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AFFIRMATIVE BENEFITS OF INDUSTRIAL MergERS AND SECTION 7 OF THE CLAYTON ACT

RICHARD A. GIVENS†

The 1950 amendment to section 7 of the Clayton Act¹ not only made acquisitions of assets as well as stock subject to its limitations upon mergers, but also made it clear that section 7 prohibited some mergers which would be permitted if section 2 of the Sherman Act with its prohibition of monopolizing had been the only standard.² The 1957 decision in the DuPont-GM case³ further indicated that even the unamended section 7 could be applied to strike down stock acquisitions made many years in the past, while the Bethlehem-Youngstown⁴ and American Crystal Sugar⁵ decisions demonstrated the amended section was likely to be vigorously applied. In the light of these decisions, it becomes important to consider the possible relevance of affirmative benefits of mergers questioned under the section.

Price competition between two enterprises is as completely eliminated by a combination of the two into one enterprise as by an agreement between them upon the prices to be charged. Yet the price fixing

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1. "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.

"No corporation 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 one or more corporations engaged in commerce, where in any line of commerce in any section of the country, the effect of such acquisition, of such stocks or assets, or of the use of such stock by the voting or granting of proxies or otherwise, may be substantially to lessen competition, or to tend to create a monopoly.

"This section shall not apply to corporations purchasing such stock solely for investment and not using the same by voting or otherwise to bring about or in attempting to bring about, the substantial lessening of competition. Nor shall anything contained in this section prevent a corporation engaged in commerce from causing the formation of subsidiary corporations for the actual carrying on of their immediate lawful business, or the natural and legitimate branches or extensions thereof, or from owning and holding all or a part of the stock of such subsidiary corporations, when the effect of such formation is not to substantially lessen competition..." 64 Stat. 1125 (1950), 15 U.S.C. § 18 (1958), amending 38 Stat. 731 (1914).

agreement is clearly illegal in and of itself under the antitrust laws, whereas the merger will be frequently upheld. A sharp distinction has developed under the antitrust laws between loose-knit combinations among independent enterprises, which are frequently held illegal \textit{per se}, and close-knit combinations resulting in a unified enterprise, which are not. In order to develop workable criteria for the legality of close-knit combinations, we must search for the basis for this distinction between loose-knit and close-knit combinations and seek to understand the reasons lying behind it.

These reasons cannot lie in differences in the lessening of competition resulting from close-knit and loose-knit combinations. Competition is eliminated far more completely by a close-knit combination such as a merger than by agreements limited to specific business policies. If the impact upon competition were the sole test, either both close and loose-knit combinations would fare equally harshly, or the loose-knit would be more frequently permitted. Yet the result has been the precise opposite.

A clue to the basis for holding many kinds of loose-knit combinations illegal in themselves while upholding far more competition-destroying close-knit combinations is suggested in the opinion in \textit{Northern Pacific Ry. v. United States}, holding preferential routing contracts between a railroad and lessees of its lands unlawful under the Sherman Act:

\begin{quote}
. . . there 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. . . .\textsuperscript{10} (Emphasis added.)
\end{quote}

The question of "lack of any redeeming virtue" is the chief distinction between those kinds of loose-knit combinations which are held in

\begin{itemize}
\item 10. \textit{Id.} at 5.
\end{itemize}
unreasonable restraint of trade in and of themselves and the close-knit combinations. Loose-knit combinations such as agreements fixing prices or allocating markets do not permit economies of scale or from unified management to be achieved, nor do they permit the greater resources of unified enterprises to become available for research or development. On the contrary, such loose combinations for internal political reasons must seek to maintain their least efficient members in business at the expense of the public. Thus the loose-knit combinations which have been condemned have none of the redeeming virtues which sometimes apply to large industrial enterprises, arising through mergers or internal growth.

That the distinction between loose-knit and close-knit combinations is essentially based upon the probable affirmative benefits of many close-knit combinations was explicitly recognized by the Supreme Court in holding that DuPont did not have an illegal monopoly in the cellophane market: "A considerable size is often essential for efficient operation in research, manufacture and distribution." This does not mean that larger units are necessarily more efficient in all cases, or in any particular case. It does suggest that the reason for our reluctance to break up or block close-knit combinations has been our desire not to obstruct the development of enterprises of the size necessary for modern industrialism. The chief cases prior to 1950 in which close-knit combinations were broken up or blocked under the antitrust laws have been railroad cases during the period when competing forms of transportation had not yet

