big firms to the economies of what are mostly small countries. Germany has been something of a special case since the war. Here, the influence of economic policy on competition policy is less than in the other EEC countries. However, it has been observed that the 1973 amendment to the German Act against Restraints of Competition leans more toward the view that, depending on circumstances, not only competition but also restraints of competition can help to improve economic performance.⁴⁷ Under the EEC Treaty, competition policy is seen as one of the ways of attaining economic union and thus forms part of the economic policy which is laid down in the Treaty. This is evidenced by a number of Treaty provisions that bring competition policy into line with other means of achieving the Community's objectives (for instance, the exceptions under Article 42, Article 85(3), Article 92(2) and (3) and Article 94).

This difference between the American and the European approach is clearly brought out in the law on dominant-firm behavior. Unlike the Sherman Act, which is directed against exclusionary conduct by dominant firms with a view to keeping competition free from restraints (the logical remedy for which is dissolution), competition laws in the EEC prohibit abuses of market dominance – either in general language or by a nonexhaustive enumeration of undesirable practices – especially those which impair performance (high prices, limitation of production and the like). British legislation and the EEC Treaty are the most specific in this respect, though Article 86 should not be construed in such a way as to make it apply to all acts of a dominant firm that have an incidence on market performance. Another point is that remedial powers under these laws are much more limited than in the United States, no provision being made for structural remedies (except in the United Kingdom, where the Secretary of State for Prices and Consumer Protection is empowered to order structural reorganization as a remedy, though he has not used his powers to date).

⁴⁷ Here the point needs to be made that however substantial the advantages of merger may sometimes be as a means of enabling firms to attain optimum scale, this is certainly not the case universally. In practice merger does not appear to be such a successful vehicle for small companies to bridge the gap between themselves and their large competitors.

⁴⁸ Alex Hunter, 'Mergers and Industry Concentration in Britain', 22 *Banca Nazionale del Lavoro Q. Rev.* 372 (1969).

⁴⁹ Statement of Prof. Ernst-Joachim Mestmäcker before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary, 15 Sept. 1973.

The other important aspect of competition policy toward concentration of economic power – merger policy – was for a long time virtually neglected by lawmakers in Europe. For years, the United Kingdom was the only country with statutory rules on mergers, and at supranational level it is only in the coal and steel industries that mergers are subjected to regulation. The basic attitude of European governments until recently has been to foster rather than control mergers. Their indulgence toward big corporations has been considerably reinforced by advances in economic integration, which are gradually dismantling barriers to trade and making the industries of individual countries face up to competition from outside. In Britain, for instance, there has been official encouragement of mergers, witness the activities of the Industrial Reorganization Corporation, which from 1966 to 1970 had the task of promoting mergers so as to make British firms better able to compete in world markets with American giants. Two instances typifying the British attitude were the creation of the GEC/English Electric/AEI group, which accounts for about 40 percent of the electrical-engineering industry's production, and of the British Leyland group.

However, this state of affairs now seems to be changing. In August 1973, after years of discussion, Germany's Act against Restraints of Competition was amended to introduce merger control into the law. Then there have been developments at supranational level too. Concentration problems have been taken up at the highest level of political discussion in Europe:

The Heads of State or of Government consider it necessary to seek to establish a single industrial base for the Community as a whole.

This involves ... the formulation of measures to ensure that mergers affecting firms established in the Community are in harmony with the economic and social aims of the Community, and the maintenance of fair competition as much within the common market as in external markets in conformity with the rules laid down by the Treaties.⁵⁰

This has now resulted in the Commission of the European Communities laying before the Council a proposal for a regulation 'on the control of concentrations between undertakings.'⁵¹

It is impossible to put too much emphasis on the importance that attaches to the introduction of a merger law into the Community's legislation at a time when, as we have said, concentration in a number of industries is already such as to impair the functioning of the market mechanism. Several considerations come to mind here. First, correcting the behavior of dominant firms or groups of firms through legislation on abuse lays a heavy burden of proof on enforcement agencies if it is to be done on any significant scale. So it cannot

be considered a real substitute for merger policy. The American antitrust policy under the Sherman Act, though different in scope, proves this. Second, we do not believe that regulation of certain mergers will impair the competitiveness of European industry against big firms from other countries, notwithstanding the contrary opinions held and persuasively expressed in both national and supranational quarters.⁵² In our view, the proposition that restraint of competition resulting from concentration will have to be accepted as part of the price of enabling Community firms to compete on world markets is generally false. For the elimination of competition within the common market by means of concentration will not in itself make it easier for the firms involved to stand up to international competition. The enlargement of the European Economic Community will not remove the basic need to regulate mergers because the danger of excessive concentration in certain industries will at best be simply deferred.⁵³ It is clear that the growing economic integration of Europe requires that any surveillance of competitive relationships must be first and foremost a matter for the Community as a whole. This is the only means of ensuring that the concentration process is appraised in an objective and responsible manner; and there is also the risk if supervision is left in the hands of the several member countries that international mergers will either be unnecessarily obstructed or will not be checked at all. We shall briefly describe here the British and German law and then go on in more detail to discuss merger control at Community level.

Under the British Fair Trading Act 1973, which replaces, with revised provision, the 1948 and 1965 legislation, the Secretary of State (for Trade and Industry when the Act became law, for Prices and Consumer Protection since the change of government early in 1974) may refer mergers to the Monopolies and Mergers Commission (originally established as the Monopolies and Restrictive Practices Commission in 1948, renamed the Monopolies Commission in 1956) where either (a) as a result, at least one quarter of the goods or services supplied in the United Kingdom or a substantial part of the United Kingdom are supplied by or to one and the same person or by or to the merging firms, or (b) the value of the assets taken over exceeds £5 million.

⁵⁰ Communiqué issued by the Heads of State or of Government of the countries of the enlarged Community, Paris, 19–20 Oct. 1972, point 7.

⁵¹ 16 *Official Journal of the European Communities* No. C 92, 31 Oct. 1973, p. 1.

⁵² See, e.g., the sources mentioned in Commission of the European Communities, *Industrial Policy in the Community: Memorandum from the Commission to the Council* (Brussels, 1970).

⁵³ See also Hartmut Berg, 'Zur Notwendigkeit einer europäischen Fusionskontrolle', 22 *Wirtschaft und Wettbewerb* 5 (1972).

(There are specific provisions for newspaper mergers where average daily circulation after merger totals 500 000 or more copies. This reflects the government's concern to ensure that the press in Britain is not concentrated in too few hands.)

