Merger Doctrine: Some Emerging Issues

Howard Adler Jr.
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by Howard Adler, Jr.**

The late 1960's witnessed an unprecedented merger movement—a movement distinguished particularly by the number of very large acquisitions that were made. Statistics compiled by the Federal Trade Commission show that in 1968 there were 201 acquisitions of manufacturing or mining concerns having $10 million or more in assets, and that these acquisitions accounted for a combined $12.8 billion in assets. Twenty years earlier, in 1948, there were only six acquisitions in this size category, and they accounted in toto for only $101 million in assets.1

The current merger movement is also distinguished by the dramatic role being played by the “conglomerates”. While there are many significant differences among the group of companies commonly known as conglomerates, they do tend to have some characteristics in common. They are new, at least when compared to the established giants of American industry; they tend to be more highly leveraged in their financing than the old line companies; and of course they have achieved rapid growth through acquisitions, including tender and exchange offers made for sometimes unwilling corporate partners.

It was probably inevitable that both the pace of merger activity and the techniques being used by some conglomerates would lead to governmental action aimed at slowing down the merger trend. Tax legislation designed to inhibit the use of debt securities in acquisitions has been enacted;2 the Securities and Exchange Commission has adopted rules that require a conglomerate to make separate financial reports for each of its component product lines;3 accounting rules believed to encourage acquisitions are being modified; and last, but not least, the

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Antitrust Division of the Department of Justice has been unleashed.\(^4\)

The current activity of the Antitrust Division in opposing very large conglomerate mergers is in sharp contrast to the passive role assumed by the Division during the previous administration. The prior administration's position reflected a deliberate policy judgment by Assistant Attorney General Donald F. Turner that Section 7 of the Clayton Act,\(^5\) as presently written, would not prohibit conglomerate mergers just because they are large. It was his position, as reflected both in an article\(^6\) written while he was still a professor at the Harvard Law School and in the Division's Merger Guidelines\(^7\) issued on the eve of his return to Harvard, that in most cases the effects of conglomerate mergers were too ambiguous to permit Section 7 to be invoked.

Shortly after the current administration took office, it became clear that it would assume a more militant stance against conglomerate mergers. In March of 1969, Assistant Attorney General Richard McLaren announced to the Congress that the Division was “willing to risk losing some cases to find out how far Section 7 will take us in halting the current accelerated trend toward concentration by mergers. . . .”\(^8\) Attorney General Mitchell has enthusiastically supported Mr. McLaren and in a speech to the Georgia Bar Association in June, 1969, he announced that “the Department may very well oppose any merger among the top 200 manufacturing firms . . .” and “will probably oppose any merger by one of the top 200 manufacturing firms with any leading producer in any concentrated industry.”\(^9\)

Mr. McLaren has certainly fulfilled his promise to explore the outer limits of Section 7. Since April, 1969, he has brought five potential landmark cases which should go a long way toward determining the latitude of applicability of Section 7 to large conglomerate mergers. Ling-Temco-Vought's (LTV) acquisition of Jones & Laughlin Steel Corporation (J&L) has been challenged;\(^10\) three separate cases have been


\(^6\) Turner, Conglomerate Mergers and Section 7 of the Clayton Act, 78 HARV. L. REV. 1313 (1965).

\(^7\) Department of Justice, Merger Guidelines, in 1 TRADE REG. REP. ¶ 4430 (1968).


\(^10\) United States v. Ling-Temco-Vought, Inc., Civil No. 69-438 (W.D. Pa., filed Apr. 14, 1969). The Department's challenge to LTV's takeover of J&L has, however, now been settled. A consent decree was entered granting LTV the right to retain
filed attacking International Telephone & Telegraph's (ITT) acquisition of Canteen Corporation, Grinnell Corporation and The Hartford Fire Insurance Company; and the Department sued to enjoin Northwest Industries' attempted takeover of the B.F. Goodrich Company. Similar issues were raised by the FTC's complaint against the threatened takeover of Allis-Chalmers Manufacturing Company by White Consolidated Industries, Inc. This article, however, deals primarily with new issues of merger doctrine raised in the recent Department of Justice complaints.

