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Antitrust--Standards for the Conglomerate Merger

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Utilizing the doctrine of the *MacPherson* case, the courts will likely impose a duty on the manufacturer to use due care in ascertaining the effect of his product on hypersensitive consumers and to warn the consumer of any discovered danger. Although the imposition of that duty might result in strict liability, it would have the beneficial effect of hastening the elimination of allergens from many products.

The *Sterling Drug* case appears to be the beginning of strict liability in the field of prescription products. It does not seem highly improbable that such liability will, in the very near future, extend into the field of non-prescription products.

Jack R. Anderson

ANTITRUST—Standards for the Conglomerate Merger

Procter & Gamble, a large, diversified manufacturer of low price, high turnover household products — primarily soaps, detergents and cleaners — merged with Clorox Chemical Company, the leading manufacturer in the heavily concentrated household liquid bleach industry. The Federal Trade Commission ordered divestiture.[1]

Without placing any reliance on post-acquisition evidence, the Commission found that the merger violated Section 7 of the Clayton Act.[2] The Commission believed the merger might substantially lessen competition or tend to create a monopoly in the production and sale of household bleaches. The substitution of Procter's huge assets and advertising advantages

[1] FTC v. Procter & Gamble Co., 63 F.T.C.——(1963), *rev'd,* 358 F.2d 74 (6th Cir. 1966), *rev'd,* 87 S. Ct. 1224 (1967).

[2] 15 U.S.C. § 18 (1964).

for the already dominate Clorox would dissuade new firms from entering the bleach market as well as discourage active competition from firms already in the industry. There was danger that Procter might underprice its Clorox bleach in order to drive out competition by subsidizing the loss with revenues from other products. Because they might stock other products manufactured by Procter, retailers could be induced to give favored shelf space to Procter's Clorox bleach. The Commission also pointed out that the merger would seriously diminish potential competition. Prior to the merger, Procter was the most likely entrant into the liquid bleach industry. Without the merger, Procter would have remained on the periphery and restrained Clorox from exercising its dominant market power. The practical tendency of the merger was to transform the bleach industry into a market where only big businesses could successfully compete. Unable to compete with their giant rivals, the remaining small firms would fall by the wayside.[3]

The Court of Appeals for the Sixth Circuit set aside the Commission's order. The court held the Commission's finding of illegality to be mere "treacherous conjecture" based upon hypotheses which the evidence showed had never taken place.[4] Even though Clorox controlled almost fifty percent of the household liquid bleach industry and only six firms controlled eighty percent, the court dismissed the fact that the market was oligopolistic. It relied heavily on post-acquisition evidence to point out that subsequent to the merger producers were selling more bleach for more money than ever before[5] and that there had been no significant change in Clorox's market share in the four years subsequent to the merger.

The Supreme Court, in reversing the circuit court, stated

3 87 S. Ct. at 1228-229.

4 358 F.2d at 83.

5 *Cf.* Utah Pie Co. v. Continental Baking Co., 87 S.Ct. 1326 (1967) (similar argument involving price war).

that the court had misinterpreted the standard applicable in a Section 7 proceeding.[6] All mergers are within the reach of Section 7, whether they are classified as horizontal,[7] vertical[8] or conglomerate.[9] The purpose of Section 7 is to arrest the anticompetitive effects of market power in their incipiency. The core question is whether a merger may substantially lessen competition. This necessarily requires a prediction of the merger's impact on both present and future competition.[10] Section 7 deals with probabilities only, not certainties.[11]

Since the 1957 decision of *United States v. E. I. du Pont de Nemours & Co.*,[12] numerous legal periodicals discussed the antitrust problems faced by large corporations seeking to

6 87 S. Ct. at 1229.

7 *A horizontal merger* is an acquisition by a producer of the stock or assets of a firm producing an identical product or close substitute and selling in the same geographic market. Turner, *Conglomerate Mergers and Section 7 of the Clayton Act,* 78 HARV. L. REV. 1313, 1315 (1965).

8 *A vertical merger* is an acquisition of the stock or assets of a firm that buys the products sold by the acquirer or sells a product bought by the acquirer. *Id.*

9 A *pure conglomerate merger* is one in which there are no discernible economic relationships between the business of the acquiring and the acquired firm. *Id.*
Mixed conglomerates have some vertical or horizontal relationships. They include the acquisition of a firm producing the same product as the acquirer but selling in a different geographic market, and the acquisition of a company manufacturing a different product which is nevertheless related to a product or products of the acquiring firm because it can be produced with much the same facilities, sold through the same distributing channels, or made a part of the same research and development efforts. *Id.*

10 87 S. Ct. at 1229.

11 *Id.*; Brown Shoe Co. v. United States, 370 U.S. 323 (1962).

12 353 U.S. 586 (1957).

diversify into other areas through the process of merger.[13] The central themes of the articles favoring the corporate position are:

1. Large corporations are being penalized for their bigness by being deprived of the economies that are possible by entering a new industry through merger.
2. Other than in theory, it has not been proved that mergers of this type actually have an anti-competitive effect.

Donald Turner, head of the Antitrust Division of the Department of Justice, has suggested that the antitrust standards should be less severe on conglomerate mergers than on other types of mergers. He believes the anticompetitive consequences of the conglomerate merger are the least predictable. The arrangement simply substitutes one firm for another and leaves the industry concentration as it was. [14]

To understand why the Court has ignored all of these arguments one must realize that "[t]he problem of antitrust is a problem of the use of power."[15] The antitrust laws arose as a reaction to the rising tide of economic concentration in the American economy. They are the political expression of the American belief in a free enterprise system. In the famous *United States v. Trenton Potteries Co.* decision, Mr. Justice Stone remarked that

> [t]he power to fix prices whether reasonably exercised or not, involves the power to control the market and

[13] *See, e.g.,* Blair, *The Conglomerate Merger in Economics and Law,* 46 GEO. L.J. 672 (1958); Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics,* 74 HARV. L. REV. 226 (1960); Turner, *supra* note 7.