Merger references to the Commission must be made within six months of the merger, and within six months of the reference (subject to possible extension by the Secretary of State for a further three months) the Commission must investigate and report on whether a merger operates or may be expected to operate against the public interest. If the Commission finds that these two tests are satisfied, it is to consider, and may recommend in its report, what action should be taken (either by the government or by the firms involved) to remedy or prevent the merger's adverse effects. Once a report specifying the adverse effects of a qualifying merger situation has been made to the government and laid before Parliament, the Secretary of State may order such remedial or preventive action under the Act as he considers necessary. A merger reference may also be made where the Secretary of State considers that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a merger situation qualifying for investigation.⁵⁴

In Germany, the Act against Restraints of Competition, as amended,⁵⁵ provides for notification of mergers planned or already consummated (the latter were also notifiable before the law was amended) and for their prohibition or dissolution under certain conditions. Premerger notification is mandatory if the sales of at least two of the firms involved totalled DM 1 000 million or more each during the last full business year. Postmerger notification is mandatory if the firms involved have a joint market share of at least 20 percent in the territory of the Federal Republic or in a substantial part thereof or if the firms involved together had at least ten thousand employees or their joint sales totalled at least DM 500 million at any time during the last full business year before the merger. Mergers are not caught by the Act where the sales of all the firms involved totalled less than DM 500 million in the last full business year, where the sales of the acquired firm did not exceed DM 50 million in the last full business year, where the restraint of competition is not expected to affect the whole territory of the Federal Republic or a substantial part thereof, or where sales on the market concerned totalled less than DM 10 million in the last full calendar year. Planned mergers which do not reach the limits at which notification is mandatory but are not so insignificant as to be beyond the reach of the Act altogether *may* be notified. The advantages of premerger notification for the merging corporations is that the Federal Cartel Office must act within a shorter time than in the case of

postmerger notification. The consummation of a proposed merger can only be prohibited if the firms involved have been informed that their merger plans are being investigated within one month of notification; and if the Cartel Office wishes to issue an injunction, it has to do so within a further three months after that. The Office may nevertheless enjoin the merger after this four-month period has expired if the merger plans are carried out before its expiry or in a number of other eventualities (e.g. where there has been a fundamental change in circumstances or inaccurate information has been supplied). If firms do not notify, the Cartel Office may institute proceedings at any time after consummation. A merger already consummated cannot be undone after one year has elapsed since notification.

The Federal Cartel Office will prohibit a merger if it is likely to create or reinforce a dominant position unless this is offset by an improvement in competitive conditions on the relevant market. Although the relevant geographic market is generally taken to be the whole or part of the territory of the Federal Republic, this does not necessarily mean that international considerations cannot play a role in the application of the law: the preamble to the bill laid before parliament made it clear that the regulation of mergers in Germany must have regard to the conditions of competition on European and world markets. The Federal Cartel Office is empowered to prohibit mergers violating the Act through an administrative order. The order is subject to judicial review. In addition, and as an alternative to judicial review, the firm may apply for authorization by the Federal Minister of Economic Affairs. The Minister may overrule the Cartel Office's prohibition of a merger if the restraint of competition is outweighed by overall economic benefits or if the merger is felt to be in the public interest. Application for authorization by the Minister must be made within one month of prohibition by the Cartel Office, and the Minister must rule within four months.

Unlike that of its counterpart in the United Kingdom, the task of the German Monopolies Commission set up under the 1973 amendment is limited in the main to supervision and enforcement of the law in general. It is the Commission's duty to report regularly to the government on the degree and

⁵⁴ Fair Trading Act 1973, c. 41, §§ 57-75.

⁵⁵ The Act describes in comprehensive detail (amended § 23 (2)) what constitutes a merger, the definition including acquisition of assets, acquisition of shares (25% or more of the voting capital of the acquired firm), agreements creating or enlarging corporate groups as defined in the *Aktiengesetz* and any other business combination which permits one or more firms directly or indirectly to exercise a controlling influence over another firm. While this is not expressly stipulated, the Act reaches all forms of merger activity (horizontal, vertical, conglomerate and joint ventures).

probable trend of economic concentration, taking into account its implications for economic policy in general and competition policy in particular. The Commission is also to evaluate the application of the Act's provisions concerning mergers and abuse of market dominance and to suggest such amendments to the Act as it considers appropriate. The Minister of Economic Affairs can consult the Commission on particular mergers referred to him.

How should the introduction of national merger legislation be judged, given its absence in most members of the European Communities and the efforts being made to produce Community legislation in this area? The introduction of merger legislation in a country which, like Germany, is a major international trader and forms part of a larger economic grouping may prove to be ineffective.⁵⁶ If the law is rigorously enforced, companies may move abroad to do what they are not allowed to do in their own country. Merger regulation may also hinder cross-frontier mergers because foreign companies will be unwilling to merge with German firms if they risk prosecution. Cautious enforcement will perhaps mitigate some of these drawbacks, but the only efficient means of avoiding the disadvantages inherent in having a variety of national laws and at the same time of dealing with the merger problem effectively and in a uniform manner is regulation at Community level. The discussions on the introduction of national merger laws point up the urgency of the situation, and this is an important contribution.⁵⁷

Under the ECSC Treaty of 1951 prior authorization is required for mergers in the coal and steel industries. Mergers are not approved unless there is no danger of the firms concerned acquiring a dominant position which would enable them 'to determine prices, to control or restrict production or distribution or to hinder effective competition in a substantial part of the market' in coal or steel, or 'to evade the rules of competition instituted under [the] Treaty, in particular by establishing an artificially privileged position involving a substantial advantage in access to supplies or markets.'⁵⁸ The ECSC High Authority (or, since 1967, the Commission of the European Communities) has not yet prohibited a single merger, though in some cases firms in fact have abandoned their merger plans in anticipation of being refused authorization.