Conglomerate mergers are not virgin territory to the Supreme Court. The Court has discussed and developed concepts of potential competition, reciprocity and entrenchment of leading firms, and has invoked those concepts to invalidate a number of conglomerate mergers. The recent complaints, while couched in terms of potential competition, reciprocity and entrenchment, actually go well beyond anything yet decided by the Court. Specifically, they invite the Court to expand existing merger doctrine in three important areas: 1) Potential competition, 2) reciprocity, and 3) aggregate concentration of manufacturing assets. A fourth area of potential doctrinal significance is the possible role of competitive benefits as a defense under Section 7. The latter is not directly raised by the conglomerate complaints, but several of the defendants have made clear that they will urge that the pro-competitive effects outweigh the possible adverse effects.

I. POTENTIAL COMPETITION

The Supreme Court has dealt with potential competition in several cases. In United States v. Penn-Olin Chem. Co., the Court reasoned that merger with a potential competitor was anticompetitive because

the threat of entry into an oligopolistic market was, in itself, an
important competitive force that ought not lightly be removed. The
Court stated: "[T]he existence of an aggressive, well equipped and
well financed corporation engaged in the same or related lines of com-
erce waiting anxiously to enter an oligopolistic market would be a
substantial incentive to competition which cannot be underestimated."
This reasoning was reaffirmed in FTC v. Procter & Gamble Co.
(Clorox) where the Court found that "the market behavior of the liquid
bleach industry was influenced by each firm's predictions of the market
behavior of its competitors, actual and potential." Procter's acquisi-
tion of Clorox was struck down, in part, because Procter was the "most
likely entrant" into the highly concentrated bleach market, and "the
number of potential entrants was not so large that the elimination of
one would be insignificant." Thus the potential competition theory,
as articulated by the Court, is tied closely to the existence of an oligop-
olistic market and the elimination, as a potential entrant, of one of
relatively few likely entrants.

The Merger Guidelines issued by the previous administration in
May of 1968 appeared to accept that concept of potential competition.
They stated, in essence, that the Department would sue to prevent one of
the most likely entrants into a concentrated market from acquiring one of
the leading firms in that market. In other words, the potential com-
petition theory, as seen by the prior administration, required proof that
the market involved was highly concentrated or oligopolistic, that one
of the merging companies was one of the most likely entrants, and that
the other was one of the leading firms in the market. The recent con-
glomerate merger complaints expand significantly on that theory.

The LTV-J&L complaint is of particular interest since it contains
three separate and distinct potential competition theories, two of which
are novel. The first, and most familiar, is that the merger elimi-
nated LTV as a potential entrant into various sectors of the steel in-
dustry. LTV's track record, however, does not seem to mark it
as a prime candidate for entry into a basic industry, like steel, through

18 Id. at 174.
19 386 U.S. 568 (1967).
20 Id. at 581.
21 Id.
22 Department of Justice, Merger Guidelines, supra note 7, at 6687-88.
23 Complaint, United States v. Ling-Temco-Vought, Inc., Civil No. 69-438 (W.D.
24 Id. at ¶¶ 22, 25, 33(a).
internal growth. Whatever the facts may prove to be, this allegation raises a conventional issue of potential competition which presumably will be resolved on the basis of evidence regarding the extent of concentration in the steel industry, the number of potential entrants, and the likelihood that LTV, had it not acquired J&L, would have entered the steel industry, or some sector of it, through internal expansion or possibly by means of a small “foothold” acquisition.

The other two theories are more fanciful. The first is the claim that both LTV and J&L were diversification minded; that each had considered entering by acquisition a large number of markets, and that both companies had considered entry into certain industries, among them primary aluminum, building materials, machine tools, and industrial and scientific instruments. It is further alleged that many of these industries are highly concentrated, and that LTV and J&L were among a relatively few potential entrants into them. As a result, the complaint charges, “[p]otential independent competition by LTV and J&L may be diminished . . . in certain . . . markets in which neither of them presently competes.”