11. See note 6 supra for cases exemplifying the rule of per se illegality.
13. Pribram, Cartel Problems 86-87 (1953); see Burns, The Decline of Competition 20-21 (1936); Note, 58 Colum. L. Rev. 673, 683-84 (1958). Even loose-knit combinations have been upheld, of course, where the specific facts indicated that possible affirmative benefits took the restraints out of the intent of the antitrust prohibitions. See Maple Flooring Mfrs. Ass'n. v. United States, 268 U.S. 563 (1925); see also Chicago Board of Trade v. United States, 246 U.S. 231 (1918); Appalachian Coals, Inc. v. United States, 288 U.S. 344 (1933). On the other hand, many specific kinds of loose-knit combinations have been held so devoid of redeeming virtue as to be illegal in and of themselves. See, e.g., cases cited notes 6, 12, supra.
15. On the relationship between size and efficiency which can be either favorable or unfavorable depending upon the circumstances, see the authorities cited in Kessler & Stern, Competition, Contract, and Vertical Integration, 69 Yale L.J. 1, 8-10 (1959); Note, 68 Yale L.J. 1627, 1654-1662 (1959); Note, 58 Colum. L. Rev. 673, 683 n. 74 (1958).
come into their own.\textsuperscript{16} Except for the early railroad cases, the decision of Judge Learned Hand in the \textit{Alcoa} case in 1945\textsuperscript{17} was the only successful major challenge before 1950 to a large unified enterprise or close-knit combination based upon its degree of market control as distinct from its coercive methods, and even there no relief was ultimately awarded because of changed conditions at the time relief was considered.\textsuperscript{18}

Prior to the 1950 amendment, section 7 of the Clayton Act had been almost completely a dead letter. It did not apply to acquisitions of assets but only to acquisitions of stock.\textsuperscript{19} If the party acquiring stock could then consummate an asset acquisition before proceedings began, the statute was held inapplicable.\textsuperscript{20} Since a literal interpretation of the wording of the 1914 act would have banned all stock acquisitions between competing corporations it was held to merely prohibit such acquisitions as would be banned in any event by the Sherman Act.\textsuperscript{21}

The 1950 act was designed to correct these shortcomings.\textsuperscript{22} In this context, it is clear that no general presumption that mergers are necessary to industrial efficiency should be permitted to make the amended section 7 a dead letter as was its predecessor; on the other hand, there is also no need to assume that it was the intention of Congress to completely obliterate the distinction between close-knit and loose-knit combinations which had been a part of our antitrust philosophy for many years, or to ignore the reasons behind this distinction. In fact, should section 7 be rigidly applied to prohibit almost all mergers of any size, it might run counter to an overriding national policy of protecting the productiveness of our economy in its great competition with totalitarian systems. The courts have in fact avoided commitment to any automatic approach of illegality in section 7 cases by interpreting the statutory criterion of “to substantially lessen competition” as contemplating a qualitative rather than merely a quantitative inquiry.\textsuperscript{23}

\textsuperscript{17} United States v. Aluminum Co. of America, 148 F.2d 416 (2d Cir. 1945), approved in American Tobacco Co. v. United States, 328 U.S. 781 (1946).
\textsuperscript{20} Arrow-Hart & Hegemen Elec. Co. v. FTC, 291 U.S. 587 (1934); see Note, 52 Colum. L. Rev. 766, 769 (1952).
\textsuperscript{21} See authorities cited, note 7 \textit{supra}.
\textsuperscript{23} See Note, 58 Colum. L. Rev. 1269, 1281-82 (1958).
The difficulty with considering the underlying reasons for the distinction between close-knit and loose-knit combinations in section 7 cases involving close-knit combinations is that it may lead to an incredibly complex economic investigation which the courts are ill-equipped to undertake and which will frequently lead to inconclusive results. For these reasons, many courts have taken the position that they cannot consider whether, for example, a proposed merger will increase industrial efficiency, and this has not been recognized as a separate and independent defense in any decision under the amended section 7. It appears probable that affirmative benefits based upon efficiency will not be recognized as a separate defense in section 7 cases. The same appears true of any defense based upon the revitalizing of competition by a stronger merged enterprise competing with others. The defense that one party to the merger would otherwise fail has been accepted in some cases. This defense flows logically from the fact that the competition of the failing firm would be eliminated in any event, by either merger or failure. The case where one party to a merger would otherwise fail is a clear example of the relevance of affirmative benefits but is a special situation from which it is difficult to generalize to the more controversial kinds of cases where affirmative benefits are alleged.