Although the European Commission does not publish the criteria on which it judges mergers in these industries, we can assume that market share – i.e. in most cases the share of the merging companies in the common market in crude steel – is the Commission's main criterion.⁵⁹ Illustrative of this is a statement by the Commission to the effect that effective competition requires that no fewer than about ten firms should account for 90 percent of crude-steel production in the common market, the market share of the biggest firm not to exceed 13 percent. No market shares are specified in respect of processed

steel products. The Commission acknowledges the fact that crude production may not always be an accurate measure of a firm's market position, but no other quantitative criteria are stated. The Commission simply notes that each case must be judged on its merits, account being taken of the peculiar characteristics of the markets in question and of the industrial, financial and commercial implications of the proposed merger. For instance, a merger that would create a dominant position on certain product markets would not be authorized, even if the joint market share in terms of crude-steel production were acceptable.⁶⁰ In the recent series of mergers in the German, French and Belgian steel industries this limit was not in fact overstepped – or not by very much. One consideration to which the Commission attached considerable importance was that the balance between the biggest firms in the industry should not be upset. This is reflected in the fact that the authorizations were generally subject to conditions such as the prohibition of all restrictive agreements between the firms that emerged from these mergers other than joint sales and specialization agreements and the prohibition of interlocking directorates. Apart from their activities in the merger field, the High Authority and its successor, the Commission, have approved a number of joint sales and specialization agreements, the first of them setting up the Geitling, Präsident and Mausegatt sales agencies, which provided a fresh basis for cooperation following the postwar deconcentration of Germany's coal industry. In view of the structural difficulties caused by the declining demand for coal, bigger

⁵⁶ The matter was exhaustively discussed in Germany during the years when the bill was being prepared. See, e.g., Fritz Rittner, 'Konzentrationskontrolle – aber wie?', 23 *Der Betrieb* 669 & 717 (1970); Werner Benisch, 'Die Problematik einer nationalen Konzentrationskontrolle', 16 *Wettbewerb in Recht und Praxis* 93 (1970).

⁵⁷ See, e.g., *Entwurf eines Zweiten Gesetzes zur Änderung des Gesetzes gegen Wettbewerbsbeschränkungen* 16, Bundesdrucksache VI/2520, 18 Aug. 1971: 'Solange es eine voll entwickelte überstaatliche Wettbewerbspolitik der Europäischen Gemeinschaften nicht gibt, muss die Bundesregierung das im Rahmen dieser Zielsetzungen Notwendige selbst tun.'

⁵⁸ *Treaty establishing the European Coal and Steel Community*, Paris, 18 April 1951, Art. 66(2). The drafters of the subsequent *Treaty establishing the European Economic Community*, Rome, 25 March 1957, made express provision that the new Treaty should not affect the earlier one, 'in particular as regards the rights and obligations of Member States, the powers of the institutions [of the ECSC] and the rules laid down [by the ECSC Treaty] for the functioning of the common market in coal and steel.' Art. 232 (1).

⁵⁹ See the *General Reports* of the Commission since 1967 and of the ECSC High Authority for preceding years. For a broad view, see also Hans Müller, 'The Policy of the European Coal and Steel Community Towards Mergers and Agreements by Steel Companies', 14 *Antitrust Bull.* 413 (1969).

⁶⁰ Commission des Communautés européennes, 'Grandes lignes d'une politique de concurrence en matière de structures de l'industrie sidérurgique', 13 *Journal officiel des Communautés européennes* No. C 12, 30 Jan. 1970, p. 7 (§§ 13–14).

market shares were authorized in this case.⁶¹ In the steel industry, care has generally been taken to ensure that the groups constituted by agreements are not so big that the market share mentioned above is exceeded by very much. Higher market shares may be authorized for special steels (depending on how severe a restraint of competition is involved in the agreement), the Commission considering that agreements are more easy to undo than mergers. This is clear from the latest decisions of the Commission authorizing the creation of four groups of German steel companies for specialization in rolled-steel production and for joint buying or selling of ore and various types of steel.⁶² A further development in this sector is the merger of two very large steel companies, August Thyssen-Hütte and Rheinstahl. The merger has recently been authorized by the Commission, but with the proviso that a number of conditions must be satisfied. The most important condition is that Thyssen should offer its competitor Mannesmann part of its share in their jointly owned steel-pipe company. Another is that Thyssen may not acquire more than 10 percent of any other firm in the steel industry without prior approval by the Commission. Lastly, Thyssen/Rheinstahl must leave the joint sales agencies to which the separate companies belonged before merging.⁶³ But for these conditions, the merger would result in a far greater concentration of power than is consistent with the Commission's policy in the steel industry.

Outside the coal and steel industries, there has been considerable discussion on the applicability of Articles 85 and 86 of the EEC Treaty to mergers. We shall first look at this and then go on with an analysis of the Commission's merger proposals mentioned earlier in this section. Article 85 is generally considered not to apply to mergers. The earlier commentaries on the EEC Treaty were all of the opinion that mergers fell outside its scope,⁶⁴ but interest in the reach of the article was revived when the EEC Commission asked a group of four university professors to investigate the status of combinations under Article 85. A majority of the group came to the conclusion that combinations based upon agreements under which the firms remained legally distinct entities after merging were caught by Article 85 if they led to an appreciable restriction of competition.⁶⁵ This interpretation was rejected by the Commission, which considered Article 85 inapplicable to combinations of any kind.⁶⁶ Though reliable information on the legislative history is hard to come by, it is almost certain that the authors of the Treaty did not intend Article 85 to apply to mergers. The actual language of the article, however, can be construed in such a way as to bring mergers within its reach.⁶⁷

In view of the prevailing opinion that Article 85 does not apply to mergers, commentators and the Commission have concentrated on the scope of Ar-

ticle 86. The Commission has taken the line that the reinforcement of an existing dominant position by merger should be treated as an abuse of economic power. The essence of the Commission's reasoning is that under both Articles 85 and 86 of the Treaty the elimination of competition must be held abusive since it conflicts with the objective of creating a common market laid down in Article 2. It would be unreasonable to prohibit a lessening of competition by a restrictive agreement under Article 85 but to permit a merger between a firm already dominant and its remaining competitors. Apart from that, a monopoly position can have exactly the same harmful effects as those described in Article 85(3)(b).⁶⁸

This approach, though clearly justified under Article 86, does not offer much of a solution to the merger problem. First, harmful effects of the sort described in Article 86(b) are inherent not only in complete but also in substantial market dominance, so that applying the law to mergers that engender monopolies but not to those that result 'only' in dominant firms is not very consistent and makes no significant contribution to improving competition on the relevant market. Furthermore, the practical reach of the law, given such an interpretation, is not very extensive, since the number of dominant

⁶¹ Decisions Nos. 5, 6, 7 and 8/56, 15 Feb. 1956, 5 *Journal officiel de la Communauté européenne du charbon et de l'acier* 31 (1956). See also ECSC High Authority, *Fourth General Report on the Activities of the Community* § 133 (Luxembourg, 1956).

⁶² Decisions Nos. 71/312-15/ECSC, 27 July 1971, 14 *Amtsblatt der Europäischen Gemeinschaften* No. L 201, 5 Sept. 1971.

⁶³ Decision No. 74/153/ECSC, 20 Dec. 1973, 17 *Amtsblatt der Europäischen Gemeinschaften* No. L 84, 28 March 1974.