This situation is different from the typical potential competition case in which an actual competitor merges with a potential entrant, thereby foreclosing entirely the prospect of new entry by the merging company. In the LTV-J&L situation there is no effect on actual competition in the industries which J&L and LTV may have been considering entering. The number of existing competitors remains the same and they continue to face the prospect of entry by the merged firm, if not by the two merging companies separately. All that has happened is that the number of potential entrants has been reduced by one. Conceivably, this might be significant where there were only two or three potential entrants, but a reduction in the number of entrants from six to five, or five to four, would not seem likely to have substantial effect on competition. This is especially true when, as is alleged in the LTV-J&L complaint, both companies were considering entry only by acquisition of an existing competitor—not through internal growth.

The second novel potential competition theory contained in the LTV-J&L case is that the merger, by combining two large diversification minded companies, has reduced “the number of firms capable of entering concentrated markets.” There are two basic problems with

\[\text{\textsuperscript{25} Id. at } \S 27.\]
\[\text{\textsuperscript{26} Id. at } \S 33(a).\]
\[\text{\textsuperscript{27} See id at } \S\ S 20, 23, 24.\]
\[\text{\textsuperscript{28} Id. at } \S 33(c).\]
this allegation. First, it does not claim an effect on competition in any line of commerce in any section of the country, which is what Section 7 requires, but rather, alleges that the economy as a whole will in some way be adversely affected. The second problem is that there are numerous large and well-financed companies with approximately the same capability of entering concentrated markets as J&L. According to the complaint, J&L ranks 100th in sales and 80th in assets, so that there are 80 to 100 firms of greater size than J&L, as well as many of approximately the same or slightly smaller size, which continue to provide a reservoir of potential entrants.

The Department's theories of potential competition have thus far been rejected by the courts. In United States v. Northwest Industries, Inc., the government alleged that the merger would increase aggregate concentration of assets, and thereby would, among other things, reduce the "number of firms capable of entering concentrated markets." Responding to these allegations, the court held that it did not read Section 7 as applying to:

"the consolidation of two of the country's one hundred largest corporations . . . without any specific demonstration of a substantial lessening of competition in any section of the country . . . . The law as it now stands . . . makes the adverse effect on competition the test of validity and until Congress broadens the criteria, the Court must judge proposed transactions on that standard." A similar result was reached in United States v. International Telegraph and Telephone Corp., where the court held that "evidence that a merger may increase economic concentration, without more, is not sufficient to halt a merger under Section 7 without a specific showing that it may have anti-competitive effects."

II. RECIPROCITY

The Report of the Task Force on Productivity and Competition, the

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29 Section 7 provides:

No corporation engaged in commerce shall acquire . . . the whole or any part of the assets of . . . another corporation . . . where in any line of commerce in any section of the country, the effect . . . may be . . . to lessen competition . . . . 15 U.S.C. § 18 (1964), amending 15 U.S.C. § 18 (1946).


35 Id. at 87,658.
“Stigler Report”, emphatically rejected reciprocity as a competitive threat. "The economic threat to competition from reciprocity is either small or nonexistent; monopoly power in one commodity is not effectively exploited by manipulating the price of an unrelated commodity." Professor Posner, in his separate statement in the Report of the ABA Commission to Study the Federal Trade Commission, takes an equally calm view of reciprocity. “Reciprocal buying is . . . hard to fathom either as a means to or as a manifestation of monopoly . . . . [A] prohibition of reciprocal buying seems, therefore, unwarranted; and a rule outlawing mergers that facilitate the practice is built on sand. . . .” Professor Posner adds parenthetically that such a rule can “be used to justify attacking virtually any acquisition by a large company.”

These views have left the Department of Justice unmoved. The five recent complaints (as well as White Consolidated) urge that the merger should be struck down on reciprocity grounds. From the evidence, it appears that the Department agrees only with Professor Posner's parenthetical comment as to the utility of reciprocity in attacking virtually any large company acquisition.