[14] Turner, *supra* note 7, at 1320, 1322.

[15] Hamilton, *The Legal Tolerance of Economic Power,* 46 GEO. L.J. 561 (1958).

> to fix arbitrary and unreasonable prices. The reasonable price fixed today may . . . become the unreasonable price tomorrow . . . . Agreements which create such potential power may well be held to be in themselves unreasonable or unlawful restraints, without the necessity of minute inquiry whether a particular price is reasonable or unreasonable as fixed and without placing on the Government . . . the burden of ascertaining from day to day whether it has become unreasonable through the variation of economic conditions.[16]

Mr. Justice Stone feared that the Court might become the battleground of rival economic philosophies.

The reference to *Trenton Potteries* should not infer that anytime a large corporation seeks to diversify through merger it should be struck down as anticompetitive per se. The effect of any particular merger depends not only upon the physical structure of the market entered, but also upon the power relationships which exist between the competitors.[17] The size of a firm, its sales in dollars, and its percent of the total market give important information in determining its anticompetitive effect. However, the relative effect of all factors varies with the setting into which they are placed. Competition is not a static thing—it is action and reaction. Under the theory of workable competition, no competitor can reasonably make a marketing decision without considering the response his actions will evoke from the others.[18] In any industry a given equilibrium should be established which reflects the relative power and behavior of the component firms. It is the task of the antitrust lawyers to predict the extent to which merger will alter this established equilibrium.[19]

An atomistic industry is one in which there are generally small competitors, none of whom possess any monopoly power.

[16] 273 U.S. 392, 397-98 (1927).
[17] *See* REPORT OF THE ATTORNEY GENERAL'S NATIONAL COMMITTEE TO STUDY THE ANTITRUST LAWS 43-62 (1955).
[18] *Id.* at 315-42.
[19] *Supra* note 17.

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If a firm possessing monopoly or oligopoly power in another industry enters an atomistic industry, it will significantly affect the action of competitors in the newly entered market.[20] Aware of their vulnerability to the leverage which could be applied by the conglomerate, small firms may be reluctant to challenge their new competitor. Yet, this problem exists whether the conglomerate enters the new industry through merger or internal expansion. No law states that a firm may not compete because of its size.[21]

The problem is different in an oligopolistic market. The industry is dominated by a few concerns which possess, either individually or collectively, monopoly power.[22] The substitution of a large diversified company, possessing great market power, for one of the oligopolists would be considered good business. It merges the resources and marketing ability of the former with the industrial know-how of the latter. However, redeeming social or economic values will not save an act when it violates the antitrust laws. Congress supposedly weighed these values when it amended Section 7. "It therefore proscribed anticompetitive mergers, the benign and malignant alike, fully aware . . . that some price may have to be paid."[23]

If Procter entered the household liquid bleach market through internal expansion, it is probable that it would have become one of the oligopolists, challenging Clorox for its share of that market.[24] The Commission noted that Procter was the most likely entrant to the industry. It must be remembered that Clorox had the particular knowledge of the household liquid bleach industry which Procter desired

20 Blair, *supra* note 13, at 690.

21 United States v. United States Steel Co., 251 U.S. 417 (1920).

22 Blair, *supra* note 13, at 693.

23 United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 371 (1963).

24 87 S. Ct. at 1229.

to obtain and utilize. Without it, an entry by Procter was subject to new-market blunders.

In *United States v. First National Bank*[25] the Court noted that "the image of bigness" is a powerful attraction to customers, an advantage that increases progressively with size. The Commission doubted that the remaining companies could compete with the aggressive campaign that Procter could muster. The natural effect of this type of merger is for small companies to drop out of competition and large companies to seek merger. What was once an oligopoly of relatively small companies could be transformed into a triopoly or duopoly of corporate giants.

This danger of superconcentration underlies all antitrust laws. Mr. Justice Brennan, in *United States v. Philadelphia National Bank,* stated that because of Congress' intense concern with superconcentration, certain cases should warrant dispensing with elaborate proof of market structure, market behavior or probable anticompetitive effects.[26] In the *Philadelphia National Bank* case, the large percent of the market controlled by the bank resulted from the merger of two large competitors. The Court held that the merger was "inherently likely to lessen competition." "Such a test lightens the burden of proving illegality only with respect to mergers whose size makes them inherently suspect in light of Congress' design in Section 7 to prevent undue concentration."[27] This approach was applied in the *Procter & Gamble* case. However, instead of comparing the size of the competitors, the Court was concerned with the great change the merger would make in the market's power equilibrium.

Not all conglomerate mergers involving large firms will be struck down. An analysis of each merger will involve:

1. looking at the purpose of amended Section 7,

25 376 U.S. 665, 669 (1964) (the Lexington Bank case).
26 374 U.S. at 363.
27 *Id.*

2. identifying the physical structure of the relevant market, and
3. studying the power relationships in that market.

Only where this analysis proves inconclusive will resort to post-merger facts be made.

Any other test will hold a merger suspect and subject to antitrust prosecution years after the event. An otherwise lawful merger could become unlawful because of a twist of economic circumstances. Likewise, where a potential monopoly has failed to exercise its tremendous power and has been a "good trust," it is nonetheless subject to the law.[28] Certainty is best obtained through simplicity.

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[28] United States v. Quaker Oats Co., 232 F. 499, 502 (N.D. Ill. 1916).