⁶⁴ See, e.g., Alfred Gleiss and Martin Hirsch, *EWG-Kartellrecht* 100 (Heidelberg: Recht und Wirtschaft, 2d ed. 1965); Arved Deringer, 'Das Wettbewerbsrecht der Europäischen Wirtschaftsgemeinschaft: Kommentar zu den EWG-Wettbewerbsregeln (Art. 85ff.) nebst Durchführungsverordnungen und -richtlinien', 13 *Wirtschaft und Wettbewerb* 376 (1963); J. Thiesing in Hans von der Groeben and Hans von Boeckh (eds.), *Kommentar zum EWG-Vertrag* Vol. 1, at 279 (Baden-Baden: Lutzeyer, 1958); Eberhard Günther, 'Die Regelung des Wettbewerbs im Vertrag zur Gründung der Europäischen Wirtschaftsgemeinschaft', 7 *Wirtschaft und Wettbewerb* 275, 284 (1957).

⁶⁵ Commission de la Communauté économique européenne, *op. cit. supra* note 4, at 21.

⁶⁶ *Id.* at 22-24.

⁶⁷ But see Joliet, *op. cit. supra* note 6, at 274-83.

⁶⁸ Commission de la Communauté économique européenne, *op. cit. supra* note 4, at 26. For a comprehensive defense of the Commission's position, see Ernst-Joachim Mestmäcker, 'Die Beurteilung von Unternehmenszusammenschlüssen nach Artikel 86 des Vertrages über die Europäische Wirtschaftsgemeinschaft', in Ernst von Caemmerer, Hans-Jürgen Schlochauer and Ernst Steindorff (eds.), *Probleme des europäischen Rechts* (Frankfurt/Main: Klostermann, 1966), and P. VerLoren van Themaat, 'Grensoverschrijdende fusies binnen de EEG', 16 *Sociaal-Economische Wetgeving* 162, 172-80 (1968).

firms wanting to extend their grip on the market is not very large. On the other hand, mergers that lead to market dominance are not only of much more frequent occurrence in the present wave of mergers sweeping Europe: their impact on competition is also much greater. It is clear that to bring such cases under the law is to stretch to the limit the applicability of Article 86 to mergers. In defending this interpretation, however, some legal writers have made the point – correctly in our opinion – that it is difficult to accept that the law should confine itself to regulating the use made of dominant positions and should do nothing to hinder their creation.⁶⁹

In *Continental Can*,⁷⁰ its first ruling on the applicability of Article 86 to mergers, the Court of Justice of the European Communities did not go as far as that. The Court held that an abuse of a dominant position could occur if the dominant firm strengthened its position to the point where it substantially restrained competition, the only companies remaining on the market being dependent on the dominant firm itself. The Court arrived at this view by a type of reasoning akin to that of the Commission outlined above. As the purpose of both Articles 85 and 86 is to maintain effective competition in the common market and Article 85 even prohibits restraints which merely *affect* trade between Member States, it cannot be supposed that Article 86 allows firms to attain, through combination, ‘such a dominant position that any serious chance of competition is practically rendered impossible.’ To treat restrictive agreements differently from combinations under the EEC Treaty would ‘make a breach in the entire competition law which could jeopardize the proper functioning of the common market.’⁷¹

However, the Commission lost its case against *Continental Can*: the Court ruled that it had not clearly defined the market in which the company was alleged to hold a dominant position. In its decision attacking *Continental Can* the Commission had found that Continental, through its European subsidiary Europemballage, held a dominant position in the ‘market for light containers for canned meat products,’ in the ‘market for light containers for canned seafood’ and in the ‘market for metal closures for the food packing industry, other than crown corks’ in Germany, with market shares of 70 to 80 percent, 80 to 90 percent and 50 to 55 percent respectively.⁷² As the German market constitutes a substantial part of the common market, the Commission concluded that Continental was dominant in a substantial part of the common market and had abused its dominance by acquiring the largest Dutch company in this field.⁷³ The Court was dissatisfied with this market definition, stating that it was unclear from the Commission’s decision how the three markets differed from each other and from the general market for light metal containers: at some points the Commission appeared to contradict itself by

citing as competitors firms operating in markets that it considered distinct. For the Court, definition of a distinct market requires that

the products in question must be individualized, not only by the mere fact that they are used for packing certain products, but by particular characteristics of production which make them specifically [*sic*] suitable for this purpose. Consequently, a dominant position on the market for light metal containers for meat and fish cannot be decisive, as long as it has not been proved that competitors from other sectors of the market for light metal containers are not in a position to enter this market, by a simple adaptation, with sufficient strength to create a serious counterweight.⁷⁴

Although the Court's ruling made for greater certainty in the law, it is not conducive to effective control of mergers because it requires proof of preexisting dominance, which considerably restricts the scope for action by the Commission. Apart from this point, the view prevailing in the Commission is that, whatever interpretation is put on Article 86, action cannot be taken until after the merger has been consummated. It is doubtful, however, if the Commission is right in considering this a real barrier to enforcement. For if a firm presents its merger plans to the Commission and asks for negative clearance but the Commission refuses, it is surely only a small step further to prohibit the merger outright. In any case, in its proposal for a regulation on the control of concentrations between undertakings the Commission has attempted to solve both these problems. The proposal provides that any concentration of firms, 'whereby they acquire or enhance the power to hinder effective competition in the common market or in a substantial part thereof, is incompatible with the common market in so far as the concentration may affect trade between Member States.'⁷⁵ So the Commission eschews quantitative tests and relies on the concept of maintaining effective competition to which the Court of Justice had specifically referred in describing the object of the Treaty's competition rules in its *Continental Can* ruling.⁷⁶ This concept embraces a large number of

⁶⁹ VerLoren van Themaat, *supra* note 68, at 179.

⁷⁰ *Europemballage Corp. & Continental Can Co. Inc. v. Commission of the European Communities*, Court of Justice of the European Communities, Luxembourg, Case 6/72, 21 Feb. 1973, 19 *Reports of Cases before the Court* 215.

⁷¹ *Id.* at 244-45.

⁷² Décision de la Commission du 9 décembre 1971 relative à une procédure d'application de l'article 86 du traité CEE (IV/26811 - Continental Can Company), 15 *Journal officiel des Communautés européennes* No. L 7, 8 Jan. 1972, p. 25, 35.

⁷³ *Id.* at 37-38.

⁷⁴ 19 *Reports of Cases before the Court* at 248.

⁷⁵ *Supra* note 51, Art. 1 (1).