As in the case of potential competition, reciprocity concepts alleged in the recent complaints go well beyond anything yet established by the Supreme Court. The only Supreme Court case to deal with reciprocity is FTC v. Consolidated Foods Corp. The Court held, “where, as here, the acquisition is of a company that commands a substantial share of a market, a finding of probability of reciprocal buying of the Commission . . . should be honored, if there is substantial evidence to support it.” It had no difficulty finding such substantial evidence since, in the Court's words, “reciprocity was tried over and again and it sometimes worked.” In this setting, the Court agreed with the Commission's conclusion that “the two-firm oligopoly structure of the industry is strengthened and solidified and new entry by others is discouraged.” The Court made clear that it was not holding that any acquisition that creates a “probability of reciprocal buying” is unlawful, since, “some

38 Id.
40 Id. at 600.
41 Id.
42 Id. at 601.
situations may amount only to *de minimis.*"\(^{43}\)

*Consolidated Foods* is somewhat extreme on its facts. The Court is not likely to require proof in future cases that reciprocity was actually employed after the merger; nor would it appear essential that the reciprocal buying opportunity created by the merger solidify a "two-firm oligopoly structure". On the other hand, the Court seemed to regard it as essential that there be proof of a probability of reciprocal buying. Thus nothing in *Consolidated Foods* supports the notion that an increase in the opportunity for reciprocity, without more, is enough to show a violation of Section 7.

This could be significant since the Department alleges in its recent complaints that the merged firm will have substantially greater purchasing capacity and product diversity, which will result in an increase in reciprocity power. But increase in reciprocity power, without more, may not be enough to violate the statute. Thus in denying a preliminary injunction in *Northwest Industries*, the court concluded:

> While it is clear that the potential for reciprocity would be substantially increased, the extent to which actual reciprocity would be practiced and, therefore, the probable actual anti-competitive effect thereof, is, on the basis of the present record, difficult if not impossible to forecast.\(^{44}\)

Similar allegations were rejected in the *ITT* cases.\(^{45}\)

One of the most interesting aspects of the recent complaints is the distinction made between "reciprocity" and "reciprocity effect". All five of the complaints contain the following definitions:

> 'Reciprocity' refers to a seller's practice of utilizing the volume or potential volume of its purchases to induce others to buy its products or services. 'Reciprocity effect' refers to the tendency of a firm desiring to sell to another company to channel its purchases to that company.\(^{46}\)

The difference is that "reciprocity" is actively brought about, by agreement or otherwise, whereas "reciprocity effect" just happens as a consequence of a firm's supposed natural tendency to buy from its customers.

Some interesting reciprocity issues are certain to arise in the pending litigation. Suppose for example, that prior to its acquisition by LTV, J&L had an active reciprocity program. Suppose further that LTV had a strict anti-reciprocity policy which all its subsidiaries must ob-

\(^{43}\) *Id.* at 600.


\(^{46}\) See complaints cited notes 49 & 50 infra.
serve, that each of its subsidiaries is operated as a separate profit center, with separate sales and purchasing functions and with substantial public minority ownership, and that, for these reasons, there is no mechanism for co-ordinating sales and purchasing records and activities among the various LTV subsidiaries. Is it not arguable that the acquisitions will lessen, rather than increase, reciprocity, or at least that the structure and *modus operandi* of the company tend to insure that substantial reciprocity will not occur? This is virtually certain to become an important issue in the pending litigation since this defense is being asserted not only by LTV but by Northwest Industries and ITT as well. Indeed, ITT’s separate profit center scheme of organization and its anti-reciprocity policy were given great weight in the ITT cases.47

“Reciprocity effect”, appears to present a real frontier issue. While this notion affords the Department a fallback position if it is unable to prove that the merged company is likely to “utilize” its purchasing power to induce others to buy its products, it raises deep and difficult questions as to whether, in fact, firms will significantly channel their purchases to favor their customers. Probably the most that can be said is that all else being equal, some companies will purchase from their customers. But how often is everything equal? Two years ago, a high Antitrust Division official told the New York Bar that the problem raised by “so-called tacit, unspoken, or accommodative reciprocity . . . [evaporates] once we are enlightened—as we have been—by the discovery that, in its virulent form, reciprocity typically does not happen spontaneously . . . [but] requires affirmative efforts by large corporate organizations.”48 To the extent this is true, it would seem to minimize the competitive importance of the “reciprocity effect”.