Assuming that no detailed economic inquiry into whether a challenged merger will or will not strengthen economic productiveness can be workably undertaken in section 7 cases, the inquiry here is whether broad distinctions between types of acquisitions nevertheless can give some effect to the reasons underlying the distinction between close and loose-knit combinations without involving an "economic extravaganza."

One way in which these questions will be considered by the courts is

24. Cf. Northern Pacific Ry. v. United States, 356 U.S. 1, 5 (1958) (one reason for per se rules in Sherman Act cases is to avoid "an incredibly complicated and protracted economic investigation.")


27. See Note, 58 Colum. L. Rev. 1269, 1285-86 (1958).


as an undefined felt element in decisions articulated in terms of the degree of lessening of competition. Thus, for example, the concept of relevant market is highly flexible, as are the concepts of substantial lessening of competition, and of lines of commerce and sections of the country. In fact, there is no principle which dictates that these terms mean precisely the same thing in different contexts. If two mergers are under consideration, one in a vital defense industry involving large scale research efforts requiring expensive facilities and huge investments in plant and equipment, the other in a light consumer goods industry where only a small investment is clearly necessary for efficient operations, the decisions in the two cases may well differ even if no explicit issue concerning efficiency is tried. Whether or not this kind of weighing of background factors which are not always articulated is desirable, it is probably at least to some extent inevitable, and should be recognized.

There are, however, three broad distinctions which may be drawn between different kinds of close-knit combinations without a detailed inquiry into the economic circumstances in each case.

The first is whether the combination involves merely a stock acquisition, or an actual integration of industrial operations. Where merely a stock acquisition is involved, the possible advantages in terms of industrial economies are greatly lessened if they are present at all. On the other hand the lessening of competition may be almost as great as where there is complete integration. Consequently, mere acquisitions of stock without any integration of operations might properly be classed as loose-knit rather than close-knit combinations for purposes of the distinction drawn between these two types of combinations under the antitrust laws. Such an interpretation would find support in the fact that stock acquisitions were restricted by the 1914 version of section 7 long before its amendment in 1950 to include asset acquisitions as well. In 1914, Congress felt that stock acquisitions alone were often particularly undesirable, and this judgment may remain valid today, even though asset acquisitions are also subject to judicial review under amended section 7. This approach would be supported by, and explain the result in, the DuPont-GM case which struck down the holding of substantial portions of GM stock

by a substantial seller to GM even though the acquisition had occurred many years earlier. Viewed as confined to a case where there is no industrial integration which might promote the public interest in economic productivity, the decision would not necessarily have the drastic results often attributed to it. The fact that the reasons for more favorable treatment of close-knit combinations were absent in theDuPont-GM case forms a ground for distinguishing that decision as a precedent in a future case where a true close-knit combination is involved; it also strengthens the applicability ofDuPont-GM in future cases where purely stock acquisitions, which would have been subject to attack under the 1914 version of section 7 as well as the amended section, are challenged. This would not mean that stock acquisitions not contemplating industrial integration should be illegal in themselves, but that a greater showing of lessening of competition might properly be required where industrial integration is involved than where, as inDuPont-GM, only a stock acquisition is challenged. The test here would not be a purely formal one of whether a separate corporate entity survived as a subsidiary whose stock was held by the acquiring company, but rather a realistic one of whether integration of operations was involved or not. Of course if stock acquisitions are used as a coercive method of competition against the corporation whose stock is purchased, a further issue also arises.

A second distinction which may be drawn is between recent acquisitions of stock or assets and those which are many years old. TheDuPont-GM case indicates that there is no time limit on the application of section 7 and that the lessening of competition is to be judged at the time of adjudication rather than at the time of acquisition. This case, however, involved a stock acquisition only, as previously pointed out. The breaking up of an industrial merger of many years standing would

33. For criticisms of the decision based upon its applicability to section 7 cases generally rather than merely those where there was no industrial integration see, e.g., Adelman, The DuPont—General Motors Decision, 43 VA. L. Rev. 873 (1957); Handler, Annual Review of Recent Antitrust Developments, 12 The Record 411 (1957); Markham, The DuPont-General Motors Decision, 43 VA. L. Rev. 881 (1957); Rogers, U.S. v. DuPont—A Judicial Revision of section 7, 2 Antitrust Bull., 581 (1957). A further problem raised by stock acquisition cases such as DuPont-GM concerns the tax consequences of divestiture of the stock at one time or during a limited time. This problem could be dealt with by separate legislation. See Note, 6 Howard L.J. 70 (1960); H.R. Rep. No. 8126, 86th Cong., 1st Sess. (1959). Another alternative would be the use of a voting trust removing the power of voting from the stock in question, if that would be an adequate remedy in the particular case.