⁷⁶ 19 *Reports of Cases before the Court* at 244.

structural, nonquantitative tests which the Commission must apply; they are summarized in the explanatory memorandum to the Commission's proposal – market share; possession of know-how, raw materials or capital; absolute size; links with buyers, with sellers or with firms outside the Community; the ability of the remaining firms on the market to compete and their conduct; the structure of supply and demand; barriers to entry; the rate of technical progress; the growth of the industry concerned; actual or potential international competition; and competition from substitute products. As we saw in Chapter 3, tests such as these leave considerable scope for differing judgments in specific cases, and this may cause difficulties in the Commission's premerger clearance procedure. Merger policy in the EEC, then, favors a case-by-case approach.

It is also proposed that the Commission be given extensive powers to authorize mergers found to be incompatible with the common market under Article 1(1) if it finds that the merger is 'indispensable to the attainment of an objective which is given priority treatment in the common interest of the Community.'⁷⁷ This provision is designed to take into account the requirements of the Community's industrial, technological, social and regional policies. For instance, as the explanatory memorandum notes, integration with a large group may be the only way to ensure the profitability of a firm situated in an area which is economically underdeveloped or declining and afflicted by serious employment problems. If approved by the Council, this provision will give the Commission far-reaching powers in areas in which it has hitherto had very little power indeed. It remains to be seen whether the Council will feel inclined to grant such powers.

Whereas exceptions under Article 1(3) have to be made by specific decisions under Article 3(4) authorizing the merger in question, there is a general exception to the merger rules where the aggregate turnover of the merging firms is less than 200 million units of account⁷⁸ and their share of the market in any one member country does not exceed 25 percent.⁷⁹ However, the rules are intended to apply also to concentrations involving firms one of which may have its headquarters outside the Community. But this had already been made clear when the Court of Justice ruled in the *Dyestuffs* cases⁸⁰ that non-Community firms are also subject to the Community's competition rules if their conduct has repercussions on the common market.

An important element in the Commission's new proposal is its provision for premerger notification,⁸¹ which is mandatory for firms whose aggregate turnover (or banks or other financial institutions one tenth of whose assets, or insurance companies whose premium income) totalled not less than 1 000 million units of account in the last financial year preceding the concentration. Prior notification is not compulsory if the turnover of the firm to be acquired is less than 30 million units of account and the acquiring firm's sales already

total 1 000 million units of account. The Commission must start proceedings within three months of notification where it considers that a merger is likely to be found incompatible with the common market; if it fails to do so, the merger is presumed to be compatible with the common market. Mergers which have been notified must not be consummated during these three months, and the Commission may require firms to desist from carrying through their merger plans while its proceedings are in progress. As under German law, there is no time limit for proceedings in respect of mergers that are not notified. And proceedings may be instituted after the expiry of the three-month period where the information supplied by the firm is false or misleading.

The procedural provisions in the proposal are identical, but for a few details, with those in Regulation No. 17,⁸² the first regulation implementing Articles 85 and 86. The firms involved must be informed that proceedings have been commenced, and the Commission has nine months from the commencement of proceedings in which to take a decision under Article 3.⁸³ The Member States are entitled to request the Commission to commence proceedings against specific mergers.⁸⁴

Lastly, the Commission proposal makes provision for penalties. Fines may be imposed if firms do not notify, if they supply incorrect or misleading information in a notification or in response to a request for further information, if they do not cooperate to the full in Commission investigations or if they conclude a concentration before the Commission has taken a decision or after it has found the merger incompatible with the common market. In this last case, fines may go as high as 10 percent of the value of the combined assets.⁸⁵ The Commission can also order the dissolution of a merger that has already been

⁷⁷ *Supra* note 51, Art. 1 (3).

⁷⁸ The Community's unit of account, defined in terms of weight of fine gold, is equivalent to the US dollar before it was devalued under the Smithsonian agreement of 18 December 1971.

⁷⁹ *Supra* note 51, Art. 1 (2).

⁸⁰ *Imperial Chem. Indus. Ltd. v. Commission; Badische Anilin- & Soda-Fabrik AG v. Commission; Farbenfabriken Bayer AG v. Commission; J. R. Geigy AG v. Commission; Sandoz AG v. Commission; SA Française des matières colorantes (Francolor) v. Commission; Cassella Farbwerke Mainkur AG v. Commission; Farbwerke Hoechst AG v. Commission; Azienda Colori Nazionali - ACNA SpA v. Commission*, Court of Justice of the European Communities, Luxembourg, Cases 48, 49, 51, 52, 53, 54, 55, 56, 57/69, 14 July 1972, 18 *Recueil de la jurisprudence de la Cour* 619, 713, 745, 787, 845, 851, 887, 927, 933.

⁸¹ *Supra* note 51, Arts. 4-7.

⁸² 5 *Official Journal of the European Communities* No. 13, 21 Feb. 1962, p. 204.

⁸³ *Supra* note 51, Arts. 6(1) & 17(1).

⁸⁴ *Id.* Art. 19(2).

⁸⁵ *Id.* Art. 13.

consummated.⁸⁶ And, finally, it has power to impose periodic penalty payments where firms fail to comply with a dissolution order, to supply complete and correct information or to submit to investigation.⁸⁷

Now that definite form and content is being given to competition policy in respect of mergers at both national and supranational level in the European Community, it is possible to judge it in the light of American policy in this field. We shall disregard the fact that in the Community competition policy is generally enforced by an administrative body while in the United States this is in the main the task of the courts and concentrate on two typical differences in the design of the law – one procedural and the other with regard to the statutory tests.

As for the first aspect, it is noteworthy that in the United States a merger can be found violative of the law years after it has been consummated. Firms have only very limited means of protecting themselves against this because although there are Merger Guidelines firms cannot apply to the antitrust agencies for clearance in borderline cases. Merger policy in the European Community, on the other hand, does make provision for this: German law and the European Commission's proposals provide for mandatory notification of mergers in excess of a stated size, and there is voluntary notification for smaller mergers in both these cases and in United Kingdom law (where there is no mandatory notification). The essential difference on the procedural plane, however, is that in Europe the regulatory agencies have to act against a proposed merger within a specified (and short) period of time after notification, failing which the merger cannot be challenged. Since it is only firms which notify the authorities of their merger plans that can be certain of being granted or refused authorization, it is of little consequence whether premerger notification is mandatory or optional. For the risk involved in carrying through a large merger without first referring it to the authorities is so great where mandatory notification is restricted to mergers above a specified size that in a considerable number of cases firms contemplating mergers in respect of which notification is not mandatory will refrain from going ahead until the authorities give the green light.