III. AGGREGATE CONCENTRATION

The increase in aggregate concentration is alleged to violate Section 7 in three of the Justice Department cases, *LTV-J&L*, *Northwest-Goodrich*, *ITT-Grinnell* and in the FTC’s *White Consolidated* case. The most significant feature of these allegations is that they are cosmic in scope rather than confined to any specific, identifiable product or geographic market.

Relying on statistics developed by the FTC, the Department asserts in four of its five conglomerate complaints that the “proportion of the

total assets of the nation's manufacturing corporations held by the 200 largest firms increased from 48.1 per cent in 1948 to 54.2 per cent in 1960, and to 58.7 per cent in 1967. The fifth complaint, ITT-Hartford, alleges, without benefit of statistics, that "in the last twenty years, an accelerating merger movement in the United States has substantially increased aggregate concentration and eliminated the independent existence of a rising number of very large firms.

Although perhaps not pertinent to the subject of merger doctrine, it is noteworthy that not everyone has accepted the FTC's statistics at face value. For example, the White House Task Force Report on Antitrust Policy, the "Neal Report", after referring to these statistics, had the following to say:

[It] is clear that mergers are not solely responsible for the continued growth of the largest units in the economy, and have accounted for only a minor portion of such growth . . . . Further, the merger movement does not seem likely to cause the disappearance of smaller firms. The numbers of manufacturing firms with assets of $5 million to $10 million, $10 million to $25 million, and $25 million to $50 million have remained steady or increased somewhat during the period of greatest merger activity.

One authority has suggested that there may be statistical infirmities with the FTC's data in that, while purporting to show concentration of manufacturing assets of U.S. firms, they fail to exclude the non-manufacturing assets of U.S. firms, they fail to exclude the non-manufacturing and foreign assets and sales of the top 200 companies.

Even assuming that the FTC's statistics are valid and that they point to an accelerating concentration of manufacturing assets in the hands of the top 200 firms, it does not follow that Section 7, as presently written, can be applied in the absence of anti-competitive effects in one or more identifiable product or geographic markets. Certainly the Supreme Court has always assumed that Section 7 deals with competitive


effects in specific markets. Thus in United States v. E. I. du Pont de
Nemours & Co., the Court observed that:

[D]etermination of the relevant market is a necessary predicate to a
finding of a violation of the Clayton Act because the threatened mono-
poly must be one which will substantially lessen competition 'within the
area of effective competition.' Substantiality can be determined only
in terms of the market affected.

Later cases have adhered to this concept of Section 7. For example,
in Brown Shoe Co. v. United States, the Court noted that "the proper
definition of the market is a 'necessary predicate' to an examination of
the competition that may be affected by the horizontal aspects of the
merger."

The fact that Congress was concerned with increasing concentration
when it amended Section 7 of the Clayton Act in 1950 does not
mean that a merger which increases the concentration of manufactur-
ing assets held by the top 200 firms is unlawful. Congress chose to at-
tack the problem of rising concentration by prohibiting mergers and
acquisitions having substantial anti-competitive effects "in any line of
commerce in any section of the country . . ." There is, perhaps, an
analogy to the criminal law. One of the purposes of the criminal law is
to ensure that dangerous or potentially dangerous persons are isolated
from society. The issue in a criminal case is not whether the de-
fendant is dangerous or potentially dangerous, but whether he com-
mited the specific crime with which he is charged. Similarly in cases
under Section 7, the issue is not whether concentration is increased,
but whether the acquisition has the anti-competitive effects described
in the statute. Significantly, the district courts in both Northwest-
Goodrich and ITT-Hartford rejected the aggregate concentration con-
cept, ruling that if the standard of illegality is to be increase in con-
centration, rather than substantial lessening of competition, this standard
will have to be established by Congress rather than by the court.