34. Cf. American Crystal Sugar Co. v. Cuban-American Sugar Co., 259 F.2d 524 (2d Cir. 1958), affirming 152 F. Supp. 387 (S.D.N.Y. 1957). Of course, in determining whether a stock acquisition may substantially lessen competition, the questions of whether the acquisition was for investment purposes only, or for control, and of the degree of control acquired, are relevant.
involve two great difficulties absent in the DuPont-GM case: (1) the assets and identities of the merged enterprises might be inseparably intertwined, leading to difficulties in accomplishing a separation ("un-scrambling the eggs"); and (2) industrial efficiency might suffer because of the disruption of established relationships within the working parts of an integrated enterprise. Accordingly it should be held that where a consummated merger involving actual integration of operations of several years standing is challenged, either the standards of section 7 of the Clayton Act should approach those of the Sherman Act, or the Sherman Act rather than the Clayton Act test should be held to apply. This would mean that except where true monopolization is approached, coercive practices would be necessary for condemnation. 35 Such a differentiation is logical in view of the distinction between section 7 and the Sherman Act itself.

A third distinction may be drawn between cases where some justification of a merger as designed to make possible integrated operations for more efficient research or production is presented, and where no such justification exists in any degree. This is relevant not merely to whether affirmative benefits would in fact flow from the merger, but to the issue of lessening of competition itself. The Northern Pacific Ry. case 36 indicates that where a tying agreement is entered into, it will be assumed to be an exercise of monopoly power unless some other explanation is offered. Where no affirmative public benefits whatsoever are presented in support of a challenged merger, it is likely to be assumed as a practical matter that the chief purpose was to gain greater market power for the acquiring concern. Evidence of possible public benefits through efficiency or other results should be admitted at least for the purpose of repelling such an adverse inference. The issue then would not be whether the claimed benefits would in fact flow from the merger, but rather whether there was a sufficient possibility of such benefits to afford a motive for the merger other than a naked increase in market power. If a motive other than increase in market power alone might reasonably have existed, the probabilities are less that a substantial lessening of competition will result. While a motive to secure affirmative benefits of industrial efficiency need not be inconsistent with a further motive to secure greater market power, if the sole motive were to add market power the inference might be drawn that a lessening of competition would be

especially probable. The defendant should be allowed to negate such an inference by showing affirmatively any motive to secure benefits other than market power. That the aim of business conduct is relevant to determining its probable result was made clear in the Trenton Potteries decision which laid down the rule that private price fixing agreements were unreasonable in themselves, when the Court said that "the aim and result of every price-fixing agreement, if effective, is the elimination of one form of competition." (Emphasis added.)

Since the issue would be whether there was any motive for the merger other than an increase in market power, rather than whether affirmative benefits would actually result, an "economic extravaganza" should not be necessary. If the defendant is able to introduce any evidence at all of reasonably contemplated affirmative benefits, this should be pertinent on the issue of motive, without attempting to determine whether the contemplated benefits would in fact flow from the merger. By the same token, this would not make affirmative benefits a separate defense in a section 7 case, because even though the motives underlying the merger were found to be other than mere aggregation of market power, the court might nevertheless find that the merger did substantially lessen competition. Motive is merely one element to be considered on the issue of lessening of competition, and possible affirmative benefits constitute one factor to be considered in evaluating the probable motives for an acquisition. The distinction concerning evidence of motive of course interlaces with that between actual industrial integration and the mere acquisition of stock, because in a purely stock acquisition such as that in the DuPont-GM case where no integration of operations occurred, the motive for the acquisition could not have been affirmative benefits to operating effectiveness, but rather either control, investment or both.

Finally, the controls which are available to limit any abuses which might result from greater market power may be relevant. Thus if an industry is subjected to detailed regulation, the benefits which may flow from large enterprise may outweigh possible abuses which are limited by regulation, even though the merger might otherwise be held unlawful. This is recognized in the provisions of amended section 7 referring to the authority of the major federal regulatory agencies. It may also be recognized in Sherman Act cases under the flexibility of the rule of reason.  