The second typical difference between the American and the European approach relates to the tests by which mergers are judged. While in the United States competition-policy considerations alone enter into the judgment of a merger, in the systems proposed or already operating in the Community objections from the competition angle can be set aside if other factors tell in favor. And United Kingdom law provides that mergers can be forbidden also where considerations other than competition policy so require. The possibility of objections from the competition angle being weighed against benefits from other angles evidences the close ties between competition policy and other sectors of

economic policy in the European Community.⁸⁶ Then there are the tests contained in the various competition laws. In this respect the market-structure criteria in the proposed Community regulation, which are defined without reference to market share, are not so very different from the tests that could be applied under the broadly drafted Clayton Act. The latter, however, is increasingly being interpreted in a quantitative sense; we must wait and see whether the European tests will be interpreted in such a way too.

Provided there is a clearance procedure, premerger notification has considerable advantages both for companies and for the enforcement agencies. It provides companies with the assurance that the agencies will or will not take action, and they can react accordingly. Such provisions for clearance as are laid down in the laws in the European Community (within three or nine months) may be judged reasonable. The complaint sometimes voiced by firms that by the time the clearance period has elapsed economic circumstances may have changed so much that there is no further point in carrying on with the merger, even if it is eventually cleared, seems to us unimportant in the light of the overwhelming arguments in favor of merger control. The major advantage of premerger notification for the enforcement agencies is that they are automatically kept informed of plans for large mergers and can thus enforce the law much more effectively. It is likely as a result that not only will more mergers be examined than under the American system but also that the preventive effect of the law will be greater. For firms which merge in the United States can always hope that the merger will not be challenged since the American enforcement agencies manage to investigate less than one percent of the mergers effected in any given year. In practice, however, premerger notification with a specified clearance period demands rapid decisions from the authorities. The time given the Commission and the German authorities is short. And then there are particular problems connected with the collection of evidence and subsequent examination in the case of mergers which differ from those encountered in investigating restrictive agreements. The European enforcement agencies will not be able to cope with merger control involving premerger notification unless they are properly staffed.

It is true that the Commission already has far-reaching powers to obtain information under Regulation No. 17. But there is an essential difference in

⁸⁶ *Id.* Art. 3(3).

⁸⁷ *Id.* Art. 14.

⁸⁸ In form the ECSC Treaty provisions appear to deviate from this principle, but the tests employed to establish whether or not a restraint of competition can be shown do in fact follow it.

fact-finding between restrictive agreements, on which the Commission and national antitrust agencies have concentrated so far, and mergers. In the first case, the authorities generally know all market participants as a matter of course and consequently have a full picture of the market; this is not the case with mergers, where initially the authorities only have information about the merging companies and not their competitors. While restrictive agreements relate to specified products, the American experience shows that it is often difficult to determine relevant markets for mergers. But it is only when the market has been defined that the authorities can ascertain the number of competitors and potential competitors and other factors relevant to an assessment of the merger. The American antitrust agencies have found that their ideas about market definition are often at variance with reality. Firms which are assumed to be competitors do not consider themselves competitors, and real competitors are sometimes overlooked. In many cases, then, there is a need for thorough investigation before the agency has a true picture of actual market relationships; not until then can it begin to judge the impact of a merger. The long list of tests to be applied simultaneously in the Commission proposal is designed to obviate reliance on simple quantitative criteria. Although this detailed approach is to be welcomed, it really does put a heavier burden of proof on the antitrust authorities than if they only have quantitative rules to apply. On the other hand, after a serious investigation by the enforcement agencies leading to prohibition of a merger, only very few firms will presumably be inclined to go to court. For this implies postponing the realization of merger plans and all the financial insecurity that this entails. In this respect we feel that the situation in the Community will not be the same as in the United States, where most mergers are already consummated before they come to court and the firms' interest in keeping the merger intact is consequently much greater.

To sum up, the main advantages of the Commission's proposal for merger control compared with the current position under Article 86 are (1) that dominance need no longer be shown and (2) that the Commission's final answer must be given within a reasonably short time, which can only improve certainty in the law. Nevertheless, there are still a number of unsatisfactory points in that the explanatory memorandum could be more explicit and certain clauses in the proposal itself need more elaborate drafting.

The maintenance of effective competition is served not only by laws that restrain the actions of dominant firms or are intended to prevent their creation but also by a more positive policy of support for viable small firms to enable them to compete with much bigger firms on large markets. Traditionally, this has been done in Europe and in the United States by special government

programs, most of them providing financial assistance, to improve the competitive status of such firms. However, competition policy can give adequate support as well – by seeing to it that smaller companies are not squeezed out of the market by unfair price tactics, exclusive relationships, refusals to deal and the like on the part of their large competitors. Antitrust in the United States has long and fruitful experience here, and the authorities in Europe are starting to follow in the Americans' footsteps. But competition policy can react in another way as well, by taking a benevolent attitude toward cooperation agreements between small firms. In the European Community the relevant provisions of the Rome Treaty have been interpreted in a way that leaves room for a balanced approach by allowing certain kinds of cooperation agreement between small firms. In particular, there is the Commission's notice exempting such agreements from Article 85(1) provided they strengthen the firms' competitive capacity in the common market⁸⁹ and its notice concerning *de minimis* agreements.⁹⁰ The latter provides that agreements between firms with market shares of up to 5 percent and sales of up to 15 million units of account in the case of industrial firms or 20 million in the case of commercial firms are not caught by Article 85(1). Then there are a number of types of more specialized agreement which are exempted, including exclusive-dealing agreements provided they do not bestow absolute territorial protection⁹¹ and agreements covering standards or types, cooperation in research and development or specialization in production or sales.⁹² Lastly, the Commission has taken a series of decisions exempting a variety of forms of specialization and technical cooperation.

⁸⁹ Communication relative aux accords, décisions et pratiques concertées concernant la coopération entre entreprises, 11 *Journal officiel des Communautés européennes* No. C 75, 29 July 1968, p. 3.

⁹⁰ Communication de la Commission, du 27 mai 1970, concernant les accords d'importance mineure qui ne sont pas visés par les dispositions de l'article 85 paragraphe 1 du traité instituant la Communauté économique européenne, 13 *Journal officiel des Communautés européennes* No. C 64, 2 June 1970, p. 1.

⁹¹ Commission Regulation No. 67/67/EEC of 22 March 1967 on the application of Article 85(3) of the Treaty to certain categories of exclusive dealing agreements, 10 *Official Journal of the European Communities* No. 57, 25 March 1967, p. 849. Originally due to expire on 31 December 1972, this Regulation was extended for ten years by Commission Regulation (EEC) No. 2591/72 of 8 Dec. 1972, 15 *Official Journal of the European Communities* No. L 276, 9 Dec. 1972, p. 15.

⁹² Council Regulation (EEC) No. 2821/71 of 20 Dec. 1971 on application of Article 85(3) of the Treaty to categories of agreements, decisions and concerted practices, 14 *Official Journal of the European Communities* No. L 285, 29 Dec. 1971, p. 46.