54 Id. at 593.
56 Id. at 335.
58 Id.
59 United States v. International Tel. & Tel. Corp., 1969 Trade Cas. 87,633, 87,658
(N.D. Ill. 1969).
IV. PROCOMPETITIVE EFFECTS

The answer in *LTV-J&L* avers that the "static condition of the steel industry, over an uninterrupted period of two decades, indicates that the acquisition of the Jones & Laughlin Steel Corporation by Ling-Temco-Vought, Inc., ... a newcomer in the industry, promises beneficial competitive effects, rather than a lessening of competition . . . ."  

Similarly at the hearing on the Government’s application for a preliminary injunction in *Northwest-Goodrich*, Northwest presented the expert testimony of Dean Rostow, who testified that "the entrance of new forces and new ideas into the market can increase the intensity of competition in particular markets, rather than diminish it . . . [and that] the new policy-making system in Goodrich Company will intensify competition in the rubber industry."  

Thus in considering the new conglomerate cases, the courts are almost certain to be called upon to consider as a defense the mergers’ possible procompetitive effects.

In the past, the Supreme Court has been unreceptive to arguments that the anti-competitive effects of a merger could be outweighed by countervailing economies or competitive benefits. In *United States v. Philadelphia National Bank,* the Court observed that "[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." Accordingly, the Court rejected defendant’s argument that anti-competitive effects in the Philadelphia market would be offset by the fact that the merged bank would be enabled to compete more effectively with New York banks for very large loans. Likewise, in *Procter & Gamble*, the Court held that "[p]ossible economies cannot be used as a defense to illegality. Congress was aware that some mergers which lessen competition may also result in economies but it struck the balance in favor of protecting competition."  

While this authority is somewhat forbidding, it does not foreclose a balancing of pro and anti-competitive effects in the context of the recent conglomerate merger cases. The prior cases can be analyzed as holding that once it has been shown that a merger may substantially lessen com-

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63 Id. at 371.
petition in one or more lines of commerce, then it is irrelevant that
the merger may promote competition in some other line of commerce
or that it may lead to possible economies. On this analysis, the cases do
not foreclose a weighing of competitive advantages and detriments in
determining in the first instance whether a violation of the statute has been
shown with respect to "any line of commerce". Accordingly, the
Court might well conclude that it is not only proper, but necessary, to
weigh the possible benefit of injecting new ideas and new energy into
a previously static and underperforming market against the possible
adverse effects of losing one of several potential entrants or increasing
the potential for "reciprocity effect". In any event, this significant
frontier issue should finally be resolved in these recent conglomerate
merger cases.

CONCLUSION

So far, as we have seen, the novel theories of illegality being advanced
in the conglomerate merger cases have been rejected. It would be a
mistake, however, to assume that merger doctrine will not ultimately be
transformed in the manner foreshadowed by the Department's com-
plaints. In the earlier years of Section 7 enforcement, the Department
lost most of its horizontal merger cases at the district court level. In
virtually every case, the Supreme Court reversed. The lesson of this his-
tory is that in the final analysis it is the Supreme Court that determines
the nation's policy with respect to corporate acquisitions and mergers.
Thus we will have to wait for the pending cases to be decided by
the Court before we will know how the important new issues of
merger doctrine raised by the Government's recent complaints will be
resolved.

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65 To show a violation of the Statute it is necessary to establish a lessening of
competition in a "line of commerce." A "line of commerce" refers to a product
market which is any product or group of products that has sufficient peculiar char-
acteristics and uses that make it distinguishable from all other markets and products.
370 U.S. 294 (1962). The Court's inquiry into whether competition has been decreased
within that line of commerce will probably include a weighing of the pro and anti-
competitive effects of the merger.