38. See Note, 58 COLUM. L. REV. 673, 681-88 (1958); see also Givens, Parallel Business Conduct Under the Sherman Act, 5 ANTITRUST BULL. 273, 286-89 (1960). Regulation, while significant as a safeguard of the public interest, is regarded today.
If these differences between kinds of cases in which stock and asset acquisitions are challenged are recognized, the purposes underlying section 7 will be more fully realized, because it will not be necessary to hold the section inapplicable in almost all cases, as under the old section 7, in order to prevent unworkably drastic results. A recognition that two factors must be weighed in each case, the benefits of the acquisition, and its detriment to competition, will lead to more workable results consistent with the public interest. The difficulties of weighing each factor may lead the courts to seek to develop categories of kinds of cases rather than viewing each case as an entirely new problem. In the case of the benefits of mergers, some of the categories which may warrant consideration relate to whether an acquisition involves integration of operations or merely stock control; whether the combination was recent or of many years standing; whether reasons other than an extension of market control can account for the combination; and whether regulatory controls may counter-balance possible abuses of market power.

The question remains whether these distinctions are permissible under the statute. It appears that they are. The differentiation between purely stock acquisitions and asset acquisitions involving industrial integration finds support in the early recognition of the need to limit stock acquisitions in the 1914 act, which was continued in the 1950 amendment. Asset acquisitions once accomplished are difficult to reverse, and unlike stock ownership do not exercise an identifiable separate and continuing influence upon competition which can be measured at the time of adjudication as distinct from the time of acquisition. Whether a motive, other than desire to increase market power, can be shown for an acquisition is itself probative of the probable effect upon competition and is hence clearly relevant. Finally, regulation is explicitly recognized as relevant in section 7, and may be considered under the rule of reason where the Sherman Act is invoked.

The consideration of these factors is also consistent with our fundamental developing philosophy of antitrust law. Such consideration will take account of the underlying reasons for the difference of treatment of close-knit and loose-knit combinations. It can do so without involving an "economic extravaganza" or passing upon masses of economic evidence in each case. It will not nullify the congressional purpose, expressed in the 1950 act, that mergers be realistically scrutinized for their effect upon competition rather than being almost routinely upheld as under the 1914 act. It will make section 7 more workable and thereby strengthen its long-term prospects for effectiveness.
AFFIRMATIVE BENEFITS

The great economic power of the large organizations created by, and frequently necessary to, modern industrialism can be dealt with in several different ways. One approach is to consolidate all power in a single agency, against which the individual is helpless. This is the approach of the totalitarian dictatorship, whether of extreme left or extreme right. We have rejected that approach. A second approach, favored by Mr. Justice Brandeis,\(^\text{39}\) would be to seek to break up large units into small decentralized segments. This approach is not workable today. The third approach is to seek to insure that concentrated power is responsibly exercised, while refusing to permit large increases in concentration of power where it is not truly necessary. It is this third course which we have followed in its broad outlines. Interpretation of section 7 to include some reference to the benefits of, and need for, industrial combinations, without either making the section a dead letter as was the 1914 act, or engaging in an "economic extravaganza," is in accord with this tradition.

It is significant that Mr. Justice Stone, one of the greatest architects of our antitrust law,\(^\text{40}\) while he took the same position in the case in question, refused to join Justice Brandeis' opinion exploring the evils of bigness as such.\(^\text{41}\) On the other hand, he felt most deeply that power implied responsibility. In fact, he was willing to read that principle into broad statutory provisions\(^\text{42}\) perhaps on the ground that it was a presupposition which Congress must have intended to be applicable where broad language permitted its application.\(^\text{43}\)

An interpretation of section 7 to permit some consideration of the

\(^{39}\) See, e.g., Liggett Co. v. Lee, 288 U.S. 517, 580 (1933) (Brandeis, J., dissenting). For an interesting recent discussion of the pros and cons of this position, see Berle, Legal Problems of Economic Power, 60 COLUM. L. REV. 4 (1950), and Cary, Comment, id. at 11.


\(^{41}\) See Liggett Co. v. Lee, 288 U.S. 517, 580 (1933) (Brandeis, J., dissenting); Comment, 66 YALE L.J. 69 (1956).


reasons for stock and asset acquisitions, even though these reasons would not constitute a separate and complete defense in a section 7 case, would be in accord with the philosophy underlying Mr. Justice Stone's approach. To the extent that the justifications for an acquisition can be considered without an "economic extravaganza," the courts will in effect exercise judicial review over the use of economic power in this specific field, balancing the need for the acquisition against the detriment to competition and its values. Cutting across the desirability of such a full balancing of the conflicting needs is the unworkability of a full consideration of the economic factors in each case. This is reflected in the wording of the statute, which in terms refers only to the impact upon competition. However, some recognition of the possible justifications of an acquisition, to the highly limited extent discussed here, would seem both workable and consistent with the statutory scheme. It would be in accord with the public interest and would help to strengthen the workability and long-range effectiveness of the antitrust laws, and through them, of our economy.