7.5 SUMMARY AND CONCLUSIONS

Concentration is unacceptable if it impairs the free play of market forces to any substantial extent. This can happen either because the flow of wealth between buyers and sellers is interrupted (economic advantages are not passed from one stage to the next) or because governments are hampered in making proper use of the market mechanism to carry out their economic programs. After making a detailed analysis and assessment of these various factors, we concluded in Part 1 of this study that both corrective and preventive measures to limit concentration are in order.

The difficulty encountered in drafting and applying policy in the field of concentration is not so much that governments fail to realize that action is needed but that there is no general consensus about what is the most appropriate policy. The problems of concentration are extremely varied: they are not only economic but also legal, social and political, and this explains why opinions as regards concentration and the methods and degree of intervention differ so widely. The enforcement of American antitrust policy, especially Sections 1 and 2 of the Sherman Act, reflects these differences. Since the early days, for instance, a variety of factors have militated against active enforcement. In Europe, it is only recently that the first cautious moves to control concentration by means of competition policy have been made: not only are there considerable differences between the members of the European Community as to the steps to be taken, but competition policy at supranational level also has to take its place beside industrial policy, social policy and regional policy.

One problem is to decide what form of government intervention is appropriate. If we reject direct government control or outright nationalization as means of repairing the damage done by economic power because for political reasons these are not real alternatives, government still has a number of ways open to it to influence competition. For instance, it can act through trade policy, it can support small business or it can resort to various forms of intervention as part of its industrial policy, price policy or tax policy. The difficulty with all these is that such measures are generally designed to serve ends other than that of securing a competitive environment. Competition policy in the form of antitrust laws should be considered the best approach, then. Once this basic premise is accepted, another problem that arises is how to place these laws in the overall context of the government's economic policy. In the United States, antitrust policy enjoys a large measure of independence, while in other countries much more stress is placed on competition policy's being part of economic policy in general. The latter view is one that can be accepted without much trouble on economic grounds, though care does need to be taken to ensure

that competition policy is not disregarded in the light of the objectives of other areas of general economic policy. Decisions on priorities, however, are a political matter and therefore outside the scope of this study.

This brings us to the question what is the most effective orientation of competition policy. Competition policy has traditionally been aimed at existing dominant positions, the purpose being to take corrective action. Both the economic analysis we have made of the problems of economic power and our survey of the American experience with laws that allow action of this kind make it abundantly clear, however, how limited this approach can be. The difficulties are legion. First, there is the burden of proof. It is very difficult clearly to define the concept of economic power in a way that will facilitate practical application, even if we confine ourselves strictly to the economic aspects, as we have in this study. The extensive analysis to which the concept has been subjected proves that in any case it is impossible to define and assess the phenomenon on the basis of a few simple, mechanical criteria: the economic problems we encounter are too varied to permit this, and a case-by-case approach is always essential, because judgment has to be passed on aspects of business conduct and performance. Then there are the difficulties inherent in the formulation of remedies. Dissolution should be considered the answer only in the case of holding companies; it remains a hazardous undertaking to split off facilities from a going concern. So, at best, dissolution is applicable in a very limited number of cases only. For this reason, we consider that proposals advocating the dissolution of firms in excess of a stated size or proposals that this remedy be applied more frequently should not be given serious consideration. The other remedy, the prohibition of practices deemed to be abusive, does not give complete satisfaction either. It is not only that a number of abusive practices often remain undetected because the victims (other participants in the market) are unwilling to complain for fear of reprisals, but abuse can of its nature only be prohibited after the event – when the harm has already been done to other market participants. The original competitive situation on the market cannot be restored by these means. The major drawback of this approach, however, is that it does not work in oligopolistic markets because the authorities are virtually powerless to prevent oligopolists from manipulating the market mechanism to suit themselves.

In any case, the Americans have been unable to solve the problems of economic power in their economy. The reasons for this are to be found partly in the drawbacks mentioned above and partly in the nature and wording of the Sherman Act. For Section 2 of the Sherman Act forbids 'monopolization' only, and this has been interpreted as being limited to exclusionary tactics.

The only way to make more effective action possible would be to amend the Sherman Act, making the statute more precise and comprehensive. Here, the European approach as shown in Article 86 of the EEC Treaty, which consists of a nonexhaustive enumeration of undesirable practices, should stand as a model. Prohibition of abuse of a dominant position should not be confined to cases where remaining competitors are prevented from acting as they see fit: it should be directed more particularly against a series of practices which are clearly prejudicial to consumers (intermediate or ultimate) and on which the remaining competitors are incapable of exercising a restraining influence. Measures such as this undoubtedly interfere with day-to-day management decisions but on the other hand the dominance of the firm in question is not destroyed by the antitrust authorities, and for reasons we have already stated this must be considered acceptable on both sides. This does not mean, however, that the law should be extended to cover all performance aspects, for that might easily lead to direct government intervention in the way firms are run precisely because it is impossible to formulate strict tests in this field. Another objection is that comprehensive legislation may entail uncertainty in the law and lengthy proceedings.

The only effective means of doing something about dominant positions, then, is to subject the industries where they are presumed to exist to regular examinations for performance and competitive spirit. Priority should be given to industries in which demand is increasing only moderately compared with the average for industry as a whole, since it is in such a situation that market power is likely to make itself felt first of all. If anticompetitive behavior is found, either in a specific industry or in the economy as a whole, publication of the results of investigation could be used to exert pressure on the firms in question.

In view of the great difficulties involved in solving the problems of concentration *ex post facto* by means of antitrust policy, the only proper approach is to take all possible steps to prevent such concentration as is liable to create or reinforce economic power. Since merger is the most common vehicle of concentration, and since it is difficult to act against internal growth, preventive policy should take the form of regulation of mergers. American experience shows the importance of prompt intervention whenever concentration seems likely to take on dangerous proportions. In present European circumstances, therefore, it should by no means be considered premature to have merger laws: they are needed not only in the individual countries but especially for the European Community as a whole because of the growing integration of markets. Of course, they should not be used to put a stop to mergers that would have desirable macroeconomic or microeconomic consequences.

A merger policy is not easy to apply, however. The economic assessment of

mergers is dependent on a large number of divergent items such as the size and resources of the market participants, conditions of entry, the reasons behind the merger and factors extraneous to the actions of market participants. But practical enforcement requires rapid decisions, particularly where premerger-notification rules tie the authorities down to specific time limits. So we are torn between the desirability of simple quantitative criteria and the need for a full economic assessment. There are a number of major objections to writing simple quantitative tests into the law, whereby mergers that would result in a firm exceeding a specified size would be prohibited (with exceptions allowed in special cases only). First, it is difficult to show the existence of economic power on the basis of market share alone, while any policy measure aimed at halting the process of concentration before there are clear signs of market power will find itself opposing corporate activities that cannot in themselves be regarded as conflicting with the conditions of workable competition. Second, the inclusion of quantitative guidelines in the merger law would make enforcement too mechanical and inflexible, preventing account being taken of changing circumstances in individual industries. Moreover, legislation of this kind prevents the courts too from suiting their construction of the law to economic or other circumstances. The most acceptable basis for merger policy, then, is to provide nonquantitative criteria in the law, either in the general language used in Section 7 of the Clayton Act, or by an extensive enumeration of relevant structural tests as in the European Commission's draft merger law. The method is not one that makes it easy for the enforcement agencies to take quick decisions, however, and this may have drawbacks for the effectiveness of a merger policy. For this reason, we cannot entirely dispense with quantitative criteria, but they should best be used as guidelines. Merger guidelines issued by antitrust authorities on the basis of court rulings may well have a point as a means of showing firms considering a merger where they stand. The merger guidelines currently employed by the Department of Justice, however, are too severe: the quantitative limits should be increased to a level at which market power can be inferred. Then, guidelines must not become a substitute for the statutory tests, must not become the sole criteria by reference to which enforcement agencies and courts judge mergers (which is what has happened in the United States). If a merger falls within the terms of the guidelines but the companies involved feel that their merger will not harm competition and their arguments are sound, the merger should be subjected to serious examination by the enforcement agencies and the courts. For the European Community, however, all this is somewhat premature as yet. More insight needs to be gained into the scope and impact of the merger phenomenon in Europe, and the enforcement agencies, both national and supranational, must first build up

a sufficient body of case law before guidelines can be formulated.

If competition policy is to play a fruitful part in general economic policy, then the government must ensure that the requirements of effective competition are not completely overshadowed by other interests of state. Competition policy will have to assume a new role in the future: much more than in the past it must see to it that some sort of balance is held between a variety of macroeconomic targets on the one hand and the maintenance of competition on the other. Economists and politicians will have to work closely together to establish the conditions of equilibrium between the various interests involved. At the same time, this presupposes that since we have imperfect knowledge of how competition in an oligopoly functions and of the relationships between macroeconomic and microeconomic target attainment there is need for additional fundamental economic research so as to give policymakers more guidance in making their decisions.

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2. GOVERNMENTAL AND INTERNATIONAL ORGANIZATION MATERIAL

Note on the citation of European Communities material

Publications of the European Communities normally appear in all the official languages of the Communities – Dutch, French, German, Italian and (since 1 January 1973) Danish and English. Citations in this bibliography and in the footnotes are to the English versions for material published since 1 January 1973, and also for material published before that date where either an official English text has been authenticated (e.g. Treaties, legislative instruments) or the Communities had themselves published an English translation (e.g. General Reports). Otherwise, citations are to the French versions – on the assumption that, of the other Community languages, French is the one most likely to be understood by English-speaking readers.

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In this table of cases and in the footnotes, Court judgments are cited to the English edition of the Court's *Reports* if they were given on or after 1 January 1973 and to the version in the language in which the proceedings were conducted if they were given before that date. Commission decisions which are authentic in one language only (e.g. a decision addressed to a German firm will be authentic in German only) are cited to the edition of the *Official Journal* in that language; other decisions are cited to the French edition if taken before 1 January 1973, to the English edition if taken on or after that date. Cases are listed in alphabetical order, except for the nine ECSC decisions listed last – which are in chronological order.

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STELLINGEN

behorende bij het proefschrift van J. W. L. Th. Aarts

I

De binnenlandse economische politiek van de Amerikaanse regering wil te veel rekening houden met de tegengestelde opvattingen over de rol van de overheid in de volkshuishouding die in de Verenigde Staten leven, met als gevolg dat veelal te laat, te weinig en soms weinig consequent aan de oplossing van de binnenlandse economische problemen wordt gewerkt. Dit heeft dan weer een nadelige invloed op het buitenlands economisch beleid van de Verenigde Staten.

II

De visie van de regering van de Verenigde Staten betreffende de noodzaak van toenemende internationale samenwerking vindt in steeds geringere mate weerklank bij het Amerikaanse volk en zijn vertegenwoordigers. Te verwachten is dat deze ontwikkeling de Amerikaanse buitenlandse politiek de komende jaren zal beïnvloeden, waarbij ook de houding tegenover Westeuropa zal kunnen veranderen.

III

De nieuwe multilaterale handelsronde kan een belangrijke bijdrage leveren om tendensen van isolationisme en protectionisme die sinds een aantal jaren bij enkele van de belangrijkste handelsnaties, en vooral de Verenigde Staten, vallen te constateren (voorlopig) tegen te gaan.

IV

Het gevaar bestaat dat de centrale rol die het Amerikaanse Congres zich in verband met de multilaterale onderhandelingen heeft toegeëigend wegneming van niet-tarifaire handelsbelemmeringen zal hinderen, vertragend zal werken

op het tot stand komen van handelsakkoorden, en protectionistische belangengroeperingen gelegenheid zal geven oplossingen voor deze problemen te dwarsbomen.

V

Een vrijwaringsclausule als handelspolitiek instrument dient selectief en onder internationaal toezicht te worden toegepast.

VI

Door zijn bijdragen tot het beslechten van bepaalde politieke conflicten bewijst Dr. Kissinger dat het paren van wetenschappelijke benadering aan praktisch inzicht positieve resultaten kan opleveren op het gebied van de internationale politiek.

VII

Het is bijzonder nadelig voor de mededingingspolitiek als zelfstandig element in de economische politiek wanneer onder haar dekmantel maatregelen worden genomen om doeleinden na te streven die in strijd zijn met de gezichtspunten die voor de ontwikkeling en uitvoering van de overige mededingingspolitiek bepalend zijn geweest.

VIII

De mening van de Jong, dat het Continental Can arrest van het Europese Hof van Justitie neerkomt op „de opheffing van de dubbele standaard” een ommekeer zal betekenen, in het mededingingsbeleid van de Europese Commissie is onjuist. Een gelijktrekking van beleid met betrekking tot kartels en fusies moet bovendien ook als onwenselijk van de hand worden gewezen.

(Dr. H. W. de Jong, Wending in de Europese mededingingspolitiek, artikel in ESB van 7 maart 1973, citaat op p. 211).

Bibliotheek K. U. Brabant

17 000 01558395 9

ISBN 90.207.0